

Directive regarding Management Commentary (Directive Management Commentary, DMC)

Dated: 21 September 2011

Basis: Art. 1, 4, 5 and Art. 49 para. 2 LR

Nestlé Comments

I. General Requirements

<p><i>Art. 1</i> <i>Objective</i></p>	<p>¹ The objective of the Directive regarding Management Commentary is to require issuers to provide users of financial statements with integrated information regarding the financial position, financial performance and cash flows of an entity in the context of the entity's objectives and strategies in a meaningful format and from the point of view of management.</p> <p>² The Directive incorporates the requirements of the IFRS Practice Statement "Management Commentary".</p>	<p>While we would agree with the objective as per paragraph 1, we consider that it should be up to the issuers to decide whether the information should continue to be placed in the Annual Report ("Jahresbericht") or whether it should consist of a specific section or structure. Moreover we believe that a separate section on Management Commentary does not go into the direction of an integrated reporting.</p> <p>We also consider that the requirements of article 5 go much further than the general objectives of this paragraph and we would suggest to align the requirements of these two paragraphs.</p> <p>Finally there should be no reference to the IFRS Practice statement because it is non-binding, the SIX Regulatory Board should not pick up isolated elements to make them a specific, mandatory part of the financial reporting obligations under SIX listing rules.</p>
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<p><i>Art. 2</i> <i>Scope</i></p>	<p>¹ This Directive is applicable to all issuers incorporated in Switzerland with equity securities listed on SIX Swiss Exchange, who apply either IFRS or US GAAP as their accounting standard.</p> <p>² Issuers, who are not incorporated in Switzerland, are also required to comply with this Directive, if their equity securities are primary-listed on SIX Swiss Exchange.</p>	<p>Paragraphs 1 and 2 are confusing because they do not reflect the situation of an issuer which has a secondary listing. We would suggest to merge the two paragraphs and to <i>reword</i> them as follows : “This Directive is applicable to all issuers with equity securities listed on SIX Swiss Exchange. <i>Issuers that are listed on another foreign exchange may have to comply with the requirements of that exchange in addition to this directive</i>”.</p>
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II. Reporting Obligations

<p><i>Art. 3</i> <i>Qualitative Characteristics</i></p>	<p>Qualitative characteristics are expected to increase the usefulness of the information included in the Management Commentary for users of financial statements. The four most important qualitative characteristics are understandability, relevance, verifiability and comparability.</p>	<p>We have reservations about this article because the regulatory board is just taking three qualitative characteristics of the IASB Conceptual Framework and makes them binding for the issuers. Let's recall that the Conceptual Framework is not a standard but a guide that should help the standard setters to issue their standards and help the preparers in the absence of a clear requirement in a standard. Therefore while the Regulatory Board may want to consider these qualitative characteristics, it cannot make them binding to the issuers especially if they are not explained.</p> <p>Nonetheless we would not oppose qualitative guidance if it is written by using generic words that do not need additional explanations. We would propose that the Regulatory Board says that the requested information should be complete, understandable and consistent over time with the changes being explained.</p>
<p><i>Art. 4</i> <i>Placement of Disclosure</i></p>	<p>The Management Commentary should complement the financial statements and be presented as a separate section within the annual report. The section Management Commentary may cross-reference to information in other chapters of the annual report.</p>	<p>We consider that the issuers should be given more flexibility to decide the placement of the disclosure in the unaudited part of the Annual Report ("Jahresbericht"). This would allow the entities to better tailor made the information to the needs of their users. Therefore we recommend to reword this article as follows :</p> <p><i>"The Management Commentary should be presented either as a separate section or be part of the Annual Report. The Management Commentary may cross-reference to information in other chapters of the annual report"</i>.</p> <p>Moreover the issue of the cross reference should be reviewed. Please see in particular our comments regarding to appendixes 3.2 on Financial Risks and 3.3 on Corporate Governance.</p>

