IFRS

STAFF PAPER

July 2019

IASB® meeting

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Project	**Management Commentary**
Paper topic	Making relevance and materiality judgements

CONTACT(S)	Jelena Voilo	jvoilo@ifrs.org	+44 (0)20 7246 6914
	Yulia Feygina	yfeygina@ifrs.org	+44 (0)20 7332 2743
	Matt Chapman	mchapman@ifrs.org	

Purpose of this paper

1. This paper discusses what guidance should be included in revised IFRS Practice Statement 1 *Management Commentary* (Practice Statement) on considering the qualitative characteristic of relevance, and specifically on making materiality judgements, in preparing management commentary and asks the International Accounting Standards Board (Board) for decisions.

Structure of this paper

2. This paper is structured as follows:

   (a) summary of staff recommendations (paragraphs 3–5);

   (b) background (paragraphs 6–9);

   (c) why more guidance is needed (paragraphs 10–15);

   (d) overview of guidance on materiality issued by other standard-setters (paragraph 16);

   (e) staff analysis and recommendations:

      (i) a principles-based approach (paragraphs 17–19);

      (ii) the starting point for the proposed guidance (paragraphs 20–31);

(iii) guidance on identifying material information (paragraphs 32–47); and

(iv) guidance on the other steps of the materiality process (paragraphs 48–55);

(f) Appendix A—Extract from the *Conceptual Framework for Financial Reporting* (*Conceptual Framework*);

(g) Appendix B—Staff commentary on how IFRS Practice Statement 2 *Making Materiality Judgements* (Materiality Practice Statement) applies in preparing management commentary; and

(h) Appendix C—Overview of the input on materiality and narrative coherence received from the Board’s consultative groups.

Summary of staff recommendations

3. The staff recommend introducing in the revised Practice Statement guidance on making materiality judgements in preparing management commentary that would:

    (a) incorporate key elements of the guidance from the Materiality Practice Statement supported, where necessary, by cross-references to further guidance in the Materiality Practice Statement;

    (b) provide additional guidance where it is necessary because the nature of management commentary differs from the nature of financial statements; and

    (c) focus on explaining the materiality process, in particular on identifying material information.

4. Further, the staff recommend that the guidance on identifying material information in the revised Practice Statement would:

    (a) recognise the guidance on content elements in the Practice Statement as a general source of identifying such information;

    (b) provide the following guidance on considering primary users’ common information needs in identifying material information:

(i) make an explicit link between identification of material information and the objective of management commentary—ie providing information that is useful in assessing the prospects for future net cash inflows to the entity and in assessing management's stewardship of the entity's economic resources; and

(ii) describe practical sources that could help management identify matters that may need to be discussed in management commentary; and

(c) explain how to consider what information about the matter needs to be provided in each content element to deliver a coherent narrative.

5. Finally, the staff recommend including in the revised Practice Statement guidance on the other steps of the materiality process that would prompt management to:

(a) consider the likelihood of the matter crystallising, not just the size of the impact, in assessing the quantitative factors when making materiality judgements;

(b) consider the appropriate level of aggregation when assessing what information an entity needs to provide in management commentary; and

(c) highlight the links between different pieces of information when organizing the information within management commentary.

Background

6. The *Conceptual Framework* describes relevant information as financial information that is capable of making a difference in the decisions made by primary users. Financial information is capable of making a difference in decisions if it has predictive value, confirmatory value or both (see Appendix A for extracts from the *Conceptual Framework*).

7. The *Conceptual Framework* further explains the qualitative characteristic of relevance by explaining the related concept of materiality. Materiality is described as an entity-specific aspect of relevance. The Basis for Conclusions on the *Conceptual Framework*

explains that immaterial information could not reasonably be expected to influence a user's decision.[1]

> 2.11 Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial reports make on the basis of those reports, which provide financial information about a specific reporting entity. In other words, materiality is an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual entity's financial report. Consequently, the Board cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation.[2]

8. The existing Practice Statement does not provide any guidance on relevance. It does refer to materiality but does not explain the concept or provide any guidance on how management should make materiality judgements in preparing management commentary.

