



STAFF PAPER

July 2020

IASB® meeting

Project	Management Commentary		
Paper topic	Financial resources		
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Purpose of this paper

1. This paper provides an update on the supporting guidance that could be included in the revised IFRS Practice Statement 1 *Management Commentary* (Practice Statement). Specifically, it discusses possible supporting guidance on reporting financial resources and asks the Board for comments.

Structure of this paper

2. This paper is structured as follows:
 - (a) background (paragraphs 3–5);
 - (b) summary of staff’s research on financial resources:
 - (i) the existing Practice Statement (paragraph 6–8);
 - (ii) investors’ and creditors’ information needs (paragraphs 9–11); and
 - (iii) feedback from the Board’s consultative groups (paragraph 12–14)
 - (c) supporting guidance on financial resources:
 - (i) guidance on reporting information about obtaining financial resources (paragraphs 18–24); and

- (ii) guidance on reporting information about allocating financial resources (paragraphs 25–26);
- (d) Appendix A—Extracts from IFRS Practice Statement 1 *Management Commentary* on financial resources; and
- (e) Appendix B— How an entity obtains and allocates financial resources.

Background

3. The Board’s discussions to date focussed on:
 - (a) how the entity creates value and generates cash flows through operation of its business model;
 - (b) management’s strategy for sustaining or developing that model;
 - (c) the resources and relationships on which that model and that strategy depend;
 - (d) risks that could disrupt that model and that strategy; and
 - (e) trends and factors in the entity’s external environment that affect the entity.

4. In discussing those topics, the Board noted that management commentary should also address:
 - (a) how operation of the entity’s business model and execution of management’s strategy are financed (for example, by cash flows generated by the entity’s operations or by obtaining financing from financial institutions or on capital markets); and
 - (b) how the entity’s financial resources are allocated (for example, reinvested in the entity’s organic growth, used to finance mergers and acquisitions or distributed to shareholders).

5. Specifically, the Board noted that financial resources are expected to be ‘key’ resources for any entity. This is because financial resources are necessary for the operation of the entity business model and execution of management’s strategy. Accordingly, availability and sources of financial resources would need to be addressed in management commentary, possibly in discussing resources and relationships, and allocation of financial

resources would also need to be addressed, possibly in discussing management’s strategy. However, the Board did not discuss in detail possible supporting guidance on financial resources and on their allocation.

Note on terminology – ‘financial resources’

- Various other publications reviewed by the staff and some stakeholders, including users of financial reports, sometimes use other terms such as ‘cash’ or ‘capital’ to refer to ‘financial resources’. However, the staff think that the revised Practice Statement should retain the term ‘financial resources’.

Summary of staff’s research on financial resources

The existing Practice Statement

6. The existing Practice Statement includes only high-level guidance on providing information about financial resources in management commentary (see Appendix A for extracts from the Practice Statement).
7. Paragraph 30 of the Practice Statement states that management commentary ‘should set out the critical financial and non-financial resources and how they are used in meeting management’s stated objectives’. The Practice Statement then describes examples of possible disclosures for various types of resources in management commentary, including:
 - (a) analysis of adequacy of the entity’s capital structure;
 - (b) analysis of financial arrangements (whether or not recognised in the statement of financial position), liquidity and cash flows; and
 - (c) plans to address any surplus resources or identified and expected inadequacies.
8. In addition, paragraph 18 of the Practice Statement states that management commentary should provide information about trends, uncertainties and other factors that could affect the entity’s liquidity and capital resources.

Investors' and creditors' information needs

9. In April 2020 Agenda Papers 15C *Strategy* and 15D *Resources and relationships* the staff identified the following concerns related to discussion of resources, including financial resources, in management commentary:
- (a) limited discussion about management's resource allocation strategies; and
 - (b) lack of useful information about an entity's key resources and relationships, including about its financial resources.
10. To understand investors' and creditors' information needs specific to financial resources, the staff have reviewed recent publications on the topic, including the Investment Association *Long-term Reporting Guidance* (May 2017), the UK FRC Lab Report *Sources and Uses of Cash* (September 2019) and ICGN (International Corporate Governance Network) *Viewpoint Capital Allocation* (July 2019).
11. The research highlighted the importance to investors and creditors of information about the availability of financial resources and about how management manages its financial resources. In particular, investors and creditors need information about how an entity:
- (a) obtains and could obtain financial resources—investors and creditors use this information to assess whether an entity can obtain sufficient financial resources to cover operation of the entity's business model and execution of management's strategy. In particular, investors and creditors are interested in:
 - (i) an entity's approach to obtaining financial resources;
 - (ii) financial resources obtained during the period and available to the entity and conditions related to those resources; and
 - (iii) potential threats to availability of financial resources.
 - (b) allocates financial resources—investors and creditors use this information to assess whether resource allocation decisions made in the reporting period and plans for resources allocation in the future are likely to affect the entity's ability to create value and generate cash flows, including over the long term. In particular, investors and creditors are interested in:

- (i) an entity's approach to allocating financial resources; and
- (ii) how financial resources were allocated during the reporting period.

