

Management reports according to “Management Commentary – A framework for presentation” – an analysis from a Swedish perspective

1 Introduction

On December, 8th, 2010, the IASB published the IFRS Practice Statement “Management Commentary – A Framework for Presentation” (IFRS-MC). The non-binding Practice Statement provides a broad framework for preparation of management reports which relates to financial statements according to IFRSs. Therefore the IFRS-MC does not prescribe a detailed list of disclosures which have to be fulfilled in the management commentary. The IASB argues that such checklists of disclosures might not be helpful to the users of the management commentary as form and content of management commentary may vary by entity.¹ Furthermore, the IASB wishes to avoid a checklist-compliance mentality which might result from specifying a detailed list.² Instead of this, the IASB encourages the management to select the information within the broad guidelines of the framework which should be presented from a management point of view in order to reach the objectives set out in the IFRS-MC.

Companies of which securities are traded on a regulated market in a member state of the EU are obliged to set up financial statements according to the IFRS standards.³ At present, the publicly listed companies in a member state of the EU have to prepare and publish a management report according to national regulations. However, national regulations are to large extent based on the EU company directives. Therefrom the question arises about the position of the management commentary according to IFRS-MC. This article aims to present the main characteristics of the IFRS-MC and compare it to current Swedish legislation and accounting standards. Are the Swedish national regulations regarding the management reports consistent with the IFRS-MC? How far is it possible to comply with IFRS-MC without breaching Swedish GAAP?

¹ See IFRS-MC, IN 5.

² See IFRS-MC, BC 47.

³ Regulation 2002/1602.

2 Incorporation of management commentary as part of the (general purpose) financial reporting according to IFRS

The management commentary is part of the (general purpose) financial reporting as defined in the Conceptual Framework.⁴ Nevertheless, due to some reasons the IASB decided not to issue any compulsory standard regarding the management commentary:

- A wish to avoid conflicts with existing national regulations regarding the management reporting.⁵
- In the case of missing national regulations for providing a management report the costs of compliance with IFRS would increase and therefore create an additional hurdle in applying IFRSs if the IASB issues a binding standard.⁶
- At present there are unanswered questions about the placement of disclosures in the financial reporting (notes to the financial statements vs. management commentary, e.g. risk reporting arising from financial instruments according to IFRS).⁷
- The IASB creates only a framework for the preparation of the management commentary and avoids consciously to prescribe detailed reporting requirements, and there is no audit requirement of the management commentary based on this framework.⁸

Therefore with the IFRS-MC, the IFRS applying entities get a framework to prepare a management commentary which allows the entities to select and present decision useful information to the users of financial reporting outside the financial statements. A much more detailed regulation of the contents of the management commentary bears the risk that the management's view which is fundamental for the preparation of the management commentary is affected adversely.⁹ Furthermore a detailed checklist of disclosure requirements does not meet the entity-specific characteristics and the entity-specific environmental factors. Nevertheless, it is up to the individual national "jurisdictions to make their own judgements on whether entities should be required to include management commentary in addition to their financial statements and whether inclusion is necessary to assert compliance with IFRSs."¹⁰

⁴ See IFRS-MC, BC 11 and Conceptual Framework, BC 1.4.

⁵ See Buchheim, Betriebs-Berater 2009, p. 1685.

⁶ See Fink, KOR, Zeitschrift für internationale und kapitalmarktorientierte Rechnungslegung 2009, p. 611, with reference to DP IFRS-MC 207 and IFRS-MC, BC 17.

⁷ This problem should be solved during phase E of the Conceptual Framework project. See IFRS-MC, BC 51.

⁸ Audit requirement however exists in Sweden according to the Company Act.

⁹ See section 4.

¹⁰ IFRS-MC, BC 16 a). Compare also the questions raised under section 1 of this article.

