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International Accounting Standards Board

This document is provided as a convenience to observers at Standards Advisory Council meetings, to assist them in following the Council's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.

Note: These notes are based on the staff paper prepared for the Council. Paragraph numbers correspond to paragraph numbers used in the Council paper.

INFORMATION FOR OBSERVERS

SAC Meeting:	**November, London**
Project:	**Agenda Proposal: Management Commentary** ***(Agenda Paper 4d)***

INTRODUCTION

1. This paper sets out proposals for a project on management commentary to be added to the Board's technical agenda. The paper proposes to use the conclusions reached in the *Management Commentary* discussion paper as a basis for moving the project from the research agenda to the technical agenda. The staff's recommendation to add the project to the technical agenda is based on the assumption that the discussion paper is an appropriate basis for developing the project's technical plan.

2. The staff intend to use both the discussion paper and the comments received on it as a starting point for the Board's deliberations on this project. The proposed project would reconsider all aspects of management commentary as the topic was presented in the discussion paper. The Board did not deliberate either the issues presented or the conclusions reached in the discussion paper sufficiently to reach any preliminary views. Consequently, the Board agreed to expose the discussion

paper on the basis that it presented the results of the research process undertaken, not the preliminary views of the IASB.

3. The proposed project would work towards an Exposure Draft to be issued by the IASB no earlier than the 4th quarter 2009.

4. This paper considers whether the proposed project meets the IASB's agenda criteria (paragraphs 18 to 54); and sets out a draft project plan (paragraphs 55 to 61).

STRUCTURE OF THE PAPER

5. The paper is structured as follows:

- Proposed objective of the project
- Proposed scope of the project
- Background—a brief discussion of the history of the research project that culminated in the discussion paper *Management Commentary* and a review of constituents' responses to the Invitation to Comment.
- IASB agenda criteria—an analysis of the proposed project relative to the agenda criteria set out in the IASB Due Process Handbook (April 2006); and
- Proposed project plan.

6. The staff has also provided background information in appendices as follows:

- Appendix A: comment letter summary presented to the Board at the January 2007 meeting; and
- Appendix B: analysis of perceived discrepancies between comment letters received by the Conceptual Framework team and those received on the *Management Commentary* discussion paper.

OBJECTIVE

7. The proposed objective of this project is to specify minimum requirements for management commentary reporting. To that end, this project would establish a framework for communicating management commentary information, in tandem with financial statements, as part of general purpose external financial reports. The staff recommends that the final output of the project be an International Financial Reporting Standard (IFRS).

8. The staff envisages that the Standard would ***not*** mandate which entities are required to produce management commentary in concert with their financial statements. However, ***if*** an entity is required, or elects, to include an IFRS compliant management commentary as part of its general purpose external financial report, it would be required to follow the framework outlined in the Standard. IAS 34 *Interim Financial Reporting* adopts a similar approach. To be clear, the staff is ***not*** advocating an approach that would require compliance with the Standard in order to assert compliance with IFRSs.

SCOPE OF THE PROJECT

9. The scope of this project would encompass both the *types* of information that might be reported and *how* to reflect that information in a management commentary report. This would include guidance on the qualitative characteristics that are applicable to management commentary. The scope would also include the principles that a management commentary of high quality should reflect in its preparation. It would also include the essential content elements of management commentary which may include both non-financial and non-IFRS financial measures and indicators.

10. The scope of this project will ***not*** include directions on what specific performance measures to report, what the goals and objectives of a specific type of entity

should be, or benchmark levels of performance that should be met. Additionally, the scope of this project is ***not*** designed to address the inclusion of other types of narrative reporting, namely sustainability reporting, environmental impact reporting or corporate social responsibility reporting, as *specific required components* of management commentary.

BACKGROUND

11. In late 2002, the IASB established a project team comprising representatives from the national standard-setters in Canada, Germany, New Zealand, and the United Kingdom to examine the potential for issuing a standard or guidance on management commentary. The project team focused its review on the practices in place in the following countries:

    - Canada
    - Germany
    - United Kingdom
    - United States
    - Australia

    The project team also reviewed the EU Modernisation Directive as well as guidance issued by the Technical Committee of the International Organization of Securities Commissions (IOSCO).

12. In October 2005, the IASB published the results of the project team's research in a discussion paper *Management Commentary*. The discussion paper presents an assessment of the role the IASB may play in improving the quality of the management commentary that accompanies financial statements. In the discussion paper, the project team presented their views regarding the users, objective and characteristics of management commentary. Essential content elements of management commentary as well as a possible placement framework were also presented.

13. At the January 2007 meeting, the Board discussed a summary of the 116[1] comment letters received in response to the discussion paper (see Appendix A). Overall, the responses received from respondents were positive. Specifically, of those who answered the related questions:

- 92 percent agree that management commentary is an integral part of a financial report;
- 95 percent agree with the objective of management commentary, including the three elements of the objective, as it was described in the discussion paper;
- 86 percent agree with the principles and qualitative characteristics identified in the discussion paper;
- 95 percent agree with the five essential content elements put forward in the discussion paper; and
- 92 percent agree that there is a need for requirements relating to management commentary.

At the end of the meeting, the project team was instructed to draft an agenda proposal for use by the Board in determining whether a management commentary project should be added to the technical agenda.

