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Le Président

AB/ PS/

N°162

Paris, 17<sup>th</sup> March 2006

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**Chairman**

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## **EFRAG DRAFT ON IASB DISCUSSION PAPER ON MANAGEMENT COMMENTARY**

Dear Stig,

I am writing on behalf of the Conseil National De la Comptabilité (CNC) to express our views on the above-mentioned EFRAG draft comment letter. Our detailed comments are set out in Appendix 1.

We agree with the EFRAG draft in the following respects:

- The Management Commentary is an integral part of the Financial Report in which the management evaluates the success of its strategies in the context of the reporting entity's environment. It contains information of a different nature to the Financial Statements and should not be considered as part of them(see Q.1)
- The Management Commentary should focus on investors' requirements in order to ensure the clarity and coherency of communication (Q.4).
- The objectives, characteristics and content of Management Commentary (Q.5, 6 and 7) of which, in our view, the most important is to establish the link between management strategies and the Financial Statements.
- The need for the IASB to develop placement criteria to determine whether information should appear in the Financial Statements or the Management Commentary (Q.9).

We disagree with the EFRAG draft in the following respects:

- The development of requirements for Management Commentary is not a priority for the IASB because the subject is covered by local legislators and until now, rightly or wrongly, by financial market regulators in most major countries (Q.2). Many constituents consider that the IASB priority is to successfully complete the overall accounting coverage of IFRS and achieve a stable reporting platform.

- We question whether it is the role of the IASB alone to define a standard for Management Commentary which contains non-financial and judgmental information outside the scope of the current Framework .If Management Commentary were brought within the scope of IFRS compliance this would lead to an equivalent extension of the audit scope with which we disagree. We believe compliance with IFRS should continue to apply to the Financial Statements under their current definition. (Q.3).
- We are concerned that a standard might not be compatible with existing local commercial law and financial market regulations .Where, as today, there are differences between IFRS and local requirements ,this can lead to double reporting of the same fact for different amounts .Such inconsistencies detract from the quality of financial communication.(Q.8)

In conclusion, whilst we share the long term objective of achieving a form of harmonisation in Management Commentary, we do not believe that a mandatory standard is the right approach .A suggestion might be to introduce guidance on best practice on a non-mandatory basis .We share the EFRAG's concern that the management should retain full responsibility for defining the content and presentation of Management Commentary. In this respect we agree with the EFRAG that any requirements would be high level and principle based. This would also reduce the risks of conflicting with local regulations.

I hope you have found these comments useful and would be pleased to provide any other explanations or information you might require.

Kind regards

**Antoine BRACCHI**

## APPENDIX 1

### Discussion Paper Management Commentary

#### Requirements for MC

The project team concluded that an entity's financial report should be viewed as a package comprising the primary financial statements, accompanying notes and MC (section 1). They also concluded that the quality of MC was likely to be enhanced if the IASB issued requirements relating to MC (section 6).

Question 1: Do you agree that MC should be considered as an integral part of financial reports? If not, why not?

#### EFRAG COMMENTARY

We regard management commentary (MC) information as an integral part of financial reports.

The financial statements as currently covered by the IFRS should be seen as a kind of stand-alone package for accounting purposes. An additional MC should complement and supplement the financial statements as part of the financial reporting package of companies. In our opinion figure 1.1 of the discussion paper (see page 12) adequately illustrates the relationship of the different financial reporting instruments. We do not think that the boundaries of the financial statements should be extended in order to include MC information.

Almost all companies that apply IFRS provide some additional statements to meet the information needs of investors and often an even wider group of stakeholders. Since the information proposed to be included in MC is derived from or linked to financial statements—for example, information about research and development of a pharmaceutical company—it should form part of the financial reporting package together with the financial statements.

Indeed, the MC is so important, and the links between it and the financial statements so great, that we believe the IASB's Framework document should be extended to cover the MC. We note in this context that the Framework is currently under examination for improvement. Since this project is still at a fairly early stage it appears to be a great opportunity to discuss a possible extension of the scope of the Framework to other financial reporting, and thereby bringing it more into line with the wording of the IASCF Constitution and the IFRS Preface. This issue could be part of phase E of the project, presentation and disclosure, including financial reporting boundaries. Such material would help ensure that a consistent approach is adopted to the subject and that conflicts between otherwise separate projects are avoided.

