IASB Meeting		Agenda reference	**2B**
Staff Paper		Date	**April, 2009**

Project	**Management commentary**
Topic	**Staff draft of the management commentary exposure draft**

Cover note to the pre-ballot draft

1. The document attached is a staff draft of the management commentary exposure draft. That document forms the background for our discussion at the April Board meeting.

2. The staff requests comments on the staff draft by 17 April 2009. The Board's feedback will be incorporated into a pre-ballot draft that is scheduled for distribution on 24 April 2009.

Staff Draft (09/04/2009)

EXPOSURE DRAFT

Management Commentary

This exposure draft *Management Commentary* is published by the International Accounting Standards Board (IASB) for comment only. The proposals may be modified in the light of the comments received before being issued in final form. Comments on the exposure draft and the Basis for Conclusions should be submitted in writing so as to be received by **20 November 2009.** Respondents are asked to send their comments electronically to the IASB Website (www.iasb.org), using the 'Open to Comment' page.

All responses will be put on the public record unless the respondent requests confidentiality. However, such requests will not normally be granted unless supported by good reason, such as commercial confidence.

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Introduction

Summary

IN1 Management commentary presents an entity's economic story as it is seen through the eyes of that entity's management. It provides a context within which the financial position, financial performance and cash flows of an entity may be interpreted. It also provides a basis for understanding management's objectives and its strategies for achieving those objectives. Users of financial reports in their capacity as capital providers routinely use the information provided in management commentary as a tool for evaluating an entity's prospects, its general risks and opportunities, and the success of management's strategies for achieving its stated objectives.

IN2 For many entities, management commentary is already an important element of their communication with the capital markets, supplementing as well as complementing the financial statements. This exposure draft presents the International Accounting Standards Board's (IASB) proposals for a broad framework for the preparation and presentation of management commentary to accompany financial statements prepared in accordance with International Financial Reporting Standards (IFRSs). It is for the management of an entity to decide how best to apply this framework in the particular circumstances of their business.

How to use this document

IN3 The proposals presented in this exposure draft will not result in an IFRS. Accordingly, it would not be a requirement that an entity must comply with the framework for the preparation and presentation of management commentary to assert compliance with IFRSs.

IN4 The Board's proposals are intended to provide a basis for the development of good management commentary. It offers a non-binding framework and limited guidance on its application, which could be adapted to the legal and economic circumstances of individual jurisdictions.

IN1 This exposure draft is prepared on the basis that management commentary lies within the boundaries of general purpose financial reporting and, therefore, must be consistent with the broader [draft] conceptual framework for financial reporting. In developing its proposals for management commentary, the Board looked to its recent work on the objective and qualitative characteristics of financial reporting.[1] Consequently, this exposure draft should be read in the context of the Phase A Framework ED, published in May 2008.

[1] See the exposure draft *An improved Conceptual Framework for Financial Reporting: Chapter 1: The Objective of Financial Reporting and Chapter 2: Qualitative Characteristics and Constraints of Decision–useful Financial Reporting Information*, IASB (May 2008) [for brevity, referred to in this exposure draft as **Phase A Framework ED**].

Invitation to comment

The International Accounting Standards Board (IASB) invites comments on its proposals for a type of disclosure called *management commentary*. The Board seeks comment on whether the framework proposed in this exposure draft would improve the usefulness of the information provided in an entity's financial reporting and help users of financial reports make decisions in their capacity as capital providers.

The Board invites comments on all matters addressed in this exposure draft and, in particular, on the questions set out below. Respondents need not comment on all issues and are encouraged to comment on additional issues the Board should consider. Comments are most helpful if they:

(a) respond to the issues as stated and indicate the specific paragraph or paragraphs to which the comments relate;

(b) contain a clear rationale; and

(c) include any alternative the Board should consider.

Respondents' comments will help the Board when it develops a final document on management commentary. In considering the comments, the Board will base its conclusions on the merits of the arguments for and against each alternative, not on the number of responses supporting each alternative.

Respondents should submit comments in writing so as to be received no later than **20 November 2009**.

Questions for respondents

[to be inserted after the April Board meeting]

[Draft] Management Commentary

Core principles

1 **An entity's management should prepare a narrative report called *management commentary* to accompany financial statements prepared in accordance with International Financial Reporting Standards (IFRSs).**

2 **Management commentary provides users of the financial reports with an opportunity to look at the entity through the eyes of that entity's *management* by providing historical and prospective commentary on the entity's financial position, financial performance and cash flows. It also provides a basis for understanding management's objectives and its strategies for achieving those objectives.**

Scope

3 [Draft] *Management Commentary* (hereafter, Guidance) has been drafted with listed companies in mind. However, the [draft] Guidance does not mandate which entities should be required to publish management commentary, how frequently an entity should do so or the level of assurance to which management commentary should be subjected.

4 Governments, securities regulators, stock exchanges and accountancy bodies often require entities whose debt or equity securities are publicly traded to publish management commentary. Management commentary encompasses reporting that is described in various jurisdictions as management's discussion and analysis (MD&A); operating and financial review (OFR); and management's report.

Identification of management commentary

5 Management should clearly identify what it is presenting as management commentary and distinguish it from other information in the same published financial report.