14. At its June 2007 meeting, the Standards Advisory Council (SAC) discussed the summary of the responses to the discussion paper. SAC members stressed the need to promote narrative reporting as both complementary to the financial statements and necessary to the production of a high quality financial reporting package.

[1] A total of 117 comment letters were received. Respondent 117 was a late submission and while acknowledging that the project is a significant task facing the international business community, it did not answer the specific questions in the discussion paper.

15. It was pointed out that, given the level of preliminary work that has already been completed on this project, the IASB would realise the greatest benefit if continued work was completed relatively quickly and was based upon the conclusions reached in the discussion paper.

16. Many SAC members indicated their desire to see the IASB focus on the Conceptual Framework project instead of broadening the current work programme. Some of the SAC members felt that the completion of the conceptual framework project may make it unnecessary to add a management commentary project to the technical agenda.

17. Additional questions raised by the SAC members included the auditability of management commentary as well as concerns about infringing upon the work already done in this area by domestic regulators.

IASB AGENDA CRITERIA

18. The IASB due process handbook sets out five criteria to be considered in deciding whether to add a potential item to the agenda:

- the relevance to users of the information involved and the reliability of information that could be provided;
- the existing guidance available;
- the possibility of increasing convergence;
- the quality of standards to be developed; and
- the extent of any resource constraints.

Criterion 1: The relevance to users of the information involved and the reliability of information that could be provided

19. The objective of a project should be to address a demand for better quality information that is of value to users of financial statements. In considering this, there are four main factors:

(a) international relevance;

(b) pervasiveness;

(c) urgency; and

(d) consequences of not taking on this project.

International relevance

20. The issues presented in the management commentary discussion paper are relevant to the IASB's constituents. As noted in paragraph 13, ninety-two percent of those who answered the question agreed that there is a need for requirements

related to management commentary. Furthermore, all but one respondent indicated that the model for management commentary detailed in the discussion paper was consistent with their local requirements.

21. Currently, a number of jurisdictions do not have requirements governing the content of management commentary reporting. IASB guidance related to management commentary would fill a regulatory gap and potentially improve the quality of financial reporting in these jurisdictions. Secondly, IASB branded guidance may assist entities with multi-jurisdictional management commentary requirements.

Pervasiveness

22. Management commentary affects all stakeholders in the financial reporting value chain in that it provides an additional layer of information for use in decision making. A project on management commentary and its resultant output has the potential for creating significant value added for all users of financial statements. Respondents to the discussion paper were nearly universal in their agreement that management commentary is an important communication tool that helps users of financial statements understand the longer term risks and opportunities facing companies.

Urgency

23. The discussion paper *Management Commentary* was well received. Additionally, the conclusions reached by the project team that wrote it were largely supported by respondents to the Invitation to Comment. Continuing work on this project by adding it to the technical agenda sends a signal to the IASB's constituents that their enthusiasm for the topic has been heard. Moving forward with this project allows the Board to capitalise on the positive sentiment generated by the discussion paper.

24. It is worth noting that, when asked whether management commentary should be a priority for the Board, 63 percent of respondents to the discussion paper

responded in the affirmative. The substantial minority supported their position by pointing to the IASB's already lengthy technical agenda.

25. While respondents supported the IASB's intention to encompass all aspects of financial reporting in its standard setting, many pointed out the inconsistency of adding a project on management commentary to the technical agenda when the boundaries of financial reporting have not been determined in the Conceptual Framework project. Further, many cited the recent adoption of IFRSs in jurisdictions and the resource burden of convergence with US GAAP as a signal that the IASB's time would be better spent resolving accounting issues instead of introducing a new dimension to financial reporting, *at this stage*.

26. In response to this feedback, the project team conducted additional research focused on reconciling feedback received by the Conceptual Framework project team with feedback received on the *Management Commentary* discussion paper. The results of this analysis are included in Appendix B.

Consequences of not taking on this project

27. If the Board chooses not to take this project onto the technical agenda, users of financial statements in jurisdictions where management commentary requirements do not exist will continue to operate at a disadvantage to users of financial statements in jurisdictions where management commentary requirements are present and enforced. High quality management commentary does more than provide context for the financial statements: it increases the transparency of the business operations of the entity being reported on. Providing a more complete picture through the use of management commentary reduces the risk that users will make suboptimal decisions based on a lack of information.

28. It is possible that, should the Board choose not to bring management commentary onto the technical agenda a securities regulator (e.g. IOSCO) may be impelled to take the project onto its own agenda.

Criterion 2: Existing guidance available

29. Mandatory requirements for management commentary exist where financial markets are the most active. These requirements are generally issued by a market regulator and stem from national and regional securities legislation that takes into account the special features of their respective securities markets.

30. Distinct management commentary requirements currently do not exist within IFRS; guidance is incorporated in IFRS by reference. For example, IFRS 7 *Financial Instruments: Disclosures* establishes a principle that entities should disclose information enabling the evaluation of the nature and extent of risks arising from financial instruments to which they are exposed at the reporting date. This information may be communicated either in the financial statements or may be incorporated by cross-reference from the financial statements to some other statement that is available to users of the financial statements on the same terms and at the same time, such as a management commentary.

31. The discussion paper examined the management commentary requirements applicable to entities operating in select jurisdictions (see paragraph 13). A cross-jurisdictional analysis of the principles and qualitative characteristics of management commentary requirements was presented in Appendix C of the discussion paper; a cross-jurisdictional analysis of the content requirements of management commentary was presented in Appendix D of the discussion paper.