3 Objective and users of the management reporting according to IFRS Management Commentary

According to IFRS-MC 3 the Practice Statement should be applied by entities that present management commentary that relates to financial statements prepared in accordance with IFRSs. As the Practice Statement does not oblige IFRS applying entities to publish a management commentary the management commentary is a voluntary financial reporting instrument.¹¹

The management commentary which forms a part of the comprehensive financial reporting should provide users of the financial statements with additional integrated information that provides a context for the related financial statements.¹² Such information are useful to the users of financial statements especially in the case if they explain “management’s view not only about what has happened, ..., but also why it has happened and what the implications are for the entity’s future.”¹³

As the management commentary supplements the information shown in the financial statements prepared in accordance with IFRSs the management commentary must have the same circle of users. Therefore, in providing information included in the management commentary the management has to consider the needs of the primary users (existing and potential investors, lenders and other creditors¹⁴) of financial reports.¹⁵ Nevertheless, this does not preclude that management commentary contains useful information also to other stakeholder groups, e.g. public authorities, fiscal authorities, associations or unions.

Although the management commentary supplements the financial statements according to IFRSs both elements of the financial reporting have to be distinguished clearly from each other, especially in the case that the management commentary is published in the same document as the financial statements.¹⁶ If the management commentary is published separately from the financial statements which it supplements, the entity should identify in the commentary the financial statements to which it relates.¹⁷ Furthermore, according to IFRS-MC 7 in the commentary the management should explain the extent to which the Practice Statement has been followed and should only make an assertion in the case of a complete compliance with the Practice Statement.

¹¹ See IFRS-MC 4.

¹² See IFRS-MC 9 sent. 1.

¹³ IFRS-MC 9 sent. 2

¹⁴ See in detail Conceptual Framework, OB 2 and OB 8 and Conceptual Framework, BC 1.15 – 1.17.

¹⁵ See IFRS-MC 8.

¹⁶ See IFRS-MC 6.

¹⁷ See IFRS-MC 5.

4 Principles of management reporting according to IFRS Management Commentary

According to the Practice Statement management should present a commentary that is consistent with the following (primary) principles:¹⁸

- (1) providing management's view of the entity's performance, position and progress, and
- (2) supplementing and complementing information presented in the financial statements.

These (primary) principles will probably be reached if the information provided in the commentary includes the additional (secondary) principles:¹⁹

- (3) forward-looking information, and
- (4) the information possesses the qualitative characteristics according to the Conceptual Framework, QC.

The first-mentioned principle is fulfilled if the information included in the management commentary provides the management's perspective of the entity's performance, position and progress, and which is from the management's point of view essential for managing the business.²⁰ This information shall enable investors to see the entity through the eyes of management²¹, especially the competitive position and the regulatory and legal environment of the entity and its most critical opportunities and threats to the future development. These information shall assist the users in evaluating the objectives set out by the management for the entity and the managerial strategies for achieving those objectives.²²

The principle of supplementing the information provided in the financial statements refers to explanations of the amounts presented in the financial statements and the conditions and events that shaped that information.²³ As an example for supplementing the information of the financial statements IFRS-MC BC 34 mentions the fact that a defined benefit pension plan has a deficit. Beside the information that a deficit exists, management could supplement the disclosure in the (notes to the) financial statements by providing a narrative explanation of the nature of the deficit and the conditions that led to the deficit (e.g. poor returns on plan assets or the demographics of those covered by the plan). Furthermore, the management could provide additional information, especially which measures the management has taken in order to

¹⁸ See IFRS-MC 12 a) and b).

¹⁹ See IFRS-MC 13 a) and b).

²⁰ See IFRS-MC. 15.

²¹ See SEC, Regulation S-K, Item 303.

²² See IFRS-MC 17.

²³ See IFRS-MC 16 sent. 1.

reduce the deficit (e.g. changing investment managers or changing the investing strategy). The management commentary can complete the information of the financial statements by providing financial and non financial information which have not affected the financial statements, e.g. information about intangibles which do not meet the capitalisation criteria of IAS 38.57.