6 When management commentary is prepared to accompany IFRS financial statements, it should not be made available for use without those accompanying IFRS financial statements.

Framework for the preparation and presentation of management commentary

7 An entity's management should apply paragraphs 8—36 when preparing management commentary to accompany financial statements prepared in accordance with IFRSs.

Purpose

8 Management commentary provides users of the financial reports with information to help them understand:

(a) what management views as the most important issues facing the entity and how it intends to manage them;

(b) the related financial statements in the context of the environment in which the entity operates; and

(c) the strategies adopted by the entity and the likelihood that they will be successful in meeting management's stated objectives.

To that end, management commentary communicates information about an entity's economic resources, claims on those resources and the transactions and other events and circumstances that change them.[2]

Users

9 The needs of present and potential capital providers as the primary users of the financial reports are paramount when management considers what information to include in management commentary.[3]

Time frame

10 Management commentary includes information regarding the period covered by the financial statements. It discusses the performance of the entity for the reporting period, identifying those trends and factors relevant to the user's assessment of the future performance of the entity and the achievement of management's stated objectives. The particular factors identified and discussed should be those that have affected performance in the period and those that are expected to have an effect on the future performance and financial position of the entity.

11 Predictive comments made in management commentaries from prior reporting periods should be discussed within the current reporting period management commentary. For example, if management has reported targets for future performance in previous reporting periods, it should report the entity's actual performance in the current reporting period and analyse and explain significant variances from its previously stated targets.

Characteristics of decision-useful management commentary

12 In developing its commentary, management should bear in mind the characteristics of decision-useful management commentary. Disclosure that is aligned with those characteristics:

(a) provides a discussion and analysis of the entity through the eyes of that entity's management;

(b) supplements and complements the financial statement information; and

(c) has an orientation to the future.

Through the eyes of management

13 Management has a unique perspective on the entity. That perspective has value for users of the financial reports. Generally, the information important to management in managing the business is the same information that is important to users for assessing financial performance and prospects.

Supplement and complement the financial statement information

14 In supplementing the financial statements, management commentary includes additional explanations of amounts reported in the financial statements and explains the conditions and events that shaped the information in the financial statements.

15 In complementing the financial statements, management commentary includes financial and non-financial information about the entity and its performance that is not reported in the financial statements.

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[2] From *Information about an entity's resources, claims on those resources and changes in resources and claims*, Phase A Framework ED, paragraphs OB15—OB25.

[3] From *Objective of general purpose financial reporting*, Phase A Framework ED, paragraph OB2.

Orientation to the future

16 Having an ‘orientation to the future’ is about communicating, from management’s perspective, the direction the entity is taking by, for example, setting out strategies and goals. The extent to which management commentary is oriented towards the future will be influenced by the regulatory and legal environment within which the entity operates. Information with an orientation to the future is described in this exposure draft as *forward–looking information*.

17 Management should include forward–looking information when there are trends, uncertainties or other factors that may result in a material impact on the entity’s liquidity, capital resources, revenues and results of operations. Forward–looking information is useful when it focuses on material events and uncertainties that may cause reported financial information to be an ineffective predictor of future operating results or of future financial performance.

Qualitative characteristics of decision-information useful

18 The degree to which the information disclosed in management commentary is useful depends on its qualitative characteristics. To be useful, financial reporting information must possess the fundamental qualitative characteristics of *relevance* and *faithful representation*.[4] The enhancing qualitative characteristics of *comparability*, *verifiability*, *timeliness* and *understandability* should be maximised.[5]

Presentation

19 The form of management commentary will vary between entities, reflecting the nature of their business, the strategies adopted by management and the regulatory environment in which they operate.

20 Management commentary, like other disclosures, should be clear and straightforward. Reciting financial statement information without analysis or presenting boilerplate analyses that do not provide any insight into the entity’s past performance or prospects as understood by management is unlikely to provide information that is useful for users of the financial reports.

21 Management commentary should be presented with a focus on the most important information, in a manner intended to address the characteristics described in the [draft] Guidance. Specifically:

(a) An entity’s management commentary should be consistent with its financial statements. If the financial statements include segment information, the information presented in the management commentary should reflect that segmentation. In formulating a judgement as to whether a discussion of segment information is necessary to an understanding of the entity, a multi-segment entity should analyse revenues, profitability and the cash needs of its significant industry segments. To the extent that any segment contributes in a disproportionate way to those items, or where discussion on a consolidated basis would present an incomplete and misleading picture of the entity, segment discussion should be included.

(b) Management should avoid replicating its financial statement note disclosure in its management commentary. Doing so may create an obstacle for users to identifying and understanding the most significant matters facing the entity. Boilerplate disclaimers and other generic language should also be avoided.

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[4] From *Fundamental qualitative characteristics*, Phase A Framework ED, paragraphs QC2—OB11.

[5] From *Enhancing qualitative characteristics*, Phase A Framework ED, paragraphs QC15—OB24.

Content elements of a decision-useful management commentary

22 Although the relevant focus of management commentary for a particular entity will depend on the facts and circumstances of that entity, a decision-useful management commentary includes information that is essential to an understanding of:

(a) the nature of the business;

(b) management's objectives and its strategies for meeting those objectives;

(c) the entity's most significant resources, risks and relationships;

(d) the results of operations and prospects; and

(e) the critical performance measures and indicators that management uses to evaluate the entity's performance against its stated objectives and strategies.

