

# PROPOSED FINANCIAL REPORTING STANDARD

ED/FRS

## EXPOSURE DRAFT

## MANAGEMENT COMMENTARY

*Comments to be received by 30 November 2009*

ED FRS *Management Commentary* is issued by the Accounting Standards Council (ASC) for comment only and does not necessarily represent the views of ASC. The proposals may be modified in the light of the comments received before being issued as a Financial Reporting Standard (FRS).

Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, clearly explain the problem and provide a suggestion for alternative wording with supporting reasoning.

Comments should be submitted in writing, so as to be received by **30 November 2009** preferably by email to MOF\_Feedback\_ASC@mof.gov.sg or addressed to:

Accounting Standards Council  
c/o Ministry of Finance  
100 High Street #10-01  
The Treasury  
Singapore 179434

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# Introduction

## Summary

Management commentary provides a context within which to interpret the financial position, financial performance and cash flows of an entity. It also provides an opportunity to understand management's objectives and its strategies for achieving those objectives. Users of financial reports in their capacity as capital providers routinely use the type of information provided in management commentary as a tool for evaluating an entity's prospects and its general risks, as well as the success of management's strategies for achieving its stated objectives.

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 proposals for a broad framework for the preparation and presentation of management commentary to accompany financial statements prepared in accordance with Financial Reporting Standards (FRSs). It is for the management of an entity to decide how best to apply this framework in the particular circumstances of its business.

## How to use this document

The proposals presented in this exposure draft will not result in an FRS. Accordingly, it would not be a requirement for an entity to comply with the framework for the preparation and presentation of management commentary as a condition for asserting compliance with FRSs.

The proposals are intended to provide a basis for the development of good management commentary. It offers a non-binding framework which could be adapted to the legal and economic circumstances of individual jurisdictions.

The exposure draft is prepared on the basis that management commentary lies within the boundaries of financial reporting and, therefore, is within the scope of the conceptual framework for financial reporting. In developing the proposals for management commentary, the recent work on the objective and qualitative characteristics of financial reporting was taken into account.<sup>\*</sup> Consequently, this exposure draft should be read in the context of the Phase A Framework exposure draft, published in May 2008.

## Invitation to comment

The equivalent exposure draft has been issued in Singapore.

The ASC invites comments on the proposals for a type of disclosure labelled *management commentary*. It seeks comment on whether the framework for the preparation and presentation of management commentary proposed in the 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 ASC 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 that should be considered. 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;

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<sup>\*</sup> 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].

- (b) contain a clear rationale; and
- (c) include any alternative it should consider.

Respondents' comments will help in developing a final document on management commentary. In considering the comments, the conclusions will be based 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 **30 November 2009**

## **Questions for respondents**

### **Status of the final work product**

The exposure draft proposes a framework for the preparation and presentation of management commentary. It is believed that the proposals provide a basis for the preparation and presentation of management commentary that will be useful to the users of financial reports. However, it is intended to publish a guidance document, not a Financial Reporting Standard (FRS).

#### **Question 1**

Do you agree with the decision to develop a guidance document for the preparation and presentation of management commentary instead of a FRS? If not, why?

### **Content elements of a decision-useful management commentary**

The proposed framework for the preparation and presentation of management commentary is intentionally general. This reflects the view that a flexible approach elicits more meaningful disclosure by encouraging entities that choose to prepare management commentary to discuss those matters most relevant to their individual circumstances. Consequently, the proposed framework for the preparation and presentation of management commentary sets out the principles, qualitative characteristics and content elements necessary to provide existing and potential capital providers with decision-useful information.

#### **Question 2**

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?

### **Application guidance and illustrative examples**

It is not intended to include application guidance or illustrative examples in the final management commentary guidance document. The concern is that such detailed guidance could be interpreted as either a floor (minimum requirements for content) or a ceiling (the only disclosures for inclusion in management commentary). It is believed that the development of application guidance or illustrative examples to help management apply the proposed framework for management commentary is best left to other organisations.

#### **Question 3**

Do you agree with the 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?

# **[Draft] Management Commentary**

## **Objective**

- 1 **This guidance prescribes a framework for the preparation and presentation of management commentary to assist management in preparing decision-useful management commentary to accompany financial statements prepared in accordance with Financial Reporting Standards (FRSs).**
- 2 Management commentary prepared in accordance with this framework can provide users of the financial statements with historical and prospective commentary on the entity's financial position, financial performance and cash flows, and a context for understanding management's objectives and its strategies for achieving those objectives.
- 3 Management commentary prepared in accordance with this framework is within the boundaries of financial reporting and, therefore, is within the scope of the conceptual framework for financial reporting.\*

## **Scope**

- 4 [Draft] *Management Commentary* (Guidance) has been developed to apply to publicly traded entities. However, it 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.
- 5 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), or management's report.