> 21 Management should include information that is material to the entity in management commentary. Materiality will be different for each entity. Materiality is an 'entity-specific aspect of relevance'; thus information that is relevant for an entity will also be material.

9. Since issuing the Practice Statement, the Board issued the Materiality Practice Statement, which provides guidance on making materiality judgements when preparing financial statements. The guidance in the Practice Statement has not been updated following the issue of the Materiality Practice Statement.

Why more guidance is needed

10. The staff's research and discussions with the Board's consultative groups suggest that currently management commentaries do not always provide relevant information that is necessary to meet the objective of management commentary. For example, some management commentaries:

    (a) do not identify matters that are important to the future of the business; or

[1] See paragraph BC2.19 of the Basis for Conclusions on the *Conceptual Framework*.

[2] The definition of material as amended by *Definition of Material* (Amendments to IAS 1 and IAS 8), issued in October 2018.

(b) may identify such matters, for example matters that affect the entity's key resources and relationships, but do not provide the information needed to help primary users understand implications of those matters for the entity's prospects.

11. Members of the Management Commentary Consultative Group suggested that preparers may face challenges in making materiality judgements because they may lack understanding of primary users' decision-making process. Absent guidance on making materiality judgements in preparing management commentary, preparers may find it difficult to determine which information could reasonably be expected to influence users' decisions and so is material.

12. Judgement is needed in deciding what information to include in financial reports. In its previous work, the Board heard that making materiality judgements is challenging in preparing financial statements. To address this issue, in 2017 the Board issued the Materiality Practice Statement.

13. Making materiality judgements is even more challenging in preparing management commentary than in preparing financial statements. This is because:

(a) the scope of management commentary is broader than that of financial statements. The proposed objective of management commentary is to provide context for an entity's financial statements and an insight into its long-term prospects and therefore by its nature management commentary is more explanatory and forward-looking than financial statements. Input from the Board's consultative groups also suggests that making materiality judgements about qualitative information or forward-looking information is more challenging than in the case of quantitative information.

(b) IFRS Standards explicitly identify a large proportion of information that preparers need to consider including in financial statements. This is not the case for the Practice Statement, which can explicitly identify only a much smaller proportion of information that preparers need to consider including in management commentary.

14. Application of the materiality concept in preparing a management commentary or a similar report has also been identified as a challenge by other standard-setters. For

example, the *Integrated Reporting Implementation Review* by the International Integrated Reporting Council highlighted that 'It is clear from a number of comments that operationalizing the materiality concept is challenging and can be misunderstood or misapplied'. Many standard-setters therefore provide guidance to support making materiality judgements is preparing management commentary or a similar report. However, the staff's research has shown that in their guidance standard-setters use various approaches to making materiality judgements (see paragraph 16).

15. For the reasons discussed in paragraphs 11 and 13–14, the staff think that the revised Practice Statement should provide guidance on making materiality judgements in preparing management commentary.

Overview of guidance on materiality issued by other standard-setters

16. As noted in paragraph 14 of Agenda Paper 15A, materiality is commonly listed by other standard-setters as a principle for preparing management commentary or a similar report. In the guidance reviewed, standard-setters adopt the following approaches to making materiality judgements:

    (a) most standard-setters link materiality judgements to information needs of users of the report. Some standard-setters identify a range of users similar to those users identified in the Practice Statement (and in the *Conceptual Framework*), while some others ask management to consider information needs of a wider range of stakeholders.

    (b) some standard-setters supplement a requirement to consider users' information needs with a list of minimum or mandatory disclosure requirements, often in relation to environmental, social and governance (ESG) information. For example, such an approach is adopted in the EU Non-financial Reporting Directive (2014/95/EU). The EU Directive requires companies to provide information relating to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters.

    (c) some standard-setters, for example, the Sustainability Accounting Standards Board in SASB Standards, provide a list of information or metrics that are expected to be important for a particular industry or for a particular subject matter (for example, climate change).