23 These content elements are related and should not be presented in isolation. Management's unique perspective on the business and its analysis of the interaction of the content elements helps users understand the entity's financial statements as well as management's objectives and its strategies for achieving those objectives.

Nature of the business

24 A description of the business helps users of the financial reports gain an understanding of the entity and the external environment in which it operates. That information serves as a logical starting point for assessing and understanding an entity's performance, strategic options and prospects. Depending on the nature of the business, management commentary may include discussion of matters such as:

(a) the industries in which the entity operates;

(b) the entity's major markets and competitive position within those markets;

(c) significant features of the legal, regulatory and macro-economic environment that influence the entity;

(d) the entity's main products and services, business processes and distribution methods; and

(e) the entity's structure and its economic model.

Objectives and strategies

25 Disclosures of objectives and strategies are most useful when they enable users of the financial reports to understand the priorities for action as well as the resources that must be managed to deliver results. Management's explanations about how success will be measured and over what period of time it should be assessed may also be useful. For example, how management intends to address market trends and the threats and opportunities those market trends represent provides users of the financial reports with insight that may shape their expectations about the entity's future performance. Discussion of the relationship between objectives, strategy, management actions and executive remuneration is also helpful.

Resources, risks and relationships

26 Management commentary that provides a clear description of the most important resources, risks and relationships that management believes may affect the entity's long-term value and how those resources, risks and relationships are managed is useful to users of the financial reports.

Resources

27 Disclosure about resources depends on the nature of the entity and the industry in which the entity operates. Management commentary should set out the critical financial and non-financial resources available to the entity and how those resources are used in meeting management's stated objectives for the entity. Analysis of the adequacy of the entity's capital structure, its financial arrangements (whether on or off balance sheet), its liquidity and cash flows, as well as plans to address any identified inadequacies or surplus resources are examples of resource disclosures that can provide information useful for users of the financial reports.

Risks

28 Management provides information useful to users of the financial reports when it identifies the critical external and internal risks that may affect the ability of management to achieve its objectives. An explanation of the potential effect of the identified risks and how they are being managed provides information useful to users of the financial reports.

29 Management can provide information useful to users of the financial reports when it discloses uncertainties as well as risks. These may include contingent liabilities relating to specific operational uncertainties, such as outstanding litigation; or market uncertainty, for example whether a new product will be successful. There are also inherent uncertainties that surround the preparation of the financial statements, which may require significant estimates and judgements. One approach is to highlight the key areas in which the judgements that are made in applying accounting policies affect each of the accompanying financial statements. Emphasising those accounting policies that are critical to the entity's performance and position can make it easier for users of the financial reports to understand the context in which those results are presented.

Relationships

30 Management provides information useful to users of the financial reports when it identifies the significant relationships the entity has in place, how those relationships are likely to affect the performance and value of the business and how those relationships are managed. This type of disclosure helps users of the financial reports to understand, for example, whether a single customer, or a small group of principal customers, represents a significant portion of an entity's business and whether that entity and its investors may be exposed to substantial risk if that customer takes its business to a competitor.

Results and prospects

31 Management commentary should include a clear description of the financial and non-financial performance achieved, the extent to which that performance is indicative of future results and management's assessment of future prospects. Useful disclosure in this area can help capital providers to make their own assessments about the assumptions and judgments used by management in preparing the financial statements.

Results

32 Explanations of the development and performance of the entity during the period under review and its position at the end of that period provides users of the financial reports with insight as to the main trends and factors affecting the business and their relationship to the objectives and strategies of the entity. Discussion and analysis of significant changes in financial position, liquidity and results compared with those of the previous period(s) helps users of the financial reports to understand the extent to which past results are indicative of future results.

Prospects

33 An analysis of the prospects of the entity including targets for financial and non-financial measures helps users of the financial reports to understand how management intends to action its strategies for the entity over the long-term. When prospects are quantified, management should explain the risks and assumptions necessary for users to assess the likelihood of achieving those stated targets.

Performance measures and indicators

34 The disclosure of performance measures and indicators, both financial and non-financial, which are used by management to assess progress against its stated objectives, can help users of the financial reports assess the degree to which goals and objectives are being achieved. Performance measures are quantified measurements that reflect the critical success factors of an entity. Indicators may be narrative evidence describing how the business is managed or quantified measures that provide indirect evidence of performance.

35 Relevant performance indicators are primarily output, outcome and efficiency measures. The performance measures and indicators that are most important to understanding a particular entity are those that management uses to manage that entity. The performance measures and indicators will reflect the industry in which the entity operates. Comparability will be enhanced if the performance measures and indicators are accepted and used widely, either within an industry sector or more generally.

36 If information from the financial statements has been adjusted for inclusion in management commentary, that fact should be disclosed. If financial performance measures that are not required or defined by IFRS are included within management commentary, those measures should be defined and explained.