Criterion 3: Possibility of increasing convergence

32. This project has the potential for increasing the convergence of aspects of management commentary across different jurisdictions. Convergence will ultimately depend on the extent to which jurisdictions may be persuaded to adopt IASB issued management commentary requirements nationally.

33. In some jurisdictions, mid to large capitalised companies are accustomed to writing management commentary due to either local requirements or regulations imposed by the public exchanges they are traded on, or both. IASB issued

requirements would prove useful to companies less seasoned or regulated in the area of management commentary and may help to drive comparability across all entities that apply IFRS, thereby improving the usefulness of the financial reports to users (see also paragraph 36). The existence of IASB requirements may encourage regulators to adopt those rather than develop their own. For those entities listed in multiple jurisdictions, following one international standard for management commentary rather than having to prepare management commentary in accordance with multiple requirements would reduce preparation costs.

34. During due process, the discussion paper garnered feedback from constituents regarding the role of the IASB with regard to the global convergence of management commentary requirements. Many constituents expressed concern that the IASB was venturing into an area in respect of which it did not have authority. The staff expects that addressing this issue will be a central component of the project's communication plan.

Criterion 4: Quality of the guidance to be developed

Availability of alternative solutions

35. There are several approaches that may be taken with regard to this project. The objective (paragraphs 7—8) and the scope (paragraphs 9—10) outlined in this agenda proposal reflect the conclusions reached in the discussion paper. These sections of the agenda proposal were included to help frame the Board's thinking about the size and time line of the project, as it is currently envisaged by the staff. Considerable work has been undertaken by the working group of partner standards-setters who developed the *Management Commentary* discussion paper. The staff believe that their research and proposals may be developed to form the basis of a comprehensive and consistent standard for management commentary.

36. The inclusion of management commentary information as part of the general purpose external financial reports has the potential for increasing the relevance, reliability, understandability and comparability of the financial statements.

Management commentary provides users of financial statements with context for understanding the information reported in the financial statements. It is this insight into managements' thinking that provides the opportunity for enhanced understanding of the financial statements and improves the overall relevance of the financial reporting package as a key source of decision useful information.

37. Additionally, because management commentary is prepared 'through the eyes of management', users of financial reports that contain management commentary information in tandem with financial statements are able to assess managements' strategy and approach to risk management on a comparative basis, in terms of both the company itself and its peers, thereby allowing for an assessment of managements' thinking over time.

38. One criticism of management commentary is that it cannot be reliable because it is inherently subjective, representing managements' best 'spin' on the business. The staff believe that the development of a management commentary framework that includes guidance on the qualitative characteristics of management commentary information as well as its key content elements would go a long way towards mitigating the perceived bias in management commentary information, thereby enhancing its reliability.

Cost/benefit considerations

39. An important aspect of the quality of a new standard is the balance between the benefits of the information produced in accordance with the standard and the costs to entities of providing such information. The staff believe that the implementation of a reporting framework for management commentary may carry significant costs, specifically for those entities that have little to no experience with narrative reporting in jurisdictions lacking specific regulatory requirements in this area.

40. It will be important to show that the Board has balanced the costs and benefits of providing management commentary reporting in conjunction with the financial

statements. The benefits of providing management commentary come in the form of improved financial reporting. Management commentary requirements could improve the quality of management commentary information reported by increasing comparability of management commentary both for an entity over time and between entities. Additionally, management commentary requirements may help to ensure that the management commentary information is consistent, or reconciled, with the IFRS financial information. Management commentary requirements would also impose a discipline for management to report in a more balanced, unbiased way.

41. The cost/benefit discussion ultimately hinges on the output of this project. As currently envisaged by the staff, the output would be a non-mandatory IFRS, similar in scope to IAS 34. In this case, jurisdictions and their entities would make their own cost/benefit assessment in determining whether to adopt the provisions of the Standard.

Feasibility

42. Management commentary is an item which has been regulated differently in different countries for many years—cultural differences amongst the IASB's constituents will have a significant impact on this project. The success of the project will depend on the extent to which the staff is able to find commonalities amongst existing requirements and synthesize them into a representative framework applicable to a global constituency.

43. In addition to revisiting management commentary in the context of the countries originally assessed in the discussion paper, additional countries will necessarily be added to the analysis. For example, management commentary (and narrative reporting in general) will be evaluated for China, Japan, India, and the region of South America.

44. Many of the issues that arise in this project are closely related to issues currently under debate in the Conceptual Framework project. There are three major cross-cutting issues:

(a) the boundaries of financial reporting, whether management commentary falls within them and, if so, is subject to the Conceptual Framework;

(b) the identification of the users of management commentary information versus the users of financial statements; and

(c) the application of the qualitative characteristics as currently envisaged in the Conceptual Framework project to management commentary.

45. The staff view a project on management commentary as being necessarily coupled with the Conceptual Framework project. The extent of that coupling, however, depends on the objective of the project. If the Board accepts the objective outlined in this proposal, the staff believe it can conduct work on this project in tandem with the Conceptual Framework project, with an eye towards limiting any significant theoretical discrepancies between the two projects.