Staff analysis and recommendations

A principles-based approach

17. As discussed in May 2019 AP 15 *Overview of the staff's approach to revision*, the staff think that the revised guidance on management commentary should remain principles-based rather than prescribe a detailed list of requirements or industry-specific or subject-matter-specific disclosures or metrics. This is because information in management commentary should be specific to the entity and reflect its unique facts and circumstances while meeting information needs of primary users of management commentary.

18. Accordingly, in developing guidance for the revised Practice Statement on making materiality judgements, the staff did not make assumptions about what is important to each entity's success and propose specific disclosure requirements about such matters. Even if the staff could identify some such *matters*, only specific circumstances of each entity would determine what *information* about those matters is material to primary users. In addition, the staff are concerned that prescribing specific disclosure requirements could result in preparers adopting a checklist approach to preparing management commentary instead of focusing on identifying information that would be material in an entity's specific circumstances.

19. Instead, the staff have focused on developing principles-based guidance that would help management make materiality judgements in preparing management commentary, with a particular emphasis on identifying information that would explain what is important for an entity's long-term success.

The starting point for the proposed guidance

20. The staff have developed recommendations for guidance on making materiality judgements in preparing management commentary using the Materiality Practice Statement as a starting point. The Materiality Practice Statement was issued in 2017 and reflects the Board's latest thinking on making materiality judgements.

21. The Materiality Practice Statement provides non-mandatory guidance and discusses materiality judgements in preparing financial statements. However, the guidance in the Materiality Practice Statement is principles-based and therefore would generally be equally applicable in preparing management commentary. At the same time, some additional guidance specific to making materiality judgements in management commentary may be needed. This is because as noted in paragraph 13, management commentary captures a broader and less defined range of information than financial statements. In particular, it captures more qualitative information and is more forward-looking than financial statements.

22. Accordingly, the staff recommend the following overall approach to guidance on making materiality judgements in the revised Practice Statement:

    (a) incorporate in the revised Practice Statement key elements of the guidance from the Materiality Practice Statement supported, where necessary, by cross-references to further guidance in the Materiality Practice Statement; and

    (b) provide additional guidance where it is necessary because the nature of management commentary differs from the nature of financial statements.

23. As noted in May 2019 Agenda Paper 15, individuals involved in preparing management commentary can be different from those involved in preparing financial statements and cannot be assumed to have knowledge of IFRS Standards. Likewise, preparers of management commentary cannot be expected to be familiar with the Materiality Practice Statement. Incorporating in the revised Practice Statement key elements of the guidance from the Materiality Practice Statement could help such preparers make more informed materiality judgements.

24. The staff have analysed the Materiality Practice Statement to identify key elements of guidance which would be particularly helpful in making materiality judgements in preparing management commentary and should be incorporated in the revised Practice Statement.

25. The Materiality Practice Statement states that an entity may find it helpful to follow a systematic process in making materiality judgments and sets out the following four-step example of such a process:

(a) Step 1—identify information that has the potential to be material;

(b) Step 2—assess whether the information identified in Step 1 is, in fact, material;

(c) Step 3—organise the information within the draft financial statements in a way that communicates the information clearly and concisely to primary users; and

(d) Step 4—review the draft financial statements to determine whether all material information has been identified and materiality considered from a wide perspective and in aggregate, on the basis of the complete set of financial statements.[3]

26. The staff think that following a systematic process is helpful in making materiality judgements in preparing both financial statements and management commentary. The staff therefore recommend that the guidance in the revised Practice Statement on making materiality judgements focuses on explaining the process of making materiality judgements (materiality process).