Appendix A

Defined terms

This appendix is an integral part of [draft] Management Commentary.

comparability[*]
The quality of information that enables users to identify similarities in and differences between two sets of economic phenomena.

economic phenomena[*]
Economic resources, claims on those resources, and the transactions and other events and circumstances that change them.

faithful representation[*]
The correspondence or agreement between the accounting measures or descriptions in financial reports and the economic phenomena they purport to represent. Faithful representation is attained when the depiction of an economic phenomenon is complete, neutral and free from material error.

management commentary
Information that accompanies financial statements as part of an entity's financial reporting. It explains the main trends and factors underlying the development, performance and position of the entity's business during the period covered by the financial statements. It also explains the main trends and factors that are likely to affect the entity's future development, performance and position.

management
Individuals responsible for the decision making and oversight reflected in the management commentary. This may include executive employees and members of a governing body (see paragraph BC33 for additional information).

neutrality[*]
The absence of bias intended to attain a predetermined result or to induce a particular behaviour.

forward–looking information
Information about the future. It includes the forward–looking equivalent of any information that might subsequently be prepared as historical information. It is subjective in nature and its preparation requires the exercise of professional judgment.

relevance[*]
A quality of information that makes it capable of making a difference in the decisions made by users in their capacity as capital providers. Information about an economic phenomenon is capable of making a difference when it has predictive value, confirmatory value or both.

timeliness[*]
Having information available to decision makers before it loses its capacity to influence decisions.

understandability[*]
The quality of information that enables users to comprehend its meaning.

verifiability[*]
A quality of information that helps assure users that information faithfully represents the economic phenomena that it purports to represent.

[*] These definitions are taken from the **Phase A Framework ED**, published May 2008.

Appendix B

Proposed amendments to IAS 1 *Presentation of Financial Statements*

The amendments in this [draft] appendix shall be applied for annual periods beginning on or after [date to be inserted after exposure]. If an entity applies this [draft] guidance for an earlier period, these amendments shall be applied for that earlier period. Amended paragraphs are shown with the new text underlined and deleted text struck through.

IAS 1 *Presentation of Financial Statements*

B1 In IAS 1, after paragraph 12, a heading is added. Paragraphs 13—14 are amended as follows.

Information provided outside the financial statements

13 Many entities present, outside the financial statements, a ~~financial review~~ type of narrative report referred to within IFRSs as management commentary. ~~by management~~ that ~~describes and explains the main features of the entity's financial performance and financial position, and the principal uncertainties it faces~~ Management commentary gives users of the financial reports an opportunity to look at the entity through the eyes of that entity's management by providing a context within which the financial position, financial performance and cash flows of an entity may be interpreted. It also provides a basis for evaluating an entity's prospects, its general risks and opportunities, and the success of management's strategies for achieving its stated objectives.. Such a report may include a review of:

(a) ~~the main factors and influences determining financial performance, including changes in the environment in which the entity operates, the entity's response to those changes and their effect, and the entity's policy for investment to maintain and enhance financial performance, including its dividend policy~~ what management views as the most important issues facing the entity and how it intends to manage them;~~.~~

(b) ~~The entity's sources of funding and its targeted ratio of liabilities to equity~~ the related financial statements in the context of the environment in which the entity operates; and

(c) ~~The entity's resources not recognised in the statement of financial position in accordance with IFRSs~~ the strategies adopted by the entity and the likelihood that they will be successful in meeting management's stated objectives.

The IASB's framework for the preparation and presentation of management commentary to accompany financial statements prepared in accordance with IFRSs is contained in the guidance document *Management Commentary*.

14 Many entities also present, outside the financial statements and management commentary, reports and statements such as environmental impact reports, corporate social responsibility reports and value added statements, particularly in industries in which environment factors are significant ~~and when employees are regarded as an important user group~~. Reports and statements that are designed to meet the needs of a user group different from the users of the financial reports are presented outside the boundary of both the financial statements and management commentary and, consequently, are outside the scope of IFRSs.

Approval of ED X by the Board

The exposure draft *Management Commentary* was approved for publication by the fourteen members of the International Accounting Standards Board.

Sir David Tweedie	Chairman
Thomas E Jones	Vice-Chairman
Mary E Barth	
Stephen Cooper	
Philippe Danjou	
Jan Engström	
Robert P Garnett	
Gilbert Gélard	
Prabhakar Kalavacherla	
James J Leisenring	
Warren J McGregor	
John T Smith	
Tatsumi Yamada	
Wei-Guo Zhang	

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, [draft] Management Commentary.

Introduction

BC1 This Basis for Conclusions summarises the International Accounting Standard Board's (IASB) considerations in developing the proposals in the exposure draft *Management Commentary* (hereafter, Guidance). Individual Board members gave greater weight to some factors than to others.

BC2 The purpose of financial statements is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions.[1] Financial statements prepared for this purpose meet the common needs of most users. However, financial statements do not provide all the information that users may need to make economic decisions because the financial statements largely portray the financial effects of past events and do not provide non-financial indicators of future earnings.[2]

BC3 To bridge the gap between what financial statements are able to achieve and the needs of users of those financial statements, the Board has developed guidance in this exposure draft for a type of disclosure called *management commentary*. This exposure draft uses the term 'disclosure' in a broad sense, encompassing items reported in the financial reports (as opposed to the financial statements, specifically).