46. If the Board chooses to pursue the global convergence of management commentary requirements as the objective for this project, the staff believe that it would be more appropriate to wait to add management commentary to the technical agenda until the Board has made a final decision in the Conceptual Framework project as to the boundaries of financial reporting. An authoritative pronouncement as to whether management commentary is within the bounds of financial reporting as envisaged in the Conceptual Framework is an effective way of responding to constituents that do not believe convergence of management commentary requirements is within the IASB's mandate.

47. The output of the final work product also has an impact on the level of influence the Conceptual Framework project may exert on the management commentary project. For example, should the Board choose to issue a 'best practices' type document instead of a Standard, an argument could be made that the staff would

have less of an obligation to use the decisions reached in the Conceptual Framework project as explicit drivers of the guidance to be developed for management commentary.

48. Another cross-cutting issue for the management commentary project is its relationship to the Small and Medium-sized Entities (SME) project. In many jurisdictions, management commentary is only required for entities of a certain size, or with certain stakeholder characteristics (such as being publicly listed). These stakeholder characteristics are substantially different from those being considered by the IASB to define SMEs.

49. As this proposal does not seek to make management commentary a mandatory component of financial reporting required for asserting compliance with IFRS, the staff sees little potential for conflict with the proposed Standard for SMEs at this time. If the Board chooses to cast the output of the project as mandatory requirements for asserting compliance with IFRS, the staff would need to conduct analysis as to whether an exemption for SMEs would be appropriate.

Criterion 5: Resource constraints

50. Although much work has been done in developing the *Management Commentary* discussion paper, there are many issues to be addressed in this project:

(a) the Board will need to reconsider and reaffirm the working group's research in the context of the Conceptual Framework project;

(b) in particular, the cross-cutting issues referred to in paragraphs 44—49 are areas where the Board is developing its thinking and may wish to revise previous conclusions reached in the management commentary project;

(c) there are many variations on the basic management commentary theme, and further research might be needed to ensure that these do not raise issues that undermine the model being developed.

Availability of expertise outside the IASB

51. The need to use outside resources is largely dependent upon the scope of the project. If the Board decides to proceed with a narrow scope, short term project that is based primarily on the conclusions reached in the *Management Commentary* discussion paper, there will be little need to require extensive expertise from outside the IASB. In this scenario, the staff will use the individuals who drafted the discussion paper as an informal peer review group.

52. On the other hand, if the Board wishes to proceed with a project aimed at the global convergence of management commentary, the staff would then view the scope as resulting in a major, long term project. In accordance with paragraph 90 of the IASB Due Process Handbook (April 2006), the IASB would establish a working group reflecting the diversity and breadth of interest involved in this topic.

53. Irrespective of the scope chosen, the staff anticipates conducting a number of field visits with interested parties that currently have management commentary requirements. The purpose of the field visits is to build consensus and support amongst constituents for the work the IASB is conducting in this area.

Amount of additional research required

54. As the work on this project is being shifted from the working group of partner standard-setters to in-house IASB staff, time will necessarily be reserved for the current staff to get up to speed on the topic. Additionally, comprehensive research into existing local requirements in a wider range of countries than those listed in the discussion paper will be undertaken.

PROPOSED PROJECT PLAN

55. The staff anticipate that the project's two most contentious issues will be the following:

- determining the final work product to be produced (e.g. is it a standard or something new like a 'best practices' document); and
- clarifying (and perhaps redefining) the roles that securities regulators and standard-setters have traditionally played in relation to the regulation of management commentary.

56. A communication plan will be developed that casts management commentary as both complementary and supplementary to the financial statements. As it is currently written in the discussion paper, the objective of management commentary is very narrow—it excludes the corporate governance type information that has traditionally been required by regulators. Because regulators have normally viewed management commentary as a place to put corporate governance information, the staff intend to make clear that our work does not propose to infringe on that particular realm of narrative reporting.

57. The Board will also need to determine if the objective of the project should be narrowly directed at those jurisdictions currently lacking in management commentary requirements or if the broader goal of international harmonisation of management commentary requirements is the objective.

58. If the Board chooses to focus the objective of the project on providing a management commentary framework for those jurisdictions currently operating without one, the staff anticipates a project of limited duration. The main points of the discussion paper would be redeliberated in the context of the comments received from respondents during due process. With this approach, the staff anticipates issuance of an Exposure Draft by the end of 2009.

59. If the Board prefers to expand the objective of the project to reflect the international convergence of management commentary requirements, the staff anticipates that the project would become a major one for the Board.

60. The arguments for and against each approach to the objective of a management commentary project are not presented in this agenda proposal. If the project is accepted onto the technical agenda, a detailed analysis of both the objective and scope of the project will be presented to the Board as the first subject for deliberation on the topic.

61. A proposed project plan to Exposure Draft, based on the objective and scope detailed in paragraphs 7—10, is provided below (time has been allowed for the participation of a working group):

Meeting	Topic
One *(Board February 2008)*	Finalise both the objective and scope of the project
Two *(WG June 2008, Board July 2008)*	Present summary of feedback received during field visits (to be conducted March and April 2008) Determine final work product (IFRS, best practices document, etc.)
Three *(WG September 2008, Board November 2008)*	Redeliberations: • Objective of MC • Users
Four *(WG January 2009, Board February 2009)*	Redeliberations: • Principles • Qualitative characteristics
Five *(WG April 2009, Board May 2009)*	Redeliberations: • Disclosure framework • Placement criteria
Six	Redeliberations:

(WG July 2009, Board September 2009)	• Assurance issues • Safe harbour provisions
Issue Exposure Draft	Fourth quarter 2009

Appendix A:

Management Commentary Comment Letter Analysis

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Introduction

1. The meeting held in October 2002 between the International Accounting Standards Board (IASB) and its partner national standard setters recommended that work should begin on a project to examine the potential for the IASB to develop standards or guidance for Management Commentary (MC). A discussion paper "Management Commentary" was published in October 2005 requesting comments by the end of April 2006. A total of 116[2] comment letters were analysed from 26 individual countries. This includes 14 responses from users and user organisations, who collectively manage funds in excess of £7.5 trillion.