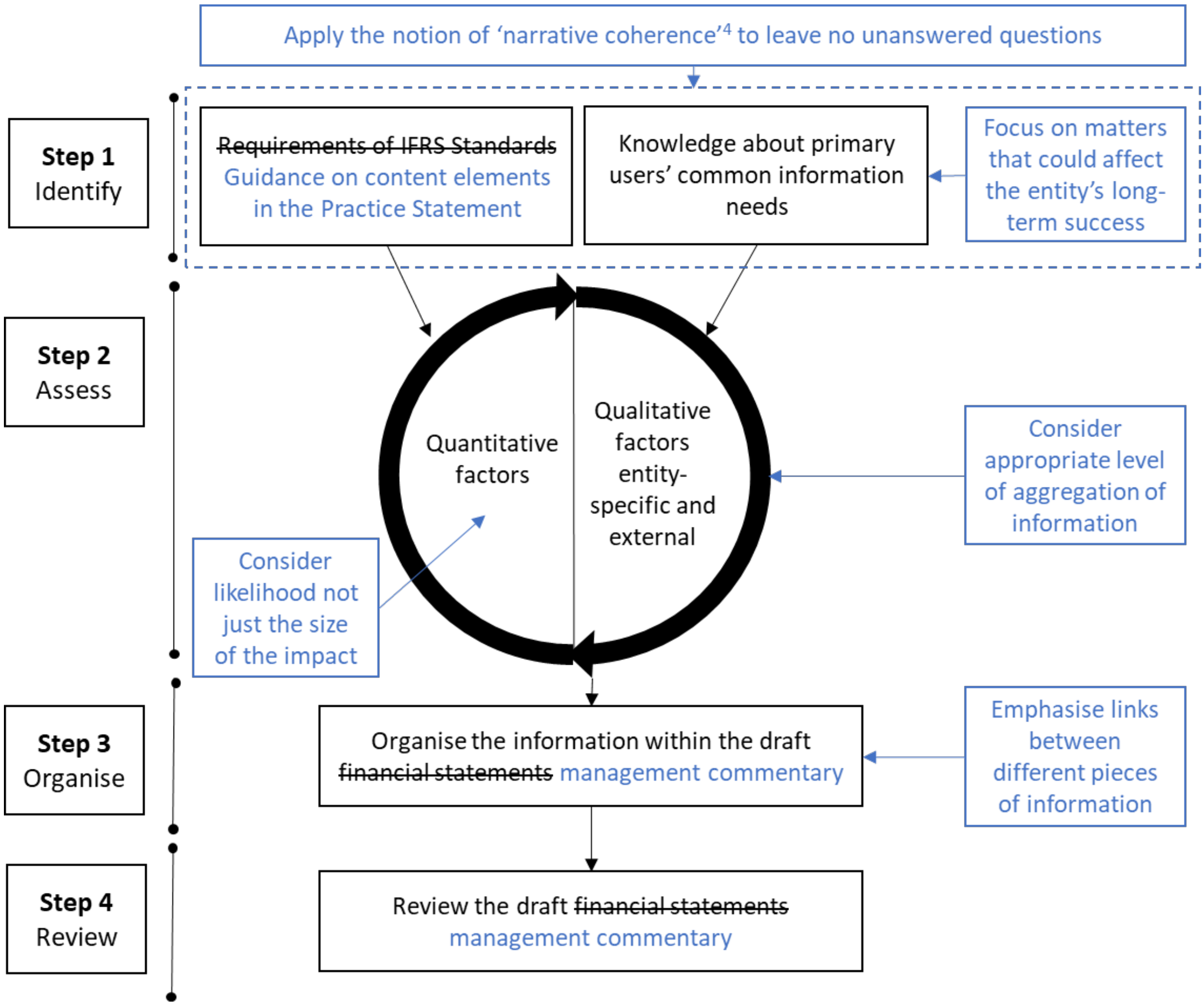
27. The staff think that this can be achieved by including in the revised Practice Statement an example of the materiality process to help management make materiality judgements in an efficient and effective way in preparing management commentary. That example would be based on the example set out in the Materiality Practice Statement adjusted to reflect the specifics of information included in management commentary.

28. In particular, as noted in paragraph 10, identification of material information (ie Step 1) has been identified as challenging in preparing management commentary. Therefore, the staff recommend that providing guidance on identifying material information is the focus of the guidance on the materiality process (paragraphs 32–47). However, the staff have also developed recommendations for additional guidance on other steps of the materiality process where such guidance is necessary because of the different nature of information in management commentary (paragraphs 48–55).

[3] See paragraph 33 of the Materiality Practice Statement.

29. Diagram A provides an overview of the staff's proposed example of the materiality process in preparing management commentary, highlighting in blue the adjustments to the example set out in the Materiality Practice Statement.