BC4 The purpose of this project is to establish a framework to guide the preparation and presentation of information in management commentary as a companion document to the financial statements. The results of this project will affect how the management of an entity communicates information on its performance, objectives and strategy to users of the financial reports.[3] The Board's goal is to improve the usefulness of the information provided in an entity's management commentary so that, when used in conjunction with the financial statements, users are better able to make decisions in their capacity as capital providers.

Background

BC5 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. In October 2005, the IASB published the results of the project team's research in a discussion paper *Management Commentary*.

BC6 In the discussion paper, the project team present their views regarding the users, objective and qualitative characteristics of management commentary. The project team also describe essential content elements of management commentary and a possible placement framework for use by standard-setters in distinguishing between information that would appear in management commentary and information that would appear in the notes to the financial statements.

BC7 This exposure draft was developed after considering the proposals contained in the 2005 discussion paper and constituents' responses to those proposals; developments in narrative reporting at the regulatory level in a variety of local and regional jurisdictions; and the Board's

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[1] IAS 1 *Presentation of Financial Statements*, paragraph 9.

[2] For example at present, IFRS reporting ignores intangible assets such as people (human capital), processes and brand position.

[3] In this document, the term 'financial reports' refers to the financial statements and the management commentary that accompanies them.

recent work (Phase A Framework ED) on the objectives and qualitative characteristics of financial reporting in their joint project with the US Financial Accounting Standards Board (FASB) to improve the conceptual framework.

Proposals

BC8 The following paragraphs summarise the Board's rationale for its proposals for:

(a) the scope of the proposed guidance (paragraphs BC9—BC12);

(b) differentiating management commentary from other types of disclosures that may be included in an entity's financial reports (paragraphs BC13—BC15);

(c) the purpose of management commentary (paragraphs BC16—BC22);

(d) the users of management commentary (paragraphs BC23—BC27);

(e) the reporting period covered by management commentary (paragraph BC28);

(f) characteristics of decision–useful management commentary (paragraphs BC29—BC43);

(g) presentation (paragraphs BC45—BC51); and

(h) content elements of a decision–useful management commentary (paragraphs BC52—BC55).

Scope

BC9 The Board considered whether the [draft] Guidance should be published as an International Financial Reporting Standard (IFRS) or as a guidance document distinct from IFRS. In the light of feedback received from respondents to the discussion paper, the Board decided that the final work product should result in a guidance document rather than an IFRS.

BC10 The Board's proposals for a framework to guide the preparation and presentation of management commentary are meant to foster good practice in management commentary reporting in such a way that an entity's management may exercise discretion in tailoring its commentary to its entity's particular circumstances. The Board noted that both the Committee of European Securities Regulators (CESR) and the International Organisation of Securities Commissions (IOSCO) support the issuance of a guidance document on management commentary. The Board also noted that a similar regime exists in the United Kingdom, where a Reporting Statement on Operating and Financial Reviews (OFRs) was published by the UK Accounting Standards Board in January 2006.

BC11 The Board's decision to develop its proposals for a framework to guide the preparation and presentation of management commentary in the form of a guidance document rather than an IFRS enables individual jurisdictions to make their own judgments as to:

(a) whether entities should be required to include management commentary in their financial reports to assert compliance with IFRS prepared financial statements;

(b) the level of assurance management commentary should be subjected to;

(c) the necessity for safe harbour provisions in relation to the inclusion of forward–looking information; and

(d) the type of entity that should prepare management commentary.

BC12 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 on which they are traded, or both. IASB guidance could prove useful to companies less seasoned or regulated in the area of management commentary and may promote comparability across all entities that apply IFRS, thereby improving the usefulness of the financial reports to users. The existence of IASB guidance may also encourage regulators to adopt it as their own.

Identification of management commentary

BC13 The [draft] Guidance applies only to disclosure within management commentary and not to other information present in either the financial statements or the broader financial reports. IAS 1 *Presentation of Financial Statements* sets out requirements for the presentation of disclosures in the statement of financial position, the statement of comprehensive income and the statement of changes in equity. IAS 7 *Statement of Cash Flows* sets out requirements for the presentation of cash flow information. Additionally, each IFRS sets out specific disclosure requirements relevant to the subject matter of that Standard.

BC14 The Board observed that it is important that users of the financial reports are able to distinguish information that is prepared using this [draft] Guidance from information that is prepared using IFRSs and from information that may be useful to users but is not the subject of the guidance described in the [draft] Guidance or the requirements in IFRSs.

BC15 This [draft] Guidance is a voluntary disclosure framework for management commentary. Consequently, the Board decided that preparer's should not be expected to include in the financial reports any formal confirmation that they have complied with the principles set out in this [draft] Guidance. However, the Board noted that including some comment on the extent to which the [draft] Guidance has been followed may be helpful to the users of the financial reports.

Purpose

BC16 At its July 2008 meeting, the Board revisited the conclusions of the discussion paper in the light of its revised thinking for phase A of the conceptual framework project. The Board chose to anchor its proposals for management commentary to its in–processs work for phase A of the conceptual framework. The Board believes its thinking on that phase of the conceptual framework to be sufficiently advanced to warrant primacy of consideration.

BC17 The Board views the conceptual framework as being an 'umbrella' that covers the management commentary project. The Board's approach to management commentary is based on the principle that a framework for management commentary must be fully consistent with the broader [draft] conceptual framework for financial reporting. Said differently, in order to remain consistent, everything in the management commentary project must take its cue from phase A of the conceptual framework.