2. The purpose of this Education Session is to present an analysis of the comment letters received. MC is not on the Board's active agenda. Accordingly, the Management Commentary project team is not asking the Board to make any decisions at this meeting. This paper summarises the comments received.

Is MC an integral part of Financial Reporting?

3. Of the comment letters analysed, 104 or 92 percent of those who answered the question, agree that MC is an integral part of financial reports. Only nine respondents disagreed with the view that MC is integral to financial reporting. The majority of these nine did so due to concerns over MC audit requirements,

[2] A total of 117 comment letters were received. Respondent 117 was a late submission and while acknowledging that the project is a significant task facing the International Business community: it did not answer the specific questions in the discussion paper.

not because they were against the concept of MC. The audit concerns are discussed in paragraphs 40 and 41 of this paper.

4. Generally the responses to the initial discussion paper question were brief with many simply answering ‘Yes’ to the question ‘Do you think that MC should be considered an integral part of financial reports?’. It was clear from the comment letters that these respondents thought it was obvious that MC is an integral part of financial reporting. Those that did provide further rationale tended to emphasis the relevance of the information to decision making for investors as well as the role MC serves by both supplementing and complementing the accompanying financial statements.

What were respondents’ views on what MC should cover?

5. Appendix A of the discussion paper included the Management Commentary project team’s preliminary views of what should be included in a standard or guidance relating to MC. Specific questions were asked relating to the following areas contained in Appendix A:

- the objective of MC;
- the principles and qualitative characteristics of MC; and
- the essential content elements that MC should cover.

Objective of MC

6. As described in the discussion paper, the purpose of MC is to provide information to help investors:

   (a) interpret and assess the related financial statements in the context of the environment in which the entity operates;

   (b) assess what management views as the most important issues facing the entity and how it intends to manage those issues; and

(c) assess the strategies adopted by the entity and the likelihood that those strategies will be successful.

7. Eighty-eight of the respondents, representing 95 percent of those who answered the question, agree with the objective and the three elements. Twenty–three did not answer the question. Those supporting the objective, including its three elements considered it to be relevant, straight forward and unambiguous.

Principles and qualitative characteristics of MC

8. The principles underpinning a high quality management commentary were described in the discussion paper as follows:

(a) MC should supplement and complement information in the financial statements.

(b) MC should provide an analysis through the eyes of management.

(c) MC should have an orientation to the future.

9. Additionally, the qualitative characteristics of understandability, relevancy, supportability, balance and comparability over time were described in the discussion paper as being applicable to management commentary.

10. The majority of the respondents, 86 responses, representing 86 percent who answered this question, agree with the principles and qualitative characteristics identified by the project team; while 14 respondents, 14 percent of the responses, disagreed. The question was not answered by seventeen respondents.

11. The majority of the respondents who disagreed had issues with the qualitative characteristics, rather than the three principles put forward in the discussion paper. The only comment of substance with regard to the principles related to the principle ‘MC should have an orientation to the future’. Some respondents were concerned about this principle because safe harbour provisions do not exist in all territories.

12. Those that disagreed believe that the terminology used to describe qualitative characteristics for MC should be the same as that used in the IASB's Conceptual Framework. Further discussion on the qualitative characteristics and the relationship with the conceptual framework project is provided in paragraphs 33 and 34.

Essential content elements that MC should cover

13. The essential content elements put forward were:

(a) the nature of the business

(b) objectives and strategies

(c) key resources, risks and relationships

(d) results and prospects

(e) performance measures and indicators.

14. Eighty-six respondents, representing 95 percent of those who answered the question, agreed with the essential content elements. Twenty-five did not respond. Those supporting the content elements for MC believe that the approach is a practical one because the content elements had been kept to a high level. In their view this was appropriate, because the nature of what needs to be disclosed within MC will differ depending on the nature of the business. Five respondents disagreed with the approach because, in their view, the essential content elements set out constituted a 'list' that could result in a compliance-driven approach to reporting by preparers. Interestingly, only one of the five respondents putting forward this view was a preparer, the other 20 preparer and preparer organisations all agreed with the suggested essential content elements.

Should guidance be provided to limit the amount of information disclosed within MC?

15. In addition, a further question was asked as to whether it would be appropriate to provide guidance or requirements to limit the amount of information disclosed within MC or at least ensure that the most important information is highlighted. This question was answered by 92 respondents. Sixty respondents, 65 percent of those who answered the question, agreed with the proposal; while 32 respondents, 35 percent of the responses, disagreed. The question was not answered by 24 respondents.

16. The feedback given was that the focus should be on issues relevant to investors; information which enhances understanding of the financial reports and issues of the greatest importance should be highlighted. Guidance should be general in nature and should expand upon the materiality concept. Actual reported information should be a matter for individual companies, their directors and management to determine. The objective should be that whatever information is disclosed, the emphasis should be on ‘quality not quantity.’