Diagram A—Overview of the staff's proposed example of the materiality process



30. Appendix B includes the staff's commentary on how the remaining guidance in the Materiality Practice Statement could be applied in preparing management commentary. As mentioned in paragraph 26, the staff recommend that the guidance in the revised Practice Statement on making materiality judgements focuses on explaining the materiality process. Accordingly, the staff do not plan to raise any of the suggestions in Appendix B for discussion in the Board meeting, unless requested to do so by a Board member.

[4] In this paper, the staff use the term 'narrative coherence' as a label for the notion discussed in more detail in paragraphs 44–47. This label may be replaced if a better label is found as the project progresses.

31. The staff discussed their proposals on materiality and narrative coherence with the Board's consultative groups. The summary of input received and the staff's comments on it are provided in Appendix C. The Accounting Standards Advisory Forum will have a further discussion on the proposed guidance on narrative coherence at its July 2019 meeting. The staff will provide to the Board an oral update on input received at that meeting.

Question 1

The staff recommend introducing in the revised Practice Statement guidance on making materiality judgements in preparing management commentary that would:

(a) incorporate key elements of the guidance from the Materiality Practice Statement supported, where necessary, by cross-references to further guidance in the Materiality Practice Statement;

(b) provide additional guidance where it is necessary because the nature of management commentary differs from the nature of financial statements;

(c) focus on explaining the materiality process, in particular on identifying material information (see paragraphs 26 and 28).

Do you agree with these recommendations?

Guidance on identifying material information

32. The aim of Step 1 of the example of the materiality process described in the Materiality Practice Statement is to identify information about an entity's transactions, other events and conditions that primary users might need to understand to make decisions about providing resources to the entity.

33. To help preparers identify such information, the Materiality Practice Statement:

(a) recommends using, as a starting point, the requirements of IFRS Standards applicable to its transactions, other events and conditions. This is the starting point because, when developing a Standard, the Board identifies the information it expects will meet the needs of a broad range of primary users for a wide variety of entities in a range or circumstances.

(b) asks an entity to consider its primary users' common information needs to identify any information—in addition to that specified in IFRS Standards—necessary to enable primary users to understand the impact of the entity's transactions, other events and conditions on the entity's financial position, financial performance and cash flows.[5]

34. Diagram A illustrates how the staff suggest adjusting the description of Step 1 of the materiality process in the revised Practice Statement:

(a) replace 'Requirements in IFRS Standards' with 'Guidance on content elements in the Practice Statement' (paragraphs 35–37);

(b) emphasise that in considering primary users' common information needs management should focus on matters that could affect the entity's long-term success (paragraphs 38–42); and

(c) explain how the notion of 'narrative coherence' can be applied to help management 'leave no unanswered questions' about those matters (paragraphs 43–47).

Guidance on content elements in the Practice Statement

35. The staff recommend that instead of referring to IFRS Standards, the revised Practice Statement recognises the guidance on content elements in the Practice Statement as a general source for identifying information that users might need to make decisions about providing resources to the entity. The Practice Statement uses the term 'content elements' to refer to the type of content that is typically expected to be included in management commentary, for example, information on the entity's business model or strategy. The content elements are intended to be the building blocks of management commentary.

36. The staff envisage that for each content element the revised Practice Statement will identify general types of information that would be expected to be relevant for primary users for a wide variety of entities. For example, in describing its business model, an entity would be expected to provide information about inputs, business activities and outputs. In addition to identifying those general types of information, in some cases, the staff envisage including in the revised Practice Statement additional guidance intended to help management identify specific types of information that may need to be provided in management commentary. For example, the staff discussed

[5] See paragraphs 35–38 of the Materiality Practice Statement.

with the Management Commentary Consultative Group whether the discussion of inputs into an entity's business model should include a description of resources and relationships that the business model depends on, in particular of resources and relationships (including intangible assets) whose continued availability and strength could affect the prospects for future net cash inflows to the entity.

37. However, as noted in paragraph 13, because management commentary may have to deal with a broader range of information than is typically the case for financial statements, the Practice Statement can identify explicitly only a much smaller proportion of the specific types of information that management would need to consider including in management commentary than IFRS Standards do for financial statements.

