

IAS Plus Update.

IASB issues proposals regarding management commentary

On 23 June 2009, the International Accounting Standards Board (IASB) issued an exposure draft (ED) ED/2009/6 *Management Commentary*. The ED proposes a framework to assist management in preparing decision-useful management commentary to accompany financial statements prepared in accordance with International Financial Reporting Standards (IFRSs). When finalised, this framework would be included in a non-binding guidance document, rather than a mandatory Standard.

The comment period for this ED is longer than usual – the IASB has requested comments by 1 March 2010.

Background

Many jurisdictions require the preparation of a document separate from the financial statements in which management sets out an expanded discussion on its objectives and strategies in managing the entity. Such documents usually include discussion and analysis of the financial position, performance and change in financial position of the entity, as well as outlining plans for the future.

To investigate the potential for issuing a Standard or guidance document on management commentary, the IASB set up a project team in late 2002 comprising representatives from four national standard-setters. The results of their analysis led to the publication of a discussion paper (DP) in October 2005.

The current ED builds on that DP as well as on the comments received on it. Additionally, legal and regulatory developments in various jurisdictions and the Board's work on phase A of the Conceptual Framework project were considered.

Objective, status, scope and identification of management commentary

The objective of the proposals is to recommend a framework for the preparation and presentation of management commentary to supplement and complement financial statements prepared in accordance with IFRSs. As such, the guidance would be within the boundaries of financial reporting as defined in the Conceptual Framework. However, based on the feedback received on its DP, the Board decided that the guidance should be non-binding.

Although the IASB has developed the guidance with listed entities in mind, the framework would not mandate which entities should be required to prepare and publish management commentary; nor would it prescribe how frequently management commentary should be prepared or the level of assurance to which it should be subjected. However, under the proposals, if an entity prepares management commentary to supplement its financial statements, it should (a) not make it available without those financial statements, and (b) clearly distinguish management commentary from other information in the same financial report.

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A framework for the preparation and presentation of management commentary

Users, timeframe and purpose of management commentary

The ED proposes that, when preparing its commentary, management should consider the same users and their information needs as are identified as the primary user group for financial statements in the Conceptual Framework (i.e. existing and potential providers of capital); they should provide those users with decision-useful information that enables them to put the financial statements into context. To fulfil that objective, management should not only report on what has happened during the reporting period, but should also include an explanation as to why it has happened and the potential future impact.

In addition to reporting on the past and the current position of the entity, the ED proposes that management should communicate information about an entity's resources, the claims thereon, and transactions, events and other circumstances that may affect those resources and claims. This information should be targeted to enabling users to understand, amongst others:

- a) the entity's risk exposures, its strategies for managing risks and the effectiveness of those strategies;
- b) how resources that are not presented in the financial statements could affect the entity's operations; and
- c) how non-financial factors have influenced the information presented in the financial statements.

Key principles of management commentary

In the ED, the IASB identifies three key characteristics that distinguish decision-useful management commentary. Such decision-useful commentary:

- discusses and analyses the entity's performance, position and development through the eyes of management – disclosing information that is important for management in steering the entity;
- supplements and complements information contained in the financial statements – providing additional explanations of amounts presented in the financial statements and including information that is not presented in the financial statements; and
- has an orientation to the future – to communicate, from management's perspective, the direction the entity is taking. Management should include forward-looking information if it is aware of any factors that could impact the entity's financial position or performance, and should discuss the extent to which forward-looking disclosures made in prior periods have been borne out.

Presentation and content of management commentary

The form and content of management commentary should reflect the nature of the business, the strategies employed, and the legal and regulatory environment in which an entity operates. For this reason, the IASB does not propose a specific format or content for management commentary, but rather provides some general guidelines.

The ED proposes that if the financial statements include segment information, the information provided in management commentary should reflect that segmentation.

To assist users in identifying and understanding matters that are significant, the ED suggests that management should avoid duplicating in its management commentary the disclosures made in the notes to the financial statements. In addition, generic ('boilerplate') disclosures should be avoided because they do not contribute to an understanding of the specific entity.

Regarding the content of management commentary, the IASB suggests that the information provided should enable users to understand:

- the nature of the business, which usually includes a macro- (e.g. industry, socio-economic and legal environment) as well as a micro-level discussion (business model, product portfolio, etc.);
- management's objectives and strategies for meeting those objectives, including priorities for action and addressing threats and opportunities of market trends;
- the entity's most significant financial and non-financial resources (e.g. personnel); its principal strategic, commercial, operational and financial risks and uncertainties; and those relationships that are likely to have an impact on the entity's performance and value (e.g. a discussion of the structure of its customer base);
- the results of operations, the extent to which those results may be indicative of future performance, and management's assessment of the entity's prospects (including targets for financial and non-financial measures and, if quantified, the risks and assumptions used); and
- the critical performance measures and indicators used by management to steer the entity and assess its performance against stated objectives.

Alternative views

Three Board members voted against publication of the ED for the following reasons;

- they believe that if the status of the final pronouncement is non-binding, this will not result in an improvement in financial reporting;
- they note that commentary prepared through the eyes of management contradicts the principle of neutrality as defined in the Framework; and
- they believe that producing a non-binding pronouncement would not represent an appropriate use of either the IASB's resources or constituents' time.

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