## **Identification of management commentary**

- 6 When an entity prepares management commentary to accompany FRS financial statements, it should not make that commentary available without those financial statements.
- 7 Management should identify clearly what it is presenting as management commentary and distinguish it from other information in the same financial report.

## **Framework for the preparation and presentation of management commentary**

- 8 An entity's management should apply paragraphs 9–39 when preparing management commentary to accompany financial statements prepared in accordance with FRSs.

### **Users**

- 9 The needs of existing and potential capital providers, as the primary users of the financial reports, are paramount when management considers what information to include in management commentary.<sup>^</sup>

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\* This exposure draft is prepared in the light of the recent thinking on the objectives of financial reporting and the qualitative characteristics and constraints of decision-useful financial reporting information [referred to in this exposure draft as Phase A Framework ED]. It is expected to finalise the proposals on those topics and publish the first chapter of the Conceptual Framework for Financial Reporting in Q3 2009.

<sup>^</sup> From *Objective of general purpose financial reporting*, Phase A Framework ED, paragraph OB2.

## **Time frame**

- 10 Management commentary should communicate information about an entity's economic resources, claims on those resources and the transactions and other events and circumstances that change them.<sup>†</sup> It also should explain the main trends and factors that are likely to affect the entity's future performance, position and development. Consequently, management commentary looks not only at the present, but also at the past and the future.

## **Purpose**

- 11 Management commentary prepared in accordance with this framework should provide existing and potential capital providers with information that helps them place the related financial statements in context. Management commentary that fulfils that purpose explains management's view on not only what has happened, but also why management believes it has happened and what management believes the implications are for the entity's future.

## **Principles for the preparation of management commentary**

- 12 Management commentary prepared in accordance with this framework can help users of the financial reports assess the performance of the entity and the actions of its management relative to stated strategies and plans for development. That type of commentary may help users of the financial reports to understand, for example:
- (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.
- 13 In developing its commentary, management should bear in mind the principles that underpin decision-useful management commentary. Commentary that is aligned with those principles:
- (a) provides management's view of the entity's performance, position and development;
  - (b) supplements and complements information presented in the financial statements; and
  - (c) has an orientation to the future.

## **Management's view**

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

## **Supplement and complement the financial statement information**

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

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<sup>†</sup> From *Information about an entity's resources, claims on those resources and changes in resources and claims*, Phase A Framework ED, paragraphs OB15–OB25.

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

### **Orientation to the future**

- 17 Having an orientation to the future is about communicating, from management’s perspective, the direction the entity is taking. For example, management can provide useful information to users of the financial reports by setting out its objectives for the entity and its strategies for achieving those objectives. The extent to which management commentary is oriented towards the future either through the use of narrative explanations or quantified data (for example, projections or forecasts), 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 document as *forward-looking information*.
- 18 Management should include forward-looking information when management is aware of trends, uncertainties or other factors that could affect the entity’s liquidity, capital resources, revenues and results of operations. Forward-looking information is useful when it focuses on the extent to which the entity’s performance is indicative of future results and includes management’s assessment of the entity’s prospects in the light of that performance.
- 19 Management should discuss the extent to which forward-looking disclosures made in the prior period management commentary have been borne out. 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. For example, if management stated 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 as well as the implications of those variances for management’s expectations for the entity’s future performance.

### **Qualitative characteristics of decision-useful information and constraints on financial reporting**

- 20 The degree to which the information in management commentary is useful depends on that information’s qualitative characteristics. To be useful, information in the financial reports must possess the fundamental qualitative characteristics of *relevance* and *faithful representation*.<sup>o</sup> The enhancing qualitative characteristics of *comparability*, *verifiability*, *timeliness* and *understandability* should be maximised.<sup>+</sup> Two pervasive constraints limit the information provided by management commentary: materiality and cost.<sup>§</sup>

### **Presentation**

- 21 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.
- 22 Management commentary, like other disclosures, should be clear and straightforward. Reciting financial statement information without analysis or presenting boilerplate discussions that do not provide insight into the entity’s past performance or prospects as understood by management is unlikely to provide information that is useful to users of the financial reports.

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<sup>o</sup> From *Fundamental qualitative characteristics*, Phase A Framework ED, paragraphs QC2–QCB11.

<sup>+</sup> From *Enhancing qualitative characteristics*, Phase A Framework ED, paragraphs QC15–QCB24.

<sup>§</sup> From *Constraints on financial reporting*, Phase A Framework ED, paragraph QC27–QC33.

- 23 Management commentary should be presented with a focus on the most important information, in a manner intended to address the principles described in this [draft] Guidance. Specifically:
- (a) Management commentary should be consistent with its related financial statements. If the financial statements include segment information, the information presented in the management commentary should reflect that segmentation.
  - (b) Management should avoid duplicating in its management commentary 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. Generic disclosures that do not relate to the practices and circumstances of the entity should also be avoided.