17. The counter argument was that requirements to restrict the amount of reported information would distract from the principle based approach proposed in the MC model. Management and directors must identify the key information and present this in a manner which is most appropriate to their business and industry, reporting style and cultural setting.

Did the respondents think that MC requirements should be issued as a standard or non-mandatory guidance?

18. One hundred respondents, representing 92 percent of those who answered the question, agreed that there is a need for requirements relating to MC, however, views were split as to the form the requirements should take. In summary, 53 respondents, 48 percent of those who answered, want guidance, while 44 respondents, 40 percent of those who answered the question, want a standard, and three want a hybrid system which includes both standards and guidance. Nine respondents do not agree with either option – mainly because they do not think it

is the IASB's role to get involved in MC. Seven did not answer or their answers were unclear.

19. Several respondents consider that guidance would be a first step – leaving open the possibility that they would support a standard at a later stage; while another respondent proposed a phased approach suggesting that MC should be developed in three stages, short term, medium term and long term.

20. The argument made by respondents for supporting guidance is the importance of recognising that not all companies, even within the same industry, are similar. This supports the case for non-mandatory guidance that would create a benchmark for best reporting practice against which companies can exercise flexibility and discretion to tailor their commentaries to their particular requirements. In addition, this approach would permit regulators of MC to align their recommendations or requirements over time with an agreed global benchmark. It should be noted that both the Committee of European Securities Regulators (CESR) and the International Organisation of Securities Commissions (IOSCO) consider that non-mandatory guidance should be issued if the Board decide to take forward the work on MC.

21. The argument made by respondents for issuing standards is that standards deliver a higher quality of disclosure than guidance. Also standards will improve the comparability of disclosure over jurisdictions. Voluntary guidance is considered to provide little value and it would be difficult to encourage compliance. Because MC is seen as an integral part of the financial report at least for listed entities, a comprehensive set of International Financial Reporting Standards should include a mandatory requirement to prepare a MC.

Did respondents view the development of requirements for MC as a priority for the Board?

22. There were 96 responses on this question; 60 respondents, 63 percent of those who answered the question, agreed that the development of standards or guidance

for MC should be a priority for the Board. Of the 60 respondents, 19, specifically stated that MC should be a medium/low priority for the Board. Of the 96 responses, 36 representing 37 percent of those who answered the question, were of the opinion that this development was not a priority for the Board.

23. The respondents in favour of MC requirements considered that a balanced and objective, principally narrative, discussion of the performance and prospects of the company written in a clear and understandable prose is essential to supplement and enhance the information that is included in the financial statements. Developing principles and guidance for MC will improve the quality of financial reporting in general and help to realise convergence in this area, especially for those territories that do not have local guidance.

24. However, the alternate view is that the IASB should not add an MC project to its active agenda at the present time. The Board has many pressing demands on its time and if added it could delay the completion of higher priority projects affecting the financial statements themselves.

25. Consistent with the view expressed by the Management Commentary project team in the discussion paper, a number of respondents also highlighted that there is a need for close co-operation with the securities regulators should the IASB consider it appropriate to take forward further work on MC.

26. In particular, CESR believe that a dialogue should be established with the IASB to minimise the risk that any guidance issued by the IASB conflicts with the standards developed by regulators. CESR consider that it is imperative that the IASB’s project be designed in such a way as to fit well with the European regulatory framework. In addition, IOSCO point out that they have already developed pronouncements in this area and national disclosure requirements exist in several IOSCO member countries as a result of securities regulations or company law. They point out that any non-mandatory IASB guidance on MC must not conflict with national securities regulations and company law.

27. However, all constituents except one stated that the model the project team put forward in the discussion paper was consistent with their local requirements.

What can we learn about the consistency between the Conceptual Framework project and Management Commentary?

Preliminary views on an Improved Conceptual Framework for Financial Reporting

28. The Management Commentary project team responded to the consultation on the preliminary views on an improved Conceptual Framework for Financial Reporting in the light of the project's team own experience of developing the MC discussion paper as well as the insights provided by 116 responses to the MC discussion paper.

Is the focus on the needs of investors appropriate?

29. In respect of the question as to whether the focus of MC on the needs of investors is appropriate, 68 respondents, 73 percent of those who answered the question, agreed that investor focus was appropriate while 25 respondents, 27 percent of the responses, disagreed. It should be noted that 14 of the dissenting responses were from national standard-setters and Institutes of Accountants. The question was not answered by twenty-three respondents.

30. There were very few comments provided in relation to this question. A number of those supporting the focus on investors noted that such a focus is consistent with the current IASB Conceptual Framework's view that if the needs of the investors are met then, largely, the needs of other users of MC would also be met. Other supporters of the focus on investors noted that they would not wish to see the scope of MC extended to a wider range of users, as there would be a risk that the amount of information disclosed would be excessive. A number of respondents explicitly noted that they agreed with the Management Commentary project team's view that MC should not replace other forms of reporting, such as sustainability or corporate social responsibility reports.

31. The alternative view put forward by respondents is that the focus should not be solely on investors, as MC is useful to a broader range of users in making economic decisions. In taking a broader view, a number of respondents referred to the current IASB framework where seven groups of users (investors, employees, lenders, suppliers, customers, government and the public) are identified. Their position was that as the IASB framework refers to multiple users, so should MC.