Considering primary users' common information needs

38. For the reasons given in paragraph 37, considering primary users' common information needs becomes more important in making materiality judgements in preparing management commentary.

39. As noted in paragraph 11, preparers may lack understanding of primary users' decision making. Paragraphs 13–23 of the Materiality Practice Statement explain what decisions primary users make and how to meet primary users' common information needs. In addition to providing cross-reference to this guidance, the staff recommend that the revised Practice Statement makes an explicit link between identification of material information and the objective of management commentary—that objective is to provide information that is useful in assessing:

(a) the amount, timing an uncertainty of (the prospects for) future net cash inflows to the entity; and

(b) management's stewardship of the entity's economic resources.

40. The Materiality Practice Statement explains that, for financial statements, such information includes information about:

(a) the resources of the entity (assets), claims against the entity (liabilities and equity) and changes in those resources and claims (income and expenses); and

(b) how efficiently and effectively the entity's management and governing board have discharged their responsibility to use the entity's resources.

41. In management commentary, information would need to be broader than information provided in financial statements about an entity's assets, liabilities, equity, income and expenses. Management commentary would also need to discuss matters that could affect the entity's long-term success. For example, such matters would include:

(a) trends and factors that affected the entity's financial performance in the current reporting period or could affect it in the future; and

(b) the features of the entity's business model that the entity depends on for its long-term success.

42. To help management identify matters that may need to be discussed in management commentary, the staff recommend that the revised Practice Statements describes the following practical sources for identifying such matters:

(a) the entity's capital markets communications (for example, investor day's presentations) because they are prepared taking into consideration primary users' information needs and are often based on those users' information requests.

(b) information management uses in managing the business. For example, this could be information considered by management in setting strategy, information about matters discussed with the entity's board, or information considered in monitoring the business's financial and operating performance. In developing the existing Practice Statement, the Board decided that management commentary should be derived from the information that is important to management because, with few exceptions, the information important to management in managing business is the information that is important to capital providers in assessing performance and prospects.[6]

[6] See paragraph BC32 of the Basis for Conclusions on the Practice Statement.

(c) information identified through engagement with the entity's key stakeholders such as customers, employees or suppliers about internal or external factors that could affect the entity's long-term success.

Applying the notion of 'narrative coherence'

43. Once management identifies matters that need to be discussed in management commentary, it would need to determine what information about those matters to provide. As mentioned in paragraph 7 of Agenda Paper 15A for this meeting, the staff heard that some management commentaries provide fragmented discussion that fails to 'tell the whole story'. When setting out overall approach to revision of the Practice Statement in May 2019 Agenda Paper 15, the staff suggested that the revised guidance will be intended to promote a coherent narrative throughout management commentary.

44. To promote a coherent narrative in management commentary that 'tells the whole story' and 'leaves no unanswered questions', the staff have been developing the notion of 'narrative coherence'.[7] The staff think that the notion of narrative coherence applies at two levels:

(a) to management commentary as a whole (paragraph 45); and

(b) to information about a particular matter identified in management commentary (paragraph 46).

45. Providing coherent narrative in management commentary as a whole means that interrelationships between different pieces of information in management commentary, as well as between information in management commentary and in financial statements, are clear. The staff plan to discuss narrative coherence of management commentary as a whole in a future paper.

46. The notion of narrative coherence is also applicable at a lower level, that is, when providing information about matters that need to be discussed in management commentary. At this level, providing a coherent narrative means 'telling the whole story' about a matter. To help management avoid leaving primary users with unanswered questions about a matter, the staff recommend that the revised Practice

[7] As the project develops, the staff will consider whether a better label can be used to describe this notion.

Statement explains how to consider what information about the matter needs to be provided in each content element. In particular, management would need to consider explaining:

(a) what part of the business is affected by the matter;

(b) how that matter can affect, or be affected by, risks the entity faces and by its operating environment;

(c) what management's strategy is for managing the matter; and

(d) what the progress is in executing that strategy and whether the potential implications of that progress are clear.

47. Table 1