BC18 That decision affected three aspects of the discussion paper: the objective, the users (see paragraphs BC23—BC27) and the qualitative characteristics (see paragraphs BC40—BC43) of management commentary.

BC19 The management commentary discussion paper was drafted under the assumption that management commentary will ultimately fall within the boundaries of financial reporting. The boundaries of financial reporting are to be established at the culmination of phase E of the conceptual framework project. At the July 2008 meeting, the Board affirmed its intention that management commentary sits alongside the financial statements as part of a 'complete' financial reporting package. The interim question is how best to position a non-authoritative management commentary guidance document in relation to the broader [draft] conceptual framework for financial reporting.

BC20 The Board observed that management commentary should not have an *objective* that is different from the objective of financial reporting described in the Phase A Framework ED. All of the components of general purpose financial reports have the same objective: to provide financial information about the reporting entity that is useful. The Board observed that management commentary has a unique *purpose*.[4]

[4] An argument can be made that management commentary does not contain information that can be categorised *explicitly* as financial information. The answer to that argument ultimately depends on how the Board decides to define the term 'financial' in phase E of the conceptual framework project.

BC21 The discussion paper is written in such a way that the framework for management commentary stands apart from the [draft] conceptual framework for financial reporting. The Board decided to reposition the management commentary framework so that its relative positioning within IFRS is clear (irrespective of its authoritative status): management commentary travels with the financial statements, both of which are covered under the umbrella of the [draft] conceptual framework for financial reporting. Consequently, the *objective* of management commentary described in the discussion paper has been recast in this exposure draft as the *purpose* of management commentary.

BC22 In determining an appropriate purpose for management commentary, the Board was guided by the objectives stated in existing requirements and guidance. Interpretive guidance issued by the SEC in December 2003 states that the purpose of MD&A is 'not complicated.' It is to provide readers with information 'necessary to an understanding of [a company's] financial condition, changes in financial condition and results of operations.'[5] Put simply, the purpose of management commentary is to provide context for the financial statements.

Users

BC23 At its July 2008 meeting, the Board determined that its proposals for management commentary should be fully consistent with its proposals for phase A of the conceptual framework (see paragraphs BC16—BC18). That decision had implications for the primary users of management commentary proposed in the discussion paper.

BC24 The discussion paper identifies 'investors' as the primary users of management commentary. In most jurisdictions the users of management commentary are confined to investors, or even a narrower group such as current shareholders. In some jurisdictions there has been much debate about which users should be the focus of management commentary—with many constituents taking the view that management commentary should meet the needs of all stakeholders.

BC25 The discussion paper includes consideration of whether management commentary should be designed to meet the needs of a wider set of users, largely because the range of information often observed accompanying financial statements is wide. This might suggest, to some, that management views the scope of management commentary, and its intended audience, as also being wide. The proposals in the discussion paper ultimately resolve that the primary users of management commentary should be the same as for the financial statements it accompanies, namely investors in publicly held companies.

BC26 The Phase A Framework ED identifies present and potential capital providers as the primary users of general purpose financial reporting. The primary user group includes both present and potential equity investors, lenders and other creditors (capital providers, collectively), regardless of how they obtained, or will obtain, their interests. The information provided by general purpose financial reporting focuses on the needs of all capital providers, not just the needs of a particular group.

BC27 The Board noted that, if management commentary is expected to provide context for an associated set of financial statements, it logically follows that the primary users of each component should be one and the same. Consequently, the focus of management commentary in the exposure draft reflects present and potential capital providers as its primary users.

Time frame

BC28 The Board observed that, even though an entity's management commentary is tied to a specific set of financial statements covering a defined reporting period, the content of that management commentary is not necessarily bound to the reporting period described by the financial statements. An important principle underpinning the information provided within management

[5] SEC, Regulation S–K, Item 303.

commentary is that it has an orientation to the future. The Board concluded that the inclusion of forward–looking information within management commentary helps users of the financial reports ascertain the likelihood that past performance is indicative of future performance.

Characteristics of decision–useful management commentary

BC29 The characteristics of decision-useful management commentary consist of three core principles and a series of qualitative characteristics. The Board relied on the proposals presented in the discussion paper to inform its proposals for the three core principles. In a departure from the discussion paper, the Board chose to base its proposals for the qualitative characteristics of management commentary on its recent work (Phase A Framework ED) on the objective and qualitative characteristics of financial reporting.

Core principles

BC30 The Board decided that, in developing its management commentary, an entity's management should align its disclosures with three principles. Specifically, a decision–useful management commentary:

(a) provides a discussion and analysis of the entity through the eyes of that entity's management;

(b) supplements and complements the financial statement information; and

(c) has an orientation to the future.

Through the eyes of management

BC31 This principle has its roots in regulation, specifically in the MD&A requirements of the United State's Securities and Exchange Commission (SEC). The first of the SEC objectives for MD&A reporting is:

> …to provide a narrative explanation of a company's financial statements that enables investors to see the company through the eyes of management.[6]

That requirement has also been enshrined in securities regulation in Canada, and appears as the first principle in the United Kingdom's Reporting Standard 1.