Feedback from the Board's consultative groups

12. The staff discussed their initial ideas for guidance on reporting how an entity obtains and allocates financial resources with the Management Commentary Consultative Group (MCCG). Suggested guidance covered:
- (a) analysis of financial resources available to an entity and of related conditions, requirements for financing working capital, discussion of leverage and of credit rating objectives and discussion of financial resources needed to execute management's strategy. Members generally agreed with these suggestions and suggested that the revised guidance should also address the entity's liquidity.
 - (b) analysis of amounts included in the financial statements in relation to allocating financial resources, in particular analysis of capital and operating expenditure, to help investors and creditors understand whether the allocation of financial resources is consistent with the entity's ongoing needs in the context of the entity's business model and management's strategy. Some members supported those suggestions and highlighted the importance of information in management commentary about allocation of financial resources and the importance of linking the discussion of financial resources allocation to strategy.
13. The staff also discussed their initial ideas for the guidance on describing how an entity obtains financial resources and their availability with the Capital Markets Advisory Committee (CMAC) and the Global Preparers' Forum (GPF). The staff suggested that the description should include:
- (a) analysis of the available financial facilities;
 - (b) discussion of financial resources needed to implement the entity's strategy; and
 - (c) discussion of how risks could affect the entity's requirements for financial resources.

14. CMAC and GPF members largely agreed with the staff’s suggestions. Furthermore, GPF members did not identify practical impediments to implementing the staff’s suggested guidance on describing how an entity obtains financial resources and their availability.

Supporting guidance on financial resources

15. Based on research of investors’ and creditors’ information needs, the staff have developed possible supporting guidance on reporting financial resources, focussing on information about obtaining and allocating those resources (see paragraphs 18–24 and 25–26).
16. The supporting guidance covers information about management’s approach to obtaining and allocating financial resources and about the decisions made during the reporting period. Provision of such information could help preparers meet the disclosure objectives both for resources and relationships and for strategy that were tentatively approved by the Board in April 2020. In particular:
- (a) for strategy, information about financial resources could help investors and creditors assess:
 - (i) the potential effect of management’s strategy on the entity’s ability to create value and generate cash flows; and
 - (ii) the entity’s ability to execute strategy; and
 - (b) for resources and relationships, information about financial resources could help investors and creditors assess:
 - (i) how much the entity depends on particular resources and relationships (in this case on financial resources and relationships with providers of those resources); and
 - (ii) whether those resources are likely to continue to be available and whether the relationships are likely to strengthen and continue.
17. The staff also note that information about financial resources is important for meeting the disclosure objective for performance and position recommended in Agenda Paper 15C *Performance and position* (for example, that information could help investors and creditors assess what drives the entity’s financial position at the end of the reporting

period). Therefore, the staff will consider in drafting the forthcoming exposure draft where best to place the supporting guidance on financial resources discussed in this paper.

Guidance on reporting information about obtaining financial resources

18. As noted in paragraph 11, investors and creditors need to understand how management is obtaining financial resources for the operation of the entity’s business model and implementation of strategy.
19. Entities obtain financial resources from cash generated by operations or from other sources of finance such as equity issue or debt finance (see the Figure 1 *How an entity obtains and allocates financial resources* in Appendix B). Provision of information about generation of cash from operations is covered by the guidance on business model discussed with the Board in April 2020. In this paper, the staff have considered what guidance could be provided in the revised Practice Statement on reporting information about obtaining financial resources from other sources.
20. This supporting guidance could cover:
 - (a) an explanation of management’s approach to obtaining resources for the operation of the entity’s business model and implementation of its strategy, including:
 - (i) sources of financial resources management plans to use. For example, explanations of management’s approach could address whether management would first seek obtaining financial resources through lending from financial institutions or raising funds in capital markets.
 - (ii) the extent of short-term financing the entity requires to cover ongoing costs of its operations, for example due to fluctuations in its working capital requirements.
 - (iii) the extent to which the execution of the entity’s strategy will be financed from sources other than cash generated from the entity’s operations.
 - (iv) management’s appetite for using short-term or long-term financing options.
 - (v) management’s financial leverage objectives;
 - (vi) management’s objectives for the entity’s own credit rating; and

- (vii) the entity’s dividend policy.
- (b) a description of financial facilities available to the entity at the end of the reporting period—both drawn and undrawn (for example, bank loans, bonds, private placements)—and explanation of significant changes during the period. Such description and explanation could cover:
 - (i) availability of financial facilities and terms of access to those facilities;
 - (ii) maturity dates;
 - (iii) options to extend or renew the facility or increase its amount; and
 - (iv) terms that could trigger early repayment.

Link to information in financial statements

- IFRS 7 *Financial Instruments: Disclosures* sets out disclosure requirements for financial instruments held by an entity. If some of that information is material for management commentary, entities may choose to include that information in management commentary directly or to incorporate it in management commentary by cross-reference to particular disclosure in the notes to the financial statements. Management commentary would also need to provide any additional information that could help users understand how financial resources have been used by the entity during the reporting period and assess whether an entity can obtain sufficient financial resources to cover operation of the entity’s business model and execution of management’s strategy.