### **Content elements of a decision-useful management commentary**

- 24 Although the relevant focus of management commentary will depend on the facts and circumstances of the 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 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 stated objectives.
- 25 The content elements are related and should not be presented in isolation. Management's 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 strategies for achieving those objectives.

#### **Nature of the business**

- 26 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 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 main markets and competitive position within those markets;
  - (c) significant features of the legal, regulatory and macro-economic environment that influence the entity and the markets in which the entity operates;
  - (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**

- 27 Disclosure 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**

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

### **Resources**

- 29 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, financial arrangements (whether or not recognised in the statement of financial position), liquidity and cash flows, as well as plans to address any identified inadequacies or surplus resources, are examples of disclosures that can provide useful information.

### **Risks**

- 30 Disclosure of an entity's principal risk exposures, its plans and strategies for bearing or mitigating those risks, and the effectiveness of its risk management strategies, helps users to evaluate the entity's risks as well as its expected outcomes. It is important that management distinguish the principal risks and uncertainties facing the entity, rather than listing all possible risks and uncertainties.
- 31 Management should disclose its principal strategic, commercial, operational and financial risks, being those that may significantly affect the entity's strategies and development of the entity's value. The description of the principal risks facing the entity should cover both exposures to negative consequences and potential opportunities. Management commentary provides useful information when it discusses the principal risks and uncertainties necessary to understand management's objectives and strategies for the entity—both when they constitute a significant external risk to the entity and when the entity's impact on other parties through its activities, products or services affects its performance.

### **Relationships**

- 32 Management provides information useful to users of the financial reports when it identifies the significant relationships the entity has with stakeholders, how those relationships are likely to affect the performance and value of the entity, 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**

- 33 Management commentary should include a clear description of the entity's financial and non-financial performance, the extent to which that performance may be indicative of future performance and management's assessment of the entity's prospects. Useful disclosure in

that area can help users to make their own assessments about the assumptions and judgements used by management in preparing the financial statements.

### **Results**

- 34 Explanations of the performance and development of the entity during the period and its position at the end of that period provide users of the financial reports with insight into the main trends and factors affecting the business. Those explanations are useful when they describe the relationship between the entity's results, management's objectives and management's strategies for achieving those objectives. Discussion and analysis of significant changes in financial position, liquidity and performance compared with those of the previous period(s) can help users to understand the extent to which past performance may be indicative of future performance.

### **Prospects**

- 35 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 implement its strategies for the entity over the long term. When targets are quantified, management should explain the risks and assumptions necessary for users to assess the likelihood of achieving those targets.

### **Performance measures and indicators**

- 36 The disclosure of performance measures and indicators (both financial and non-financial) that 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 can be narrative evidence describing how the business is managed or quantified measures that provide indirect evidence of performance.
- 37 The performance measures and indicators that are most important to understanding an entity are those that management uses to manage that entity. The performance measures and indicators will usually reflect the industry in which the entity operates. Comparability is enhanced if the performance measures and indicators are accepted and used widely, either within an industry or more generally.
- 38 Consistent reporting of performance measures and indicators increases the comparability of management commentary over time. However, management should consider whether the performance measures and indicators used in the previous period continue to be relevant. As strategies and objectives change, management might decide that the performance measures and indicators presented in the previous period management commentary are no longer relevant. When management changes the performance measures and indicators used, the changes should be identified and explained.
- 39 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 FRSs are included within management commentary, those measures should be defined and explained and, when possible, reconciled to measures presented in the financial statements.

## Appendix

### Defined terms

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

<b>comparability*</b>	The quality of information that enables users to identify similarities in and differences between two sets of economic phenomena.
<b>economic phenomena*</b>	Economic resources, claims on those resources, and the transactions and other events and circumstances that change them.
<b>faithful representation*</b>	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.
<b>forward-looking information</b>	Information about the future. It includes information about the future that might subsequently be prepared as historical information. It is subjective and its preparation requires the exercise of professional judgement.
<b>management</b>	Persons responsible for the decision-making and oversight of the entity. This may include executive employees and members of a governing body. <sup>†</sup>
<b>management commentary</b>	A narrative report accompanying financial statements prepared in accordance with FRSs that provides users with historical and prospective commentary on the entity's financial position, financial performance and cash flows, and a basis for understanding management's objectives and its strategies for achieving those objectives.
<b>relevance*</b>	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.
<b>timeliness*</b>	Having information available to decision-makers before it loses its capacity to influence decisions.
<b>understandability*</b>	The quality of information that enables users to comprehend its meaning.
<b>verifiability*</b>	A quality of information that helps assure users that information faithfully represents the economic phenomena that it purports to represent.

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

† See paragraphs BC24 and BC25 for additional information.