BC32 External research undertaken by PricewaterhouseCoopers (PwC) that involved more than 3,100 participants across fourteen countries and sixteen industries suggests that users' needs are also consistent with the 'through the eyes of management' principle. The PwC research suggests that, with few exceptions, the information important to management in managing the business is the same information that is important to capital providers in assessing performance and prospects.[7]

BC33 The inclusion of this principle raises the issue of what is meant by 'management.' IFRS 7 *Financial Insturments: Disclosures* uses the term 'key management personnel' as defined in IAS 24 *Related Party Disclosures*, meaning 'those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity.'[8]

BC34 The Board noted that determining who prepares and approves management commentary is likely to depend on jurisdictional requirements. For example, in the United Kingdom, the Operating and Financial Review (OFR) regulations require an OFR to be 'the directors' analysis.' Accordingly, management is taken to mean the entity's directors. Furthermore, it is the directors

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[6] SEC, Regulation S–K, Item 303.

[7] PwC Trends 2005.

[8] IAS 24, paragraph 9.

who are responsible for approving the OFR. There is a similar requirement in Canada and Germany.

Supplement and complement the financial statements

BC35 The Board noted that the principle of providing information to 'supplement and complement' the financial statements effectively formalises a statement already made in the *Preface to International Financial Reporting Standards* (Preface), namely that:

> Other financial reporting comprises information provided outside financial statements that assists in the interpretation of a complete set of financial statements or improves users' ability to make efficient economic decision.[9]

BC36 The Board observed that management commentary meets the definition of 'other financial reporting' described in the *Preface*.

Orientation to the future

BC37 The requirement for a focus on information that helps users of the financial reports assess prospects is found in all of the jurisdictions surveyed in the discussion paper. This principle has its roots in regulation, specifically in the MD&A requirements of the United State's SEC. The third of the SEC objectives for MD&A reporting is:

> …to provide information about the quality of, and potential variability of, a company's earnings and cash flow, so that investors can ascertain the likelihood that past performance is indicative of future performance.[10]

BC38 This United States regulatory requirement for the inclusion of information that helps investors assess prospects is found in both Canadian securities regulations and the European Modernisation Directive. The Directive has in turn influenced regulations in various jurisdictions, such as those in Germany and the United Kingdom.

BC39 The Board observed that how, and the extent to which, management commentary is oriented towards the future will be influenced by the regulatory and legal environment within which the entity operates. Explanations of past events can help users of the financial reports develop models of the entity from its past performance and current state. Although disclosure of forward–looking information is encouraged in many jurisdictions, this does not necessarily equate to making forecasts or projections. In some jurisdictions there are 'safe harbour' provisions to restrict liability claims or regulatory provisions, or both, that require cautionary statements relating to forward–looking information.

Qualitative characteristics

BC40 At its July 2008 meeting, the Board determined that its proposals for management commentary should be fully consistent with its proposals for phase A of the conceptual framework (see paragraphs BC16—BC18). That decision had implications for the qualitative characteristics of management commentary proposed in the discussion paper.

BC41 Given that management commentary supplements and complements the financial statements, the discussion paper proposed that management commentary should be expected to meet, as much as possible, qualitative standards similar to those applicable to the financial statements. At the time of drafting of the discussion paper, the conceptual framework for financial statements described four qualitative characteristics: *relevance*, *understandability*, *reliability* and *comparability*. Rather than using the qualitative characteristics of *reliability* and *comparability*, the discussion paper proposed the use of *supportability, balance* and *comparability over time* as being more relevant to management commentary.

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[9] *Preface*, paragraph 7.

[10] SEC, Regulation S-K, Item 303.

BC42 During its deliberations, the Board observed that its in–processs work on phase A of the conceptual framework applies to the broader financial reports, not just the financial statements. When the Board decided that management commentary was within the boundaries of financial reporting and subject to the conceptual framework, it also decided that it would be inconsistent to develop qualitative characteristics that are specific to management commentary only. Further, the Board determined that the logical place to resolve questions about the applicability of the qualitative characteristics to management commentary is in phase A of the conceptual framework project, not in the management commentary project.

BC43 Consequently, it is by design that this exposure draft references the qualitative characteristics described in the Phase A Framework ED but does not contain application guidance for those qualitative characteristics to management commentary. Questions about the applicability of the qualitative characteristics to management commentary will be resolved during the finalisation of Chapter 1 of the conceptual framework for financial reporting, the subject of which is the objective of financial reporting and the qualitative characteristics of decision–information useful.

Presentation

BC44 The Board considered the following three aspects of presentation when developing its proposals for management commentary:

(a) presentation of information within management commentary;

(b) presentation of management commentary in relation to the financial statements (ie positioning); and

(c) presentation of disclosure within the financial reports.

Presentation of information within management commentary

BC45 The discussion paper proposes that it is management's responsibility to decide both the content of its management commentary and the best way to present that content. Providing flexibility in both the content and presentation of management commentary reduces the risk that preparers will adopt a boilerplate approach to their preparation of management commentary.

BC46 A request was made at the June 2008 Analyst's Representative Group (ARG) meeting to develop presentation requirements for management commentary that are linked to those found in IFRS 8 *Segment Reporting*. IFRS 8 was issued in November 2006; consequently; the conclusions reached in it were not considered during the development of the management commentary discussion paper (which was published in October 2005).

