EFRAG
European Financial Reporting Advisory Group

8 March 2010

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sir/ Madam

IASB ED *Management Commentary*

On behalf of the European Financial Reporting Advisory Group (EFRAG) I am writing to comment on the IASB Exposure Draft *Management Commentary*, which was issued in June 2009 ('the ED'). This letter is submitted in EFRAG's capacity of contributing to the IASB's due process and does not necessarily indicate the conclusions that would have been reached in its capacity of advising the European Commission on endorsement, were the ED to result in material falling within the scope of the EU's IAS Regulation.

The ED describes at a high-level and in a principles-based way a framework for the preparation and presentation of Management Commentary ('MC') and the content of a decision-useful MC. The proposal is that this material will represent non-mandatory guidance on MC.

Our detailed comments on the ED are set out in the appendices. (Appendix 1 contains our responses to the questions asked in the ED, whilst appendix 2 contains some additional observations related to the objective, users and qualitative characteristics of MC and on placement principles.) To summarise our comments made in these appendices:

- we support the IASB's decision to develop high-level, principle-based, non-mandatory guidance on MC, although we do not think the project should be developed at the moment given the IASB's other priorities;
- we broadly support the detailed proposals, except that:
    - we have some concerns about the desirable qualitative characteristics it is proposed that MC should have;
    - we do not support the IASB's decision to defer the development of placement principles until Phase E of the Conceptual Framework project. We think that some sort of placement principles are necessary to increase financial reporting effectiveness where MC is prepared.
    - we think it should be clarified that financial statements prepared in accordance with IFRS that are accompanied by management commentary, not prepared in

accordance the guidance proposed in the ED, still can be said to be prepared in accordance with IFRS.

We hope that you find the comments helpful. If you wish to discuss them further, please do not hesitate to contact Rasmus Sommer or me.

Yours sincerely

Stig Enevoldsen
EFRAG, Chairman

Appendix 1
EFRAG's response to the questions asked in the ED

Question 1: The IASB's approach to the subject of MC—Do you agree with the Board's decision to develop a guidance document for the preparation and presentation of management commentary instead of an IFRS? If not, why?

EFRAG's view
• EFRAG supports the IASB in carrying out work on MC. • EFRAG agrees that at this stage it is non-mandatory guidance rather than a mandatory standard that the IASB should be developing.

1 EFRAG supports the IASB's decision to carry out an active project on MC. In our view, the MC is a very important part of the annual reporting package, and the annual reporting package is a fundamentally important element of business reporting. Even though some jurisdictions already have well-developed requirements and guidance on MC, an IASB project on the subject ought to assist:

(a) with the global convergence of MC reporting requirements; and

(b) jurisdictions that do not have MC reporting requirements and as a result improve the quality of financial reporting in those jurisdictions.

2 EFRAG carefully considered the advantages and disadvantages of either a mandatory standard or non-mandatory guidance. We for example acknowledge that a standard is more likely to guarantee a consistent application of MC requirements. In addition, Europe has a long tradition of requiring MC information (for example as laid out in the Fourth and Seventh Company Law Directives). Having said that, we are also concerned about the difficulty of developing a standard that is sufficiently detailed to have an impact on existing practice without creating inconsistencies with those existing requirements. Having weighed these arguments, we—like the IASB—have concluded that developing non-mandatory guidance would be the most appropriate approach at this time. We are therefore supportive of the IASB developing and issuing non-mandatory guidance on the subject.

3 We in particular do not agree with the three IASB dissenters, who have argued that non-mandatory guidance will not result in improvements in financial reporting. In our view, global guidance on the subject could make a difference. In some jurisdictions it will provide impetus and direction to the jurisdictional authorities to develop material (including requirements and best practice material on the subject), and in some other jurisdictions it will provide impetus and direction to the entities themselves. We accept though that there might be some jurisdictions that take little notice of non-mandatory guidance, but do not believe that this should be the IASB's concern at this stage.

4 As EFRAG agrees that IASB should develop guidance only, we think paragraph 8 of the exposure draft could be a source of confusion. Paragraph 8 states "an entity's management should apply paragraphs 9 – 39 when preparing management commentary to accompany financial statements prepared in accordance with IFRSs". In some

jurisdictions, management commentary-type reports accompanying IFRS financial statements are mandatory but their contents are defined by local legislations or regulations. Therefore EFRAG thinks the provisions of paragraph 8 could be interpreted as requiring the application of the IASB guidance every time a management commentary is included in a set of financial statements prepared in accordance with IFRSs. We think it should be made clear that an entity could prepare financial statements in accordance with IFRSs whilst also including a management commentary-type report that does not meet the requirements of paragraphs 9 – 39 of the exposure draft. Also, we think it should be stated that an entity could prepare a management commentary in accordance with the requirements of the exposure draft without preparing financial statements in accordance with IFRSs.