Forward-looking information tends to communicate management's perspective of the entity's direction and the strategies for reaching the objectives.²⁴ Projections or forecasts regarding the expected future development are not prescribed. Sufficient for providing forward-looking information are narrative explanations of trends, the most critical factors and uncertainties which might affect the entity's future development of the financial position, the performance and the net cash inflows.²⁵ Furthermore, the forward-looking information shall enable ex post comparisons and analyses between the results of a reporting period and earlier forecasts which relate to that period.²⁶ Such information include regularly useful information from the user's perspective as these information on the one side lead to a confirmation or a correction of earlier forecasts (confirmatory value) and on the other side help the users to identify the most decisive factors which were causal for variances of management's expectations for the entity's future performance. By identifying these critical factors the quality of future forecasts will probably be increased (predictive value).²⁷ The IFRS-MC does not prescribe a minimum period from the end of the reporting period for forward-looking information.²⁸

As the management commentary forms a part of the financial reporting according to IFRS the information in management commentary should also possess the qualitative characteristics set out in the Conceptual Framework.²⁹ Especially the fundamental qualitative characteristic of faithful representation with its components of completeness, neutrality and freedom from (material) errors and the enhancing qualitative characteristic of verifiability of information might cause some difficulties regarding the management's view and the forward-looking (aspect of) information.³⁰

²⁴ See IFRS-MC 17.

²⁵ See IFRS-MC 18.

²⁶ See IFRS-MC 19.

²⁷ See in detail Conceptual Framework, QC 7–10, and Kirsch, *Deutsche Steuer-Zeitung* 2011, p. 29.

²⁸ See Fink, KOR, *Zeitschrift für internationale und kapitalmarktorientierte Rechnungslegung* 2009, p. 613.

²⁹ See Conceptual Framework, QC 1–39.

³⁰ See in detail IFRS-MC, BC 42 ff.

5 Contents of IFRS Management Commentary in comparison to Swedish GAAAP

5.1 IFRS Management Commentary

Due to the management's perspective the Practice Statement does not prescribe detailed reporting disclosure notes because these depend largely upon the facts and the circumstances of each entity and its environment. Instead of this, the Practice Statement mentions only broad information fields (in the terminology of the Practice Statements called "elements") which should be subjects of the information provided in the management commentary. According to IFRS-MC 24 information about the following elements shall be included in the commentary:

- the nature of the business,
- management's objectives and its strategies for meeting those objectives,
- the entity's most significant resources, risks and relationships,
- the results of operations and prospects, and
- the critical performance measures and indicators that management uses to evaluate the entity's performance against stated objectives.

IFRS-MC, BC 48 gives reasons for the selection of these information elements. From the IASB's point of view decisive are the needs of the primary users of management commentary. Table 1 presents in form of a checklist possible information categories which could specify the elements of the management commentary taking into account the primary users' needs:

elements of the MC	primary users' needs	possible information categories
Nature of the business	knowledge of the business in which an entity is engaged and the external environment in which it operates	<ul style="list-style-type: none"> – information about the branch of the entity (e.g. competitive position, new competitors, threats through substitution products), – information about the market situation on the relevant markets, – information about the position of the entity on each of the relevant markets, – information about the main product groups, main services, critical business process models, – information about the main sales channels, – information about the entity's and the group's structure (including the suitability of the selected legal structure), – information about the macro-economic factors, e.g. growth, inflation, unemployment rate, currency exchange rates, public debts, – legal and regulatory environment, relevant natural environmental regulations