BC47 While the exposure draft maintains the premise that management is best positioned to determine the presentation of management commentary, the Board decided to formalise its intention that management commentary should be consistent with the financial statements, particularly in terms of its presentation of segment information.

Positioning of management commentary relative to the financial statements

BC48 The positioning of management commentary relative to the financial statements varies across jurisdictions that presently require that type of reporting. In some jurisdictions, management commentary accompanies the annual financial statements in a printed report to shareholders; in other jurisdictions, management commentary is contained within separate annual regulatory filings.

BC49 The Board considered whether it would be desirable to incorporate management commentary within the financial statements, perhaps by adding textual material and other information within the notes to the financial statements. The Board rejected this idea on the ground that management commentary should supplement and complement the financial statements. Consequently, management commentary should sit alongside the financial statements and not be placed within them.

BC50 In a departure from the proposals presented in the discussion paper, the Board also decided to explicitly tie management commentary to the financial statements as a stand alone document. Again, management commentary is designed specifically to supplement and complement information provided in an associated set of financial statements. Consequently, when management commentary is prepared to accompany IFRS financial statements, it should not be made available for use without those accompanying IFRS financial statements.

Presentation of disclosure within the financial reports

BC51 In October 2008, the IASB and the FASB issued a discussion paper *Preliminary Views on Financial Statement Presentation*. The scope of the project on financial statement presentation is centered on resolving presentation issues within the primary financial statements. Financial information included in the notes to the financial statements and management commentary that may accompany the financial statements is presently outside the scope of the financial statement presentation project. Consequently, the Board has not considered whether its proposals for financial statement presentation may be extended to include disclosure within management commentary.

Content elements of a decision–useful management commentary

BC52 The Board noted that specifying disclosures for management commentary may be more difficult than specifying information to be disclosed in the notes to the financial statements. The types of activities that are critical to an entity will be specific to that entity. As a consequence regulators have tended to identify the key elements that reflect the *type* of content they expect to see in management commentary rather than defining the elements themselves. Specifying a detailed list also encourages a 'tick the box' mentality, which the Board wishes to avoid.

User needs

BC53 The five content elements described in paragraphs 21—35 are based on the needs of capital providers as the primary users of management commentary information. The table below relates the five content elements to the needs of capital providers when using management commentary to assess an entity's performance and make financial decisions.

BC54

Content elements	**User needs**
Nature of the business	The knowledge of the business an entity is engaged in and the external environment in which it operates.
Objectives and strategies	To assess the strategies adopted by the entity and the likelihood that those strategies will be successful in meeting management's stated objectives.
Key resources, risks and relationships	A basis for determining the resources available to the entity as well as obligations to transfer resources to others; the ability of the entity to generate long-term, sustainable net inflows of resources; and the risks to which these resource-generating activities are exposed, both in the near term and in the long run.
Results and prospects	The ability to understand whether an entity has delivered results in line with expectations, and implicitly, of how well management has understood its market, executed its strategy and managed its resources, risks and relationships.

Performance measures and indicators	The ability to focus on the critical performance measures and indicators that management uses to assess and manage the entity's performance against stated objectives and strategies.

BC55 The Board also observed that information in management commentary will be of interest to users other than capital providers. As a result, management may need to consider the extent to which reporting on issues relevant to a wider user group may be appropriate given the degree of those issues' influence on the performance of the entity and its value. The Board noted that management commentary should not, however, be seen as a replacement for other forms of reporting addressed to a wider stakeholder group.

Placement of disclosure within the financial reports

BC56 The Board noted that IFRS does not presently include overarching principles to inform its approach for establishing disclosure requirements. One question raised by constituents centers on determining the appropriate location for disclosure: does the information belong in the notes to the financial statements or does it belong in management commentary? The discussion paper includes proposals for a placement framework to aid the Board in determining where in the financial reports disclosures are most appropriately presented.

BC57 In December 2007, as part of its decision to move the management commentary project from the research agenda to the active agenda, the Board decided to defer its work on a placement framework for disclosure to phase E of the conceptual framework project. The Board noted that phase E of the conceptual framework includes the development of overarching disclosure principles. Consequently, the Board views phase E of the conceptual framework as the appropriate project to resolve questions about the placement of disclosure in the financial reports.

BC58 The Board acknowledges that until phase E of the conceptual framework is completed, overlap will exist between the type of information that is disclosed in the notes to the financial statements and that which is disclosed in management commentary. In the light of that consideration, the Board determined it was more important to establish management commentary as a disclosure tool within IFRS than it was to immediately resolve questions of placement for that information.

Application guidance and illustrative examples

BC59 The discussion paper contains both application guidance and illustrative examples which are included to demonstrate the principles underpinning the management commentary framework.

BC60 The Board decided not to include application guidance or illustrative examples in the exposure draft for two primary reasons. First, the Board noted the risk that its application guidance or illustrative examples could be interpreted as either a floor (minimum requirements) or a ceiling (the only content elements to consider). Consequently, the Board determined that the risk of undue emphasis being place on the application guidance and illustrative examples outweighs the utility they may have provided. Second, the Board decided that the development of interpretive guidance is best left to organisations external to the IASB.