5 Although EFRAG supports the development of guidance on management commentary, it also thinks that the project should not be developed further until after June 2011. EFRAG is concerned about the overload of documents being issued by the IASB. It is not just a matter of responding to proposals, but also the effort that is required in implementing new or amended accounting standards. Even in relation to a guidance document, management will still have to consider whether or not to apply the guidance, and if so, how to implement it. Having considered the other projects on IASB's agenda, EFRAG thinks that there are more urgent projects than a guidance document on management commentary. Accordingly, this project should await the finalisation of these other more urgent projects.

Question 2: Content elements—Do you agree that the content elements described in paragraphs 24 – 39 are necessary for the preparation of a decision–useful management commentary? If not, how should those content elements be changed to provide decision-useful information to users of financial reports?

EFRAG's view

- EFRAG supports the high-level, principles-based approach that the Board is proposing to adopt.
- EFRAG is broadly supportive of the specific things the ED says on content.

6 We support the high-level principles-based approach towards the content of MC that the IASB has chosen to adopt. We think anything other than a high-level approach would have created a risk of inconsistencies between the IASB material and the guidance and requirements that already exist in many jurisdictions. And we favour principle-based material over rules.

7 We are also broadly supportive of the specific things the ED says on content. We support the direction the IASB has taken in avoiding a checklist approach to the list of essential content information in paragraph 24 of the ED. However, we think it would be preferable were this paragraph to focus more of the information objectives and the need to develop the MC with care and less on a list of information to be provided.

Question 3: Application guidance and illustrative examples—Do you agree with the Board's decision not to include detailed application guidance and illustrative examples in the final management commentary guidance document? If not, what specific guidance would you include and why?

8 EFRAG agrees with the IASB that it should not include any illustrative examples in the document. However, EFRAG has concerns about the reason given in the Basis for Conclusion (BC 48) to not include such material. In particular, EFRAG is concerned about the statement that application guidance or illustrative examples could be interpreted as a 'minimum' or 'maximum' requirement. In the view of EFRAG, this argument could also apply to other areas than management commentary.

Appendix 2
Some additional observations

1 The questions asked by the IASB in the Invitation to Comment part of the MC ED do not cover all the proposals in the ED. In particular, they do not cover the proposals on the framework for the preparation and presentation of management commentary that are described in paragraphs 8 – 23 of the ED. Set out below are EFRAG's comments on the proposals.

OBJECTIVE, USERS AND QUALITATIVE CHARACTERISTICS OF MC

EFRAG's view

- EFRAG agrees with the proposed objective and users of MC.
- We do not agree that the desirable qualitative characteristics of MC are those set out in the May 2008 Framework ED.
- We think the meaning of paragraph 23(b) is unclear.

2 In May 2008, the IASB published an ED *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*. That ED proposed inter alia that the objective of general purpose financial reports was to provide financial information about the reporting entity that is useful to the primary user group (ie present and potential equity investors, lenders, and other creditors) in making decisions in their capacity as capital providers. The MC ED notes that MC is an example of a general purpose financial report and it reaffirms that the objective set out in that May 2008 Framework ED applies equally to MC.

3 When EFRAG commented on the May 2008 Framework ED, it agreed that in principle the Framework should apply to all types of general purpose financial reports, not just to general purpose financial statements. However, we also made it clear that we were not convinced that everything that was said in that ED could be applied to all types of general purpose financial reports.

Objective of MC

4 Against that background, we agree that the information objective of MC is the same as the information objective of general purpose financial reports as set out in the Framework ED: to provide decision-useful information to the primary user group.

5 Having said that, we do not think that the description in paragraph 10 of the ED fully reflects what we see as the essence of MC. In our view the objective of MC is to put the information provided by the general purpose financial statements in context. For that reason we agree with the second sentence of paragraph 10's reference to explaining the main trends are factors that are likely to affect the entity's future performance, position and development. But we think the first sentence misses the point in describing MC in terms that apply equally to general purpose financial statements. We think the sentence should be omitted.

The users of MC

6 We also agree that the users of MC are the same as the users of general purpose financial reports as described in the Framework ED, because we think it reasonable to suppose that the various parts of the annual report package have the same primary users. It follows that we believe that MC should focus primarily on the needs of existing and potential capital providers, but also take into account the information needs of other groups of users. We therefore agree with the wider notion of users set out in paragraph 9 of the ED. However, it also follows that we do not believe general purpose financial reports (such as MC) should focus exclusively on the information needs of existing and potential capital providers and that therefore we do not think that the notion used in paragraph 11 of the ED, which limits the focus of MC to existing and potential capital providers, is appropriate. In our view it would be more consistent and appropriate if the IASB used the reference in paragraph 9 of the ED when referring to users in the MC guidance.