32. Others took a middle view. They believe that it is an essential that management take a broad view in deciding what should be included in MC – thereby acknowledging the importance of "others" an entity has a relationship with, while still accepting the focus on investors. One respondent group, a consortium of corporations, global investors and other interested parties suggested an amendment to the draft to address this concern. The suggested text is included in the project team's response to the consultation on the preliminary views on an improved Conceptual Framework for Financial Reporting in Paper 11C.

Can the same qualitative characteristics be applied to all components of financial reports?

33. Initially the project team proposed the same terms for the qualitative characteristics for MC as those in the existing IASB framework. This proposal met with concern from the IASB. Specifically the Board asked the project team to consider whether it was appropriate to relate qualitative characteristics from the Framework to MC. As a result, the team's final view contained in the discussion paper was:

> We believe that *understandability* and *relevance* should be applicable in the preparation of MC and accordingly should be reflected in the qualitative characteristics. Rather than using the *Framework* terms *reliability* and *comparability* we use *supportability*, *balance* and *comparability over time.*

34. As noted in paragraphs 10 to 12, although the majority of respondents (86 percent answering the question) agreed with the qualitative characteristics put forward by

the Management Commentary project team, 14 respondents (14 percent) disagreed. These respondents disagreed largely because they believe the same qualitative characteristics should be used for both the IASB Framework and MC. Accordingly, they disagreed with the replacement of reliability and comparability with the terms supportability, balance and comparability over time terms as used in the proposal.

Would the development of placement criteria be helpful?

35. At the request of the IASB, the Management Commentary project team developed and presented some placement criteria to assist the IASB in determining whether information should be disclosed in MC or the financial statements. The clear objective of adding this section to the discussion paper was to gain some early feedback for the conceptual framework project team.

36. Constituents were asked whether the placement criteria suggested by the project team were helpful, and, if applied, would be likely to lead to more consistent and appropriate placement of information within financial reports. The results to this question were mixed, 62 respondents, 76 percent of those who answered the question, agreed with the proposal, while 20 respondents, 24 percent of the responses, disagreed; the remaining 34 did not respond.

37. A significant number of those who did not agree with the proposal did so because they believe that placement criteria should not be part of the MC model, but should be considered within the conceptual framework project.

Other matters raised by respondents

Should entities be required to include MC in their financial reports to assert compliance with IFRSs?

38. Sixty-one percent of the 92 respondents to this question thought it would be inappropriate for entities to have to include MC to assert compliance with MC. Reasons provided include the complementary nature of MC to the financial

statements and the nature of MC itself, being management's analysis of financial information, including forward-looking information that lacks the same degree of objectivity as financial statement information.

39. The other 39 percent of respondents thought compliance with IFRSs would enhance confidence in MC and that compliance should be required because MC is necessary to be able to interpret and assess the financial statements.

Audit implications of MC

40. Some respondents noted that MC is viewed as an integral part of financial reporting but separate from financial statements. Others, however, are concerned that if MC is considered to be an integral part of financial reporting important consequences for the audit will arise as the audit of MC poses significant challenges compared to an audit of financial statements.

41. Some respondents were concerned that if MC is subject to audit this could result in a box-ticking and compliance-type mind-set to reporting.

Appendix B:

Management Commentary

Perceived discrepancy between comment letters received by the conceptual framework team and those received by the MC project team

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1. At the education session on management commentary (MC) held during the Board's meeting in January 2007, concern was expressed by one of the Board members about the perceived discrepancy between the comment letters received by the Conceptual Framework (CF) team as compared to those received by the MC project team. The view was that these discrepancies could be an indication that respondents are not as positive as the MC comment letter analysis suggests, when it comes to considering whether or not the Board should extend its remit beyond financial statements to financial reports.

CF project team analysis

2. The CF comment letters reviewed for the purpose of this section were those received in response to the first discussion paper (DP) in a series of publications being developed jointly by the US Financial Accounting Standards Board (FASB) and the IASB as part of a joint project to develop a common CF for financial reporting. The Boards plan to publish other discussion papers in due course. Presentation and disclosure aspects of the CF, including the reporting boundaries, were not explicitly addressed in the first DP. These issues are scheduled to be addressed in Phase E of the project.

3. The first DP was published in July 2006, and invited comments on all matters raised in the DP, rather than inviting comments on a series of questions as the MC DP did.

4. The CF project team received 179 comment letters, 57 (32%) of which commented directly on the extension of the objective of the CF to financial reporting. The 57 were analysed into four categories:

   (a) Agree with the proposal contained in the first DP on the conceptual framework, that the objective of financial reporting should be extended to financial reports (10 out of the 57);

   (b) Agree with the proposal as in (a) above, but have some issues (18 out of 57);

   (c) Raised concerns about the extension of the objective to financial reporting (10 out of 57);

   (d) Do not agree with the extension of the objective to financial reporting (19 out of 57).

5. Those responses categories as either (a) or (b) were grouped together as 'expressing support for the Boards' decision to address the objective of financial reporting'. Likewise, responses in categories (c) and (d) we grouped together as 'objecting to the extension'.

6. The analysis was presented to the Board on 20 February 2007 in Agenda Paper 3A, namely that: '16% expressed support for the Board's decision to address the objective of financial reporting more broadly'; while '16% … objected to the fact that the Boards have proposed an objective of financial reporting rather than a more limited objective of financial statements'.