elements of the MC	primary users' needs	possible information categories
management's objectives and its strategies for meeting those objectives	assessment of the strategies taken by management and the likelihood that those strategies will be successful in meeting the management's stated objectives	<ul style="list-style-type: none"> – information about the objectives, – information about the strategies to meet those objectives, – reasons for selecting the strategies, e.g. market trends, SWOT-analysis (strengths, weaknesses, opportunities and threats) prepared by management, – information about a change of objectives and strategies compared to the previous reporting period, – relationships between objectives, strategies and management's actions, – presentation of the executive remuneration system and the relationship to the objectives
significant resources, risks and relationships	evaluating the resources available to the entity, and evaluating the ability of the entity to generate long-term, sustainable net inflows of resources, including the risks linked to the resource-generating process	<ul style="list-style-type: none"> – information about the most important financial and non financial resources, – analysis of the capital structure, the financial resources, including credit arrangements with banks, – analysis of the potential of the employees with regard to quantitative and qualitative aspects, – analysis of the non capitalised intangibles, including advantages which do not meet the criteria of an asset, – information about the research and development activities, especially in branches in which such activities are decisive for the competitive position (branches with a high innovation rate), – management's plans to overcome existing deficits of critical resources, including plans to dispose idle assets – information about the most important risks and their development in the reporting period, – strategies in managing those risks, information about the efficiency of risk management strategies – the entity's relationships to its stakeholders, narrative explanation about managing those relationships (e.g. public relations, investor relations), information about the effect of these relationships on the results of operations and the value of the entity

elements of the MC	primary users' needs	possible information categories
results of operations and prospects	assessment whether an entity has delivered results in line with the expectations, and implicitly assessment of the management and its fitness for understanding the business and managing the entity	<ul style="list-style-type: none"> – explanation of the results of operations and the change of the entity's position during the reporting period, – analysis of the change of the performance, the financial position, the liquidity (see also significant resources), – explanation of the change of the development and the prospects of the entity based on the entity's current position, – information about financial and non financial objectives and the extent of their realisation reached by the strategies selected by management (see also management's objectives and its strategies), – assessment of the likelihood or possibility of reaching the objectives set out for the future, – managerial assumptions of the future development of the entity, – risks of the future development identified by the management
performance measures and indicators for evaluating the entity's development	management's ability to focus on the critical measures and indicators that management uses to manage the entity's performance against stated objectives and strategies	<ul style="list-style-type: none"> – information about the most important financial and non financial performance measures and indicators from the management's perspective, – existence and application of ratio analysis systems, e.g. ratio pyramid, – deriving financial measures and indicators from financial statements according to IFRSs, – change of the financial and non financial performance measures and indicators in comparison to the previous reporting period, and an explanation of the reasons for the change, – relevance of the financial and non financial performance measures and indicators for managing the entity (e.g. remuneration system), – importance of the selected financial and non financial performance measures and indicators within the branch of the entity

Table 1: Checklist of possible information categories of the management commentary

5.2 Swedish GAAP

The preparation of management reports in Swedish limited companies is regulated in the 6 chapter of the Swedish Annual Accounting Act (Årsredovisningsslag 1995:1554, ÅRL). The current regulations can be seen as a mixture of two different sets of rules. Firstly, even before the adoption of the 1995 Annual Accounting Act, the preparation of a management report in each Swedish limited company was already obligatory according to older regulations.³¹ Secondly, a great part of the Swedish material rules regarding the preparation of management report derives from art. 46 of the fourth EU company directive (78/660/EEG).

The Swedish landscape of accounting norms has been drastically altered in the last decade. Before the seventies, the accounting standards were produced by FAR, the professional institute for authorized public accountants. This private standard setter has in recent years mainly focused on the standards for good auditing and for good auditors. Nevertheless, some accounting standards produced by FAR are still applicable.

Since the late seventies, the main Swedish producer of accounting standards is the Swedish Accounting Standards Board (BFN). This Swedish authority has the competence to produce in theory non-binding accounting standards, but has no competence to produce binding regulations.³² BFN is mainly focused on non listed companies, to large extent SMEs.