21. As noted in paragraph 11(a)(iii), investors and creditors also need information about potential threats to the entity’s access to financial resources. The staff think that the disclosure objective and supporting guidance on risks discussed with the Board in May 2020 would help management identify and provide such information. Those objectives and supporting guidance cover both risks that can arise from an entity’s existing financial resources, for example risks related to a possible breach of a covenant, and risks that can affect the entity’s financial resources, for example their availability, in the future.

22. As mentioned in paragraph 11(a), investors and creditors use information about the availability of financial resources to the entity to assess whether an entity can obtain sufficient financial resources to cover operation of the entity’s business model and execution of management’s strategy. The staff discussed with the MCCG whether management commentary should also include *management’s* assessment of the sufficiency of the entity’s resources. Such a requirement is set out by some regulators. For example, the UK Corporate Governance Code requires entities to provide a viability statement.
23. Members of the MCCG expressed mixed views on whether management commentary should include that assessment. Some expressed the view that investors and creditors need information to make their own assessments on the sufficiency of the entity’s resources. However, one member commented that including a viability statement in management commentary could be useful to investors, in particular those who analyse entities in emerging economies. Some members also suggested that management commentary could provide information about the disruptive factors that could put the entity out of business. One member expressed a view that providing a discussion of an entity’s viability may be more necessary for industries which depend on resources with finite life, and that therefore management needs to explain its plans for when the resources’ life is expected to end.
24. The staff do not suggest that the revised Practice Statement should address providing information about management’s assessment of sufficiency of the entity’s financial resources. This is because the objective of management commentary is to provide information to help investors and creditors make their own assessments of the entity’s prospects and of management’s stewardship of the entity’s resources rather than to provide management’s predictions of the future.

Guidance on reporting information about allocating financial resources

25. As mentioned in paragraphs 8 and 10, the staff heard concerns that currently management commentaries include only limited discussion about management’s allocation of financial resources. This information is needed by investors and creditors to assess whether allocation decisions made in the reporting period and plans for the future are likely to

enhance the entity’s ability to create value and generate cash flows in the future, including over long term.

26. The staff considered what supporting guidance could be provided in the revised Practice Statement to help preparers provide better information about allocation of financial resources. The staff think that such possible supporting guidance could cover:
- (a) management’s approach to allocating financial resources and criteria for evaluating opportunities. For example, management could explain its long-term approach to allocating financial resources, including whether its policy is to increase dividend payments or to reinvest in the entity, or invest in the entity’s growth through mergers and acquisitions.
 - (b) analysis of key financial resources allocation decisions made and implemented during the reporting period, including any changes to or reversals of the previous decisions, and of any commitments related to future periods and expected timing of those commitments. The analysis could cover:
 - (i) explanation of how allocation of financial resources is monitored. This could cover:
 - (1) management measures and indicators used to monitor allocation of financial resources, and an explanation of any link between these measures and indicators and executive compensation;
 - (2) indication of expected returns from particular investments, for example from mergers and acquisitions;¹ and
 - (3) to the extent possible, information to help investors and creditors assess the actual returns generated by past financial resources allocation decisions;
 - (ii) explanation of management’s plans for financing financial resource allocation decisions made by management;

¹ March 2020 Disclosure Paper *Business Combination—Disclosures, Goodwill and Impairment* sets out the Board’s preliminary views on how entities can provide better information about business combinations so that investors can hold entities to account for acquisitions of other entities.

Link to other areas of content—obtaining financial resources

- The discussion of management’s plans for decisions about allocating financial resources should be linked to information on obtaining financial resources—see paragraph 20(b) of this paper.

(iii) analysis of financial resources spent during the reporting period on:

- (1) maintaining ongoing operations.
- (2) developing the entity’s ability to create value and generate cash flows.
For example, management could discuss financial resources spent on research and development or on completed mergers or acquisitions.
- (3) other purposes, for example paying dividends, repaying debts and share buy backs (see Appendix B).

Question 1 for the Board

Paragraphs 18–26 discuss possible supporting guidance on providing information about obtaining and allocating financial resources in management commentary that could be included in the revised Practice Statement. Do you have any questions or comments on the discussion?

Appendix A—Extracts from IFRS Practice Statement 1 *Management Commentary* on financial resources

Forward-looking information

- 18 Management should include forward-looking information when it is aware of trends, uncertainties and other factors that could affect the entity's liquidity, capital resources, revenues and the results of its operations. Such information should focus on the extent to which the entity's financial position, liquidity and performance may change in the future and why, and include management's assessment of the entity's prospects in the light of current period results. [...]

...

Resources, risks and relationships

- 19 Management commentary should include a clear description of the most important resources, risks and relationships that management believes can affect the entity's value and how those resources, risks and relationships are managed.

Resources

- 30 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. Disclosure about resources depends on the nature of the entity and on the industries in which the entity operates. 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, and human and intellectual capital resources, as well as plans to address any surplus resources or identified and expected inadequacies, are examples of disclosures that can provide useful information.

Appendix B—How an entity obtains and allocates financial resources

Figure 1. How an entity obtains and allocates financial resources

