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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting: **24 July 2008, London**

Project: **Management Commentary**

Subject: **Additional research (Agenda Paper 12B)**

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1. This paper provides supplementary information for the Board on the narrative reporting practices in a selection of countries not previously considered in the management commentary discussion paper.

2. As this paper is provided for informational purposes, the staff do not intend to discuss it during the meeting unless Board members wish to do so.

INTRODUCTION

3. The *Management Commentary* discussion paper focused on the narrative reporting practices in the following countries:

    - Australia
    - Canada

- Germany
- United Kingdom
- United States

The EU Modernisation Directive and guidance issued by the Technical Committee of the International Organization of Securities Comissions (IOSCO) were also reviewed.

4. Comments to the discussion paper were received from 117 constituents representing 26 countries. The majority of respondents were concentrated in the following geographic regions:

	Respondents	
Region	**Number**	**Percentage**
Europe	70	59.8%
Asia	12	10.3%
Australasia	12	10.3%
International	11	9.1%
North America	10	8.5%
Africa	2	1.7%

5. The staff determined that additional research was needed to assess narrative reporting practices in geographic areas where IFRS is permitted or required (or will be in the near term) that did not provide constituent feedback to the management commentary discussion paper. Consequently, the staff selected thirteen additional countries for review.

6. The relevant jurisdictional regulation for each of these countries specifies (though some merely suggest) that companies with publicly traded equity or debt are the only entities that should apply the corresponding rules in the production of their narrative reports. Consequently, requirements for narrative reporting (i.e., management commentary) are established by the regulator of each country's stock exchange.

FINDINGS

7. The staff research resulted in findings that could be grouped into four different types of jurisdictional requirements:

- No regulation for narrative reporting. (*Albania, Nigeria and Uruguay*[1]);
- Regulation of limited detail that is primarily focused on corporate governance**.** (*Philippines, Taiwan and Peru*);
- Regulation of moderate detail that is primarily focused on accounting matters. **(***Pakistan, Brazil, Singapore and Hong Kong*);
- Detailed narrative reporting regulations. (*Turkey, Israel and Russia*).

Regulation of limited detail—corporate governance focus

8. The **Philippine** Stock Exchange requires a statement of active business pursuits and objectives that focuses on the technical and commercial aspects of the business. The Philippine Stock Exchange does not require a financial assessment nor does it require the inclusion of forward looking information.

9. Public companies in **Taiwan** are required to publish a report to the shareholders that includes a company profile and an overview of the company's operations and its financial status. This report may include a review and analysis of the company's financial condition, its operating results and the major risks it faces. While these requirements may seem detailed, they are not; the focus of Taiwanese regulation in this area is on the corporate governance report. That report includes information on company's capital raising activities in addition to detailed requirements for disclosing its capital composition.

[1] Nigeria requires banks to report to the central bank a kind of 'strategy review'. Publicly traded companies in Uruguay are required to inform the government of their 'economic and financial situation'.

10. The **Peruvian** voluntary corporate governance framework specifies the disclosure of financial and operating results as well as the objectives and major risks that a company faces. However, the guidance focuses primarily on issues regarding ownership, the election and the power of the board of directors and governance structures and policies.

Regulation of moderate detail—accounting focus

11. The regulations of the Karachi Stock Exchange (**Pakistan**) include the following requirements:

- a statement of going concern that includes significant plans and decisions;
- disclosures of significant deviations from the previous year's operating results;
- summarised key operating and financial data for a rolling six year period;
- the inclusion of information on dividends, tax payments, and duties;
- a statement as to the value of investments of provident and pension funds; and
- related party disclosures.

12. BOVESPA, The Sao Paulo Stock Exchange establishes the **Brazilian** requirements on management commentary type disclosures. The Brazilian stock exchange has four segments: BOVESPA MAIS, Nivel 1, Nivel 2 and Novo Mercado. For two segments, Nivel 2 and the Novo Mercado, a management report is mandatory. In this jurisdiction, the management report must include an analysis and discussion of the company's financial statements and explain reasons for changes in the income statement over the most recent three year period. Additionally, the effects of inflation and the company's ability to meet its financial commitments are also mandatory components of the management report.

13. The **Singapore** Exchange listing rules concentrate on accounting specific disclosures relevant to the statement of financial position and the statement of comprehensive income. Regulation in this jurisdiction requires a review of the

performance of the company that includes a discussion of significant factors that affect turnover, costs, earnings, cash flows and working capital. Forward looking information is required to the extent that a company is describing significant trends, factors and competitive conditions that may affect it in the immediate future (as defined by a twelve month time horizon).

14. The **Hong Kong** Stock Exchange has narrative reporting requirements that are similar to those in place in Singapore: the requirements are premised on the need to present a thorough discussion of the business results. A discussion of the general development of the business during a rolling five year period of time as well as a statement of the three most recent fiscal years' revenue, operating profit or loss (displayed both thematically and geographically by segment) are required. Further, a report of physical properties, pending legal proceedings, trends or demands that could influence the company's liquidity or capital resources, commitments for capital expenditures, infrequent events/transactions or trends and uncertainties, including the impact of inflation, that could affect net sales, revenues or income, are meant for inclusion in the business report. Publically traded companies are also required to disclose quantitative information regarding their exposure to market risk in addition to their overall approach to risk management.