Regarding listed companies, they are of course obliged to set up consolidated statements according to IFRS. The annual statements in Swedish limited companies belonging to a group where the mother company is listed are on the other hand subject to Swedish legislation. As a complement, the Council for financial reporting (RFR) has produced a special accounting standard for listed companies belonging to groups subject to IFRS in the consolidated statement.

For companies with an accounting year commencing after the 31rd of December 2013 the BFN has published an accounting standard that is supposed to be default for Swedish non-listed SMEs, also known as "K3".³³ The BFN has also issued a more detailed commentary to the "K3" standard.³⁴

For an accounting year commencing before the 31rd of December 2013, older standards from the BFN are still valid.³⁵

Companies that according to the Annual Accounting Act are considered to be smaller companies, which includes the waste majority of Swedish limited companies, are already subject to simplified accounting rules in the so called "K2" standard.³⁶

³¹ Prop. 1995/96:10 del 2 p. 100.

³² 8 chapt. 1 § Bookkeeping Act (Bokföringslagen 1999: 1078).

³³ BFNAR 2012:1 Bokföringsnämndens allmänna råd om årsredovisning och koncernredovisning;

³⁴ Bokföringsnämndens vägledning: Årsredovisning och koncernredovisning, updated 2012-12-06.

³⁵ BFN U 96:6 Förvaltningsberättelsens innehåll.

³⁶ BFNAR 2008:1 Bokföringsnämndens allmänna råd om årsredovisning i mindre aktiebolag.

Since 1949, the Chartered Auditors Organisation in Sweden (FAR) has been publishing a commentary to the annual statement in limited companies.³⁷ The commentary however, is mainly a summary of the abovementioned Swedish accounting standards.³⁸

Regarding limited companies whose entities are subject for trading in a regulated market, and therefore sets up the consolidated statement according to IFRS, are however not subject to the abovementioned national accounting standards. Instead, a special accounting standard (RFR 2) for this kind of company has been released by the Council for Financial Reporting (RFR). The aim with the standard is that these companies as far as possible should apply the IFRS standards also in the company's single statement, at least as far as the international standards are not in conflict with binding Swedish legislation. RFR 2 does however not include any substantial rules regarding the management commentary, except references to IAS 1 p. 79 and the Swedish annual accounting act.³⁹ Also regarding the management commentary in the consolidated statement in the groups subject to IFRS, the accounting standard only refers to the Swedish legislation.⁴⁰

5.3 Comparison between IFRS-MC, the 4th company directive and Swedish GAAP

In the following, the content of the IFRS-MC is compared to the relevant legal sources regarding the management commentary in Sweden,

Swedish regulations/GAAP (comparison)

Elements of the MC	IFRS-MC	Dir. 78/660/EEG	ÅRL (1995:1554)	Swedish GAAP
Nature of the business	26			BFNAR 2012:1, 3.7 a), BFNAR 2008:1, 5.1 a), BFN U 96:6
Management's objectives and its strategies for meeting those objectives	27			

³⁷ RedR 1 Årsredovisning i aktiebolag.

³⁸ RedR 1 is not applicable in companies subject to the "K2" standard.

³⁹ IAS 1 p. 79 includes an obligation to give certain information regarding the company's own shares, but this information should not be a part of the management commentary.

⁴⁰ RFR 1.

Elements of the MC	IFRS-MC	Dir. 78/660/EEG	ÅRL (1995:1554)	Swedish GAAP
Significant resources, risks and relationships	29 – 33	Art. 46, 1 p. a)*	6 chapt. 1 § 2, 3 p. ÅRL	
Results of operations and prospects	34–36			
Performance measures and indicators for evaluating the entity's development	37–40	Art. 46, 1 p. a)		
Fair review of the development of the company's business and of its position		Art. 46, 1 p. a)	6 chapt. 1 § 1 ÅRL	BFNAR 2012:1, 3.7–3.8**
Any important events that have occurred since the end of the financial year		Art. 46, 2. p. a)	6 chapt. 1 § 2, 2 p. ÅRL	BFNAR 2008:1, 5.2
The company's likely future development		Art. 46, 2. p. b)	6 chapt. 1 § 2, 2 p. ÅRL	BFNAR 2012:1, 3.8
Activities in the field of research and development		Art. 46, 2. p. c)	6 chapt. 1 § 2, 4 p. ÅRL	BFNAR 2012:1, 3.9
Information concerning acquisition of own shares.		Art. 46, 2. p. d)	6 chapt. 1 § 2, 8 p. ÅRL	BFNAR 2012:1, 3.9