We think that the material that we comment on under 'Question 5' below would be a good starting point for the Framework discussion of the MC.

#### Question 1 CNC's Answer

We agree that Management Commentary should be considered as an integral part of the financial reports.

We believe that Management Commentary is an invaluable complement to the Financial Statements. It enables management to comment on how economic trends and management strategy are reflected in the Financial Statements and to disclose any major assumptions with respect to their preparation.

We do, however, consider that the Management Commentary should not be part of the Financial Statements.

This is because Management Commentary, whilst complementary to the Financial Statements, contains supplementary information of a non-financial or judgmental nature which we do not believe should be subject to audit.

Question 2: Should the development of requirements for MC be a priority for the IASB? If not, why not? If yes, what form should any requirements take?

#### EFRAG COMMENTARY

We are fully supportive of the project on MC, because we see MC as a key element of business reporting. We would support the IASB taking it onto its active agenda. We believe the IASB should adopt a principle-based high-level approach to the subject, because we think such an approach has the potential to be of great benefit internationally.

#### **Question 2 CNC's Answer**

We do not think that it is a priority for the IASB to develop requirements on Management Commentary. The correct implementation of a stable platform of IFRSs limited to the financial statements is considered to be an ambitious enough project.

Most of our constituents consider that Management Commentary is essentially a matter for the financial market regulators whose current requirements are considered to be sufficient.

In many countries, such as in the European Community, legal management reporting requirements already exist e.g. in the "Code de Commerce" in France.

There may be room in the long term for non-mandatory guidance on a high level principle based approach. It is, however, essential to preserve the freedom of expression of the management by avoiding over-regulation.

Question 3: Should entities be required to include MC in their financial report in order to assert compliance with IFRSs? Please explain why or why not.

#### EFRAG COMMENTARY

Assuming that the IASB decides to issue MC requirements, we support developing a standard. It seems that voluntary guidance already exists in many forms all over the world, thus a standard is more likely to enhance and harmonise MC information.

#### **Question 3 CNC's Answer**

We are not in favour of bringing Management Commentary within the scope of IFRS compliance.

The Management Commentary does and should contain non-financial information and management opinions, for example with respect to future development, that go beyond the existing scope of the IFRS Framework. We are not convinced that the IASB's scope of reference should be extended to cover these aspects of Management Commentary.

In our view, IFRS compliance implies subjecting the Management Commentary to audit.

We think that information of a judgmental nature important to investors cannot be subjected to audit.

## **Purpose of MC**

The project team concluded that, rather than having one dominant objective, MC has three principal objectives (section 2). The project team also concluded that the primary focus of MC is to meet the information requirements of investors.

Question 4: Do you agree with the objectives suggested by the project team or, if not, how should they be changed? Is the focus on investors appropriate?

## **EFRAG COMMENTARY**

We agree with the three principal objectives of MC, which the paper describes as being to:

- supplement and complement the financial statements;
- provide an analysis of the entity through the eyes of the management; and
- have an orientation to the future.

We think that the focus on investors is appropriate. We note in this context that the IASB has tentatively decided to revise what its Framework says about the primary users of financial statements; at the moment the Framework states that investors are the primary users, but the IASB has tentatively decided to extend this to include creditors. As we see the MC as a document prepared primarily for the capital markets, our view is that, even if the IASB implements its tentative decision, the focus of MC should remain on investors. It might be useful to include in the definition of MC a reference to this focus on investor information needs.

We also agree that the scope of MC should not be extended to meeting special needs of a wider set of stakeholders. As mentioned in paragraph 30 of the discussion paper, MC should not be a replacement of sustainability and corporate social responsibility reports prepared by many companies nowadays. Nevertheless, this kind of environmental issues, social responsibility issues as well as issues of sustainability should be included in management commentary if such issues have had or is expected to have a significant influence on the financial development or position of an entity. Even investors concerned principally with financial returns will be interested in a company's environmental and social policies to the extent that they might have an impact on risks and future financial returns. Such impacts can cause, for example reduced revenues, if customers react to a company's environmental policy, or significantly increase costs because of accidents due to poor safety standards.

## **Question 4 CNC's Answer**

The objectives of Management Commentary stated in §34 of Section 2 are:

-to interpret and assess the related financial statements in the context of the environment in which the entity operates

-to assess what management views as the most important issues facing the entity and how it intends to manage those issues; and

-to assess the strategies adopted by the entity and the likelihood that those strategies will be successful

In our view the three points above resume well the objectives of Management Commentary.

It would seem to us that, underlying the above three objectives, is the requirement to disclose and evaluate major assumptions made by the management.

Furthermore, we agree that the main focus should be on investors .To include items that may interest only creditors or staff may overload the commentary and detract from its clarity.

### **Principles, qualitative characteristics and content of MC**

The project team concluded that it is not appropriate to specify the precise information that must be disclosed within MC, or how it is presented. Rather, they believe that any requirements for MC should set out the principles and qualitative characteristics, as well as the essential areas of MC, necessary to make the information useful to investors. It is up to management to determine what information is required to meet these requirements, and to determine how the information is presented. The project team has also suggested that it is appropriate consider ways to limit the amount of information management is allowed to disclose, as a way of ensuring that it is the most important information which is presented to investors. (See sections 3 and 4)

Question 5: Do you agree with the principles and qualitative characteristics that the project team believes are essential in the preparation of MC? If not, what additional principles or characteristics are required, or which ones suggested by the project team would you change?

### **EFRAG COMMENTARY**

Having qualitative characteristics for management commentary is essential for improving the quality of such financial reports. We agree with the characteristics as set out in the discussion paper.

We regard the three proposed principles of MC (set out in paragraph 39) as appropriate. We recognise that, if the information is given through the eyes of management, comparability between entities is difficult to achieve, but agree that the qualitative characteristics of MC should focus on achieving comparability over time. Another important issue is the supportability of the information contained in MC as proposed and explained in paragraph 75.

### **Question 5 CNC's Answer**

We agree with the three principal characteristics set out in Section 3 §39 which are to:

- supplement and complement the financial statements;
- provide an analysis of the entity through the eyes of the management; and
- have an orientation to the future.

We also agree with the attributes derived from the Framework that make information useful to investors set out in §40: understandability, relevance, supportability, balance and comparability over time.

We would stress that, as a priority, the Management Commentary should provide the link in plain language between management strategies and the Financial Statements.

Question 6: The DP outlines the essential content areas that MC should cover. Do you agree with these? If not, what additional areas would you recommend or which ones suggested by the project team would you change?

#### EFRAG COMMENTARY

We agree with the principles-based high-level approach adopted to the content of MC. We are also broadly supportive of the specific things the paper says on content, although we have the following observations:

- We do not consider paragraph 100 to be a comprehensive list and would suggest that this is made clear in the text.
- We think there ought to be strong linkage between the information provided about the objectives and strategies of a company (paragraph 100b) and the information provided on its results and prospects (paragraph 100d). This linkage is very important for the comparability of management commentary information over time.
- Although the paper refers to segmental information, we think it should emphasise that MC information should generally be provided on a segment basis. We recognise that not all information contained in MC can be or should be segmented, e.g. information about the cash flow management. We think best practice is to segment the key MC content information unless impracticable to do so and to use the same segmentation in MC as that used in the financial statements (A13 of the proposed standard).
- We think the “key resources, risks and relationships” (paragraph 100c) should include more information about the risk management of the company. Reporting about the entity specific risk management system and its processes of identifying the risks as well as the ongoing improvement effort of the management system respectively are very important information for investors.

#### **Question 6 CNC’s Answer**

We agree with the proposal in §98 that actual content and presentation should be left to the management’s judgement.

We therefore agree that the disclosure requirements should be a “high-level” framework as set out in §100 (illustrated by the value reporting categories mentioned in §105):

- (a) The nature of the business
- (b) Its objectives and strategies
- (c) It’s key resources, risks and relationships
- (d) Its results and prospects; and
- (e) Its performance measures and indicators

We further agree that the link between strategic objectives and results should be made clear and that segmental information would be required.

Question 7: Do you think it is appropriate to provide guidance or requirements to limit the amount of information disclosed within MC, or at least ensure that the most important information is highlighted? If not, why not? If yes, how would you suggest this is best achieved?

#### EFRAG COMMENTARY

We agree with the approach of the discussion paper—it is important that the MC does not get cluttered up and its message obscured. For that reason we suggest that any standard should emphasise that:

- MC should focus on issues relevant to investors and should be presented in a way that highlights those issues of greatest importance to investors.

- the information included in the MC should be balanced and the presentation of the information should also be balanced. For example, negative information that is important to investors should be given the same prominence as positive information that is as important to investors.

### **Question 7 CNC's Answer**

We agree that the Management Commentary should focus on important issues relevant to investors in order to preserve the clarity and effectiveness of financial communication.

Question 8: Does your jurisdiction already have requirements for some entities to provide MC? If yes, are your local requirements consistent with the model the project team has set out? If they were not consistent, what would the major areas of conflict or difference be?

### **EFRAG COMMENTARY**

The Fourth and Seventh EU Company Law Directives already require the preparation and presentation of an annual report which is very similar to the management commentary as proposed by the working group. Additionally, the annual report will become a mandatory and essential part of the annual and half-yearly financial reports of security issuers listed on regulated markets in the EU from 2007 onwards. Further details of the EU legislation are set out in Appendix B12-B15 of the discussion paper. So far we are not aware of any major areas of conflict or differences.

### **Question 8 CNC's Answer**

In France, the contents of the mandatory "management report" are defined by the Code de Commerce. There would not appear to be any major inconsistencies of content between requirements under French legislation and the proposals in the "Discussion Paper". However, there are differences in definition between local legislation and IFRSs e.g. the definition of management personnel in IAS 24 and the "Code de Commerce" is not the same so that the same information may be valued at two different amounts.

### **Placement principles**

The project team concluded that it would be helpful to establish principles to guide the IASB in determining whether information it requires entities to disclose within financial reports should be placed in MC, on the face of the primary financial statements or in the notes to the financial statements. The project team has suggested some principles (section 5).

Question 9: Are the placement principles suggested by the project team helpful and, if applied, are they likely to lead to more consistent and appropriate placement of information within financial reports? If not, what is a more appropriate model?

### **EFRAG COMMENTARY**

The DP's discussion of placement and placement criteria in paragraphs 153-185 is a good discussion that is worth studying carefully. We are supportive of the suggestion that criteria are needed to determine whether a piece of information should be provided in the management commentary rather than the financial statements and vice versa. However, we suggest reconsidering and specifying the placement principles. In particular, although the criteria described in paragraph 169 b) for including information in the notes to the primary financial statements is derived from the current IASB Framework, the term "...essential to an *understanding* of the primary financial statements and its elements..." might not be suitable to define the boundary between the information within the financial statements on the one side and MC information on the other side. MC information might also be necessary for an understanding of the results and outcomes of the financial statements by providing contextual and strategic information, e.g. a report on the developments of the financial year under report.

## **Question 9 CNC's Answer**

§169 proposes the following criteria for distinguishing Management Commentary from notes to the accounts:

- (a) in MC if it provides an investor with information that puts the financial statements into the context of the entity and its operating environment
- (b) In the notes if it is essential to an understanding of the primary financial statements and its elements, whether recognised or not.

The dividing line between the Notes to the Financial Statements and the Management Commentary may not always be easy to draw.

We would broadly support what is said in (a) above with respect to the Management Commentary. In our view, Management Commentary would contain information on environment, strategy evaluation, non-financial indicators that would not normally be disclosed in the Notes.

The Notes would provide more analytical information necessary to explain how the figures in the Financial Statements are built up and valued

However, it may prove necessary to disclose major risks and assumptions in both Notes and Management Commentary since they are both relevant to an understanding of the Financial Statements and to the strategic position of an entity within its environment.

The definition in (b) above of what should go in the Notes does not appear adequate as information given in the Management Commentary would also contribute to an understanding of the primary Financial Statements.

We would suggest that the Notes should provide sufficient information to make the Financial Statements understandable on a "stand alone" basis for investors as well as being "auditable". However, management under the control of the auditors will inevitably fix the actual dividing line between Notes and Management commentary.