15. The Hong Kong Stock Exchange listing requirements also cover the inclusion of key performance indicators such as EBITDA, total capitalisation, net assets per share, and working capital. Additionally, an analysis of turnover, operating profit, assets and capital expenditures by geographical area and product line is required. The Hong Kong listing rules also require special disclosures for specific industries such as telecommunications, construction and airlines.

Detailed narrative reporting regulation

16. This section focuses on the countries that have highly detailed narrative reporting regulations. Potential conflicts with the management commentary discussion paper are also explored.

17. The **Turkish** narrative reporting guidelines are embedded in their regulations on corporate governance which are developed by the Capital Markets Board of Turkey. The Capital Market Board (CMB) is a capital market regulator and is independent from the state. A management commentary–type disclosure is not required, not even for publicly held companies. The CMB principles recommend that companies disclose the company's position and actual financial situation with respect to:

- scope of activities and sectors in which the company operates;
- defined strategic objectives, including forward looking information together with underlying statistical data and evidence, relating to the level of achievement of planned operations;
- future forecasts for sales, level of efficiency, market share, income yielding capacity, profitability and debt/equity ratios;
- internal control systems;
- rating agencies' opinions about the company;
- board members' qualifications, a statement of independence, and election procedures;
- related parties' transactions; and
- financial risks (i.e., foreseeable risk factors affecting future operations).

18. Accordingly, the CMB requirements refer to unbiased, accurate, easily and equally accessible and future orientated information. Management commentary, according to the Turkish requirements, incorporates issues that are dealt with in Turkish company law, IAS 24 *Related Party Disclosures* and IFRS 7 *Financial Instruments: Disclosures*. The Turkish requirements do not contradict the rules set out in the discussion paper.

19. In **Israel** the regulations regarding management commentary–type disclosures are part of the Israeli law system—they form part of the securities regulations. The securities regulations are elaborated by the Israel Securities Authority (ISA) and

approved by the Israeli parliament. Further, these regulations are obligatory for public companies. For management commentary, the following is required:

- description of the corporation, the state and the development of its business;
- the financial position and the results of its activities, its net cash worth and its cash flows; including its liquidity and sources of finance;
- the influence of events and trends in the corporation's activities, its business environment and the actions undertaken to respond;
- the reasons, exceptional or unique events that led to changes that occurred in the state of the corporation's business; especially, events that may indicate financial difficulties;
- details about the corporation's donations and its policy for making donations;
- exposure to market risks and the methods employed to manage them; and
- information on the directors (for example, detailed explanations about the directors' accounting and financial expertise).

20. The majority of the Israeli regulations may be easily subsumed within the discussion paper's framework for management commentary reporting. One significant difference is that the Israeli management commentary–type report includes information that falls under the heading of corporate governance while the management commentary discussion paper largely steers clear of that type of information.

21. The **Russian** regulation concerning management commentary–type disclosures is based on the Russian federal law that governs the securities market. The Russian corporate governance code that discusses management commentary issues is further elaborated by the Federal Financial Markets Service (FFMS), which is the Russian federal authority that controls and supervises the financial markets. The

code is mandatory only in specific areas and is enforceable for publicly traded companies.

22. The Russian regulation requires timely, unbiased, easily and equally accessible information as well as a stringent information policy for the company itself. It requires the disclosure of the company's:

- position in the industry and relations with competitors;
- strategic objectives, prospects for the development of sales, productivity, market share, etc.;
- discussion of annual results (actual versus planned) and financial performance including net operating profit, net profit per share and net operating profit per share, debt to equity ratio, profitability analysis, the percentage share of export income in the total annual income;
- internal and external factors that influenced the financial position and the results of its financial operations;
- outlook on the financial position, such as an estimate of change in asset composition and current/prospective liquidity of assets;
- trends that will affect the financial position in the future and major risk factors;
- dividend policy;
- related party transactions;
- information on the directors; and
- information on health care, vocational training, workplace safety and environmental protection.

23. The Russian corporate governance code highlights the importance of the 'executive bodies' assessment' of the company, thereby supporting disclosure from management's perspective (i.e. 'through the eyes of management). Except for the specific content elements regarding dividend policy, related party transactions, information about the company directors and social and

environmental reporting, the Russian regulation is largely in sync with the framework set out in the discussion paper.

SUMMARY

24. On balance, the requirements outlined in the management commentary discussion paper are more detailed than those found in the thirteen jurisdictions surveyed. Additionally, the discussion paper's focus on future-oriented information and the emphasis on its preparation as being done 'through the eyes of management' are two aspects that were not widely incorporated into the requirements of the thirteen jurisdictions surveyed.

25. The staff believe the largest take-away from this research to be a signal of possible 'conceptual' tension between management commentary and the Standards. Many of the countries surveyed have narrative reporting requirements for management commentary-type information that are currently found in individual IFRS, specifically IAS 24 *Related Party Disclosures* and IFRS 7 *Financial Instruments: Disclosures.*

26. From the Board's perspective, one approach might be to extract from the Standards any content elements that are deemed appropriate for management commentary and place those requirements in the management commentary document itself. In the short term, this cannot happen because of the lack of authoritative status that the final management commentary work product will have. Over the long term, once the disclosure framework is completed as part of Phase E of the Conceptual Framework project, the staff envisage that the placement of disclosures within IFRS (whether in the notes to the financial statements or in management commentary) will be revisited.