7 We suggest that the easiest way of addressing this concern is to use the term 'users' throughout the ED and to make it clear, probably in paragraph 9 of the ED, that the term is intended to refer to users as described in that paragraph.

Desirable qualitative characteristics of MC

8 We do not agree that the desirable qualitative characteristics of MC are those set out in the May 2008 Framework ED. That Framework ED proposed that the fundamental qualitative characteristics of general purpose financial reports are relevance and faithful representation and the enhancing qualitative characteristics are comparability (over time and between entities), verifiability, timeliness and understandability.

9 We agree that desirable qualitative characteristics of MC are relevance, comparability over time, timeliness and understandability. However, we do not believe it reasonable to expect all MC to be comparable between entities and verifiable.

(a) We do not believe that it is realistic to expect MC to be both comparable between entities and also able to show the entity's activities, position and prospects from the management's perspective and the circumstances of the entity, with an emphasis on what management views as important. MC provided by two entities in the same industry can differ because the managements have different perceptions of what is important and how they measure and report it.

(b) We are not convinced that the verifiability notion could be applied effectively to MC. Future-oriented information, for example forecasts and projections, cannot be verified. We wonder whether it might be preferable to use a notion of 'reasonableness', that is to say, do the assumptions that support the future-oriented information in financial reports make sense? Perhaps this could be supported by a 'supportability' notion, where information is deemed to be supportable if it faithfully represents factually-based strategies, plans and risk analysis.

10 We note that the ED's Basis for Conclusions states that questions about the applicability of the qualitative characteristics to MC "will be resolved during the finalisation of Chapter 1 of the Conceptual Framework for Financial Reporting". That chapter had not been published at the time we were preparing this draft letter so it has not so far been possible for us to assess whether our concerns about the applicability of the Framework's qualitative

characteristics to MC—concerns that we have raised previously both within the context of the MC project and within the context of the Framework project—have been addressed in finalising that chapter.

11 EFRAG is in agreement with the rest of paragraphs 8 - 23, although we think the meaning of paragraph 23(b) ("Management should avoid duplicating in its MC the disclosures made in the notes to its financial statements. Doing so may create an obstacle for users to identify and understand the most significant matters facing the entity") is not entirely clear and therefore should probably be clarified.

PLACEMENT PRINCIPLES

Summary of EFRAG's view: • EFRAG does not support the IASB's decision to defer development of placement principles until Phase E of the conceptual Framework is completed. We think that, in the interim period, the IASB should develop placement criteria.

12 In its reply to the MC DP, EFRAG argued that placement principles were needed because otherwise each time the IASB requires a new disclosure it would need to take an ad hoc decision as to whether that new disclosure should be presented in MC or in the notes to the financial statements. We continue to be supportive that criteria are needed to determine whether a piece of information should be provided in the MC rather than the financial statements and vice versa. It is widely accepted that it would be inappropriate to include in MC information that should be provided in the general purpose financial statements, and we think it can sometimes also be inappropriate to include MC information in the general purpose financial statements.

13 At present nonetheless, the IASB specifies requirements for disclosures in the financial statements that would rather belong to the MC. Placement criteria would help the IASB specify in each standard which disclosures should always be presented in the notes to the financial statements and which disclosures should be presented in the MC, should a MC need to be prepared in accordance with the local compliance framework. All disclosure requirements would be mandatory in all circumstances, despite the non-mandatory feature of the MC guidance. Where a MC is prepared, financial reporting would hence, in our view, be more cohesive and effective.

14 Accordingly, we do not support the IASB's decision to defer the development of placement principles to Phase E of the conceptual framework. It is our understanding that Phase E will not be completed for some years and we think that, if the financial reporting is to be effective, some principles are needed to distinguish between information that should be disclosed in the notes and that which should or could be disclosed in the MC.

FORWARD-LOOKING INFORMATION

Summary of EFRAG's view: • It should be clarified that forward-looking quantitative information is not required under the guidance.

15 While EFRAG agrees with the content of paragraph 18 of the exposure draft, it finds that the text of paragraph 19 ("That discussion should explain how and why the performance of the entity is short of, meets or exceeds the forward-looking disclosures made in the previous management commentary") in combination with paragraph 17 could lead one to think that the management commentary should include forward-looking quantitative information. The reason is that the financial statements includes quantitative information about its performance, and if an entity should compare this information with its forward-looking disclosures made in the previous management commentary, it could be argued that this information should also be quantitative in nature. We think it should be clarified that an entity has the option to provide quantitative information, but is not required to do so under the guidance.