MC DP responses

7. The MC DP team analysed 116 comment letters[3], 113 of which included a response to the question 'Do you agree that MC should be considered an integral part of financial reports?' Ninety two percent (104 respondents) of those who answered

[3] A total of 117 comment letters were received. Respondent 117 was a late submission and while acknowledging that the project is a significant task facing the International Business community: it did not answer the specific questions in the discussion paper.

the question agree that MC is an integral part of financial reports. Only nine respondents (eight percent) disagreed with the view that MC is integral to financial reporting. The reason cited by the majority of these nine related to concerns over MC audit requirements; not because they were against the concept of MC as an integral part of financial reports.

Apparent discrepancy between the two sets of comment letters

8. The MC analysis set out in paragraph 7indicates that the majority of respondents are in favour of a broader set of information, namely financial reports, and they also believe that MC is an integral part of a financial report. However, as noted in paragraph 6, the CF comment letters analysis indicates that 16% disagree with the broadening of the CF from financial statements to financial reports.

9. Given this apparent discrepancy, the MC project team analysed the comment letters received by both the MC and CF teams, where:

- Explicit views had been articulated in the CF response relating to the broadening of the scope of the CF from financial statements to financial reports; and

- The respondents had also written a comment letter to the MC project team.

In total, this amounted to 25 comment letters.

10. The 25 CF comment letters were analysed as follows by the CF project team:

Categorisation of	Number of responses	
Agree with the proposal contained in the first DP on the conceptual framework, that the objective of financial reporting should be extended to financial reports	3	
Agree with the proposal that the objective of financial reporting should be extended to financial reports, but have some issues	10	
Sub-total – Expressed support for Board's proposal		13
Raised concerns about the extension of the objective to financial reporting	4	
Do not agree with the extension of the objective to financial reporting	8	
Sub-total – Objected to the extension of the objective to financial reporting		22
Total comment letters analysed		25

Comparison of the CF responses to the MC responses

11. Of the 25 MC comment letters analysed, 24 agreed that MC was an integral part of financial reporting in their response to the MC DP. The one respondent who did not agree with the view put forward by the MC project team, did so because they believe:

> Management commentary does not fit into the scope of 'global accounting standards'.

The respondent expressed a similar view in their response to the CF team, namely:

> We re-affirm that in our view the IASB should not deal with financial reporting issues other than financial statements.

12. The issue then is:

Why do so many respondents appear to have objected to the proposal put forward in the CF DP that the objective of financial reporting should be extended to financial reporting, when, the same respondents agreed that MC was an integral part of financial reporting?

Comparison of views expressed in CF and MC response letters

13. The MC project team compared the comments made in the response letters to both the CF and MC DPs relating to financial reporting. This analysis was shared with the CF project team, who have had the opportunity to review and consider the detailed analysis (see paragraph 18). A conclusion was then reached for each respondent, as to:

(a) whether the views expressed in the two response letters were consistent;

(b) next steps if any were needed, and results of further steps taken; and

(c) if there appeared to be a discrepancy between the two response letters, the cause of the discrepancy.

14. Of the remaining 24 respondents, it is the opinion of the MC project team that the views expressed in the two comment letters were considered to be consistent, with the exception of two respondents. The project team wrote to, and received feedback from, both of these respondents clarifying their views.

15. After considering the feedback received from the two respondents referred to in paragraph 14, the MC project team categorised the 24 respondents into three distinct categories, as set out below:

Description	Number of respondents
While agreeing that MC is integral to financial reports, do not believe the objective of the CF should extend beyond financial statements because they believe: • There should be two separate frameworks; or • The framework should focus on financial statements and MC should be voluntary; or • The effort of the Boards should be on financial statements.	4
Agree that the objective of the framework should be financial reporting	7
Clear that MC is an integral part of financial reporting. However, these respondents have concerns with the broadening of the objective from financial statements to financial reports, as suggested in the CF DP[4] due to the perceived lack of debate as to: • What constitutes financial reports; and/or • Definition of financial reports.	13
Total	24

16. Comments, such as those set out below, are typical of the concern raised due to the lack of debate relating to what constitutes financial reports, as set out below:

> However, we feel that extending the scope without detailing the precise boundaries of the scope leaves constituents in a difficult position in terms of commenting on the first two chapters – the boundaries of the conceptual framework are an integral part of the framework and any comments made prior to the resolution of this may potentially need to be revised in light of future developments.

[4] CF DP, paragraph OB16 'News releases, management's forecasts or other descriptions of its plans or expectation, and description of an entity's social or environmental impact are examples of reports giving financial information other than financial statements or giving only non-financial information.'

Conclusion

17. In conclusion, it is the MC project team's view that the apparent discrepancy between the two sets of comment letters does not indicate a lack of support for MC as an integral part of financial reporting, nor a view that the Board should not extend the conceptual framework to incorporate MC. Our assessment is that the views expressed in the CF comment letters indicate a plea, on the part of the respondents, for a debate on defining the boundary of financial reporting. This is scheduled to take place as part of Phase E of the conceptual framework project.

18. As noted earlier in this paper, a member of the CF project team reviewed our detailed analysis and agrees with our conclusion that respondents to the CF DP raised concerns with regard to the scope of the CF due to the lack of definition of what constitutes financial reporting.