<p><i>Art. 5</i> <i>Content of the Disclosure</i></p>	<p>¹ The Appendix to this Directive lists information, which must be addressed in the annual report. The Appendix is an integral part of this Directive.</p> <p>² The following structure and section headings (or equivalent headings) are expected to be used:</p> <ol style="list-style-type: none">1 Nature of the business2 Objectives and strategies3 Resources, risks and relationships4 Results and outlook	<p>We agree with paragraph 1.</p> <p>Regarding paragraph 2 item 4, we are extremely concerned about the issue of forward looking statements. Therefore the Regulatory Board (RB) should clearly explain what it means by an outlook and if necessary re-expose this section with its constituents. In any case the RB should not go beyond what is currently required by the EU Transparency Directive.</p> <p>The RB should also make it clear that the order of the elements is indicative only and that an entity can adapt them to the nature of its business.</p>
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III. Concluding Provisions

<p>Art. 6 <i>Effective Date</i></p>	<p>This Directive is effective for annual periods beginning on or after 1 January 2015.</p>	<p>We agree in principle but please see our additional comment on page 8 regarding the legislative issue in Switzerland.</p>
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APPENDIX

1	<p>Nature of the Business</p>	
1.1	<p><i>Business</i> Main business operations including the major products and services of the entity</p>	<p>The RB should clarify if the “products and services” should refer to the business of the entity in general or to those which contribute to the performance of the entity. Nevertheless the guidance should not be prescriptive and should result in disclosures that are helping the users of an entity but not its competitors.</p>
1.2	<p><i>External Environment</i> Industry sectors and markets in which the entity operates and the external environment that most significantly impacts the entity</p>	<p>Such a disclosure should be high level and written in very general terms. It should allow the necessary flexibility to the issuers. This also applies to appendixes 2.1 and 2.2.</p>
2	<p>Objectives and Strategies</p>	
2.1	<p><i>Objectives</i> Description of the objectives established by the entity</p>	<p>Please see appendix 1.2 above.</p>
2.2	<p><i>Strategies</i> Strategies to achieve the entity's objectives</p>	<p>In addition to what we said under appendix 1.2 above, we have concerns that the requirement to disclose the strategies to achieve the entity's objectives would require to disclose strategic options to an entity's competitors.</p>

3	Resources, Risks and Relationships	
3.1	<p><i>Resources</i> Critical financial and non-financial resources as well as their availability and allocation</p>	<p>We would recommend to clarify what is meant by “critical financial and non financial resources” and how this is linked to the objective of the directive. Furthermore the “availability and allocation” of “financial and non-financial resources” could also result in providing information about the strategic choices of an entity.</p>
3.2	<p><i>Risks</i> Description and evaluation of the important strategic, operational and financial risks</p>	<p>While we would agree in principle, we have concerns about the financial risks section that could lead to overlap with information that is already requested by IFRS 7. The Regulatory Board should carefully consider this point and make an explicit reference to IFRS 7.</p>
3.3	<p><i>Relationships</i> Relationships to stakeholders and description of how these relationships are managed</p>	<p>We consider that the term “stakeholders” is rather generic as it could include not only shareholders but also customers, suppliers, employees, etc. Since the management commentary is primarily directed to present and future investors of company, i.e., the users as defined in article 1 of the directive, we do not see the rationale for this disclosure as employees, suppliers, lenders, etc. consist of resources that are already captured in appendix 3.1.</p> <p>Moreover we also believe that this section overlaps with the legal requirements on Corporate Governance and remuneration.</p>

4	Results and Outlook	
4.1	<i>Results</i>	
4.1.1	Entity's performance against the stated objectives and strategies as described in Art. 2 of this Appendix	We agree inasmuch as the issuers have all the latitude to decide what are the metrics that they would use under this section (including non-financial metrics). The information should in principle not go beyond to what is disclosed in the investors presentations.
4.1.2	Most significant financial and non-financial performance measures as well as the development of these measures throughout the financial year	Please see our comment under 4.1.1 above.
4.2	<i>Outlook</i> Description of the outlook, which may include targets for financial and non-financial measures	We have strong reservations about point 4.2. Please see our comment above under article 5 § 2 item 4.

5	Additional Comment	
5.1	Legislative issue.	<p>The Swiss Parliament is currently debating an amendment to the law which states that, in future, the Federal Council shall define which accounting standards are deemed to be recognised accounting standards according to the law and shall, therefore, be complied with by Swiss listed companies. This would deprive the SIX of its current competence to define which financial reporting standards shall be applied. Considering this, it seems to be inadequate for SIX, at this stage, to go beyond existing IFRS requirements which do not mandate Management Commentary, when it's not clear whether SIX will eventually lose regulatory power in this field.</p>