Elements of the MC	IFRS-MC	Dir. 78/660/EEG	ÅRL (1995:1554)	Swedish GAAP
The existence of branches in the company		Art. 46, 2. p. e)	6 chapt. 1 § 2, 5 p. ÅRL	BFNAR 2012:1, 3.9***
Financial risk management objectives and exposure to price risk etc.		Art. 46, 2. p. f)	6 chapt. 1 § 3, 1 – 2 p. ÅRL	BFNAR 2012:1, 3.9 "the use of financial instruments"

* "... the principal risks and uncertainties ..."

** According to the commentary, the fair view should comprehend four to five years.

*** Foreign branches only.

6 Conclusion

The "Management Commentary" is intended to facilitate the preparation of the management commentaries in companies subject to IFRS. The demand for a management commentary in the financial reports is not a novelty according to IFRS, but has a long tradition in EU and national company law. In a Swedish perspective, it is obvious from the table above, that most of the current demands for preparation of the management commentary in current Swedish accounting law actually is deriving from the fourth council directive. The principle rules of the directive have been implemented in the Swedish Annual Accounting Act. Regarding the non-listed companies, not subject to IFRS, the BFN has issued more detailed explanation of the requirements following the Swedish Accounting Act in the general accounting standard for Swedish limited companies "K3" and more simplified requirements regarding smaller limited companies in the "K2". As a paradox, no similar requirements have been issued from the Council for Financial Reporting regarding Swedish companies subject to IFRS. It should be emphasised that the main rules in the Swedish Accounting Act regarding the requirements for the management commentary also are valid for Swedish companies subject to IFRS. Since there is no more detailed accounting standards issued for this category of companies, the "Management Commentary" could fill a role as a guide to setup the management commentary in Swedish companies subject to IFRS. It should however be noticed, that the requirements of the "Management Commentary" and the fourth directive do not completely correspond. To some extent it might be the case that similar requirements are formulated in a different way. This could be the case regarding "the results of operations and prospects" in IFRS-MC 34–36 and "Fair review of the development of the company's business and of its position" in art.46, 1 p. a) in the fourth directive. However, some requirements in the IFRS-MC do not seem to have any equivalence in

the EU/national accounting law. One example is the requirement for “the management’s objectives and its strategies for meeting those objectives” in IFRS-MC, 27. Even if this requirement does not follow from EU or national legislation it seems unlikely that the management in a listed company would not the strategies of the company (except for company secrets), since these strategies are important in order to attract the investment market. It should also be noted that several of the requirements in the fourth directive are not outspoken in the IFRS-MC, which means that the companies subject to IFRS anyhow cannot rely solely on the IFRS-MC in order to setup the management commentary.

If the IFRS-MC in practice can have a beneficial influence on the management commentaries in the Swedish listed companies can, of course, not be evaluated without an empirical analysis of the current standards of the commentaries. This goes beyond the purpose of this article. It is however fair to assume that the IFRS-MC would have been of greater use for companies in Sweden and other EU countries if the standard more in detailed referred to the requirements of the fourth directive. It is however not surprising that the IASB has not been referring to the directive, since the IFRS is intended for worldwide use, not only in the EU.

Hanno Kirsch is a Professor in Business Administration and president of Fachhochschule Westküste in Heide, Germany. Stefan Olsson is a Professor in tax law, Karlstad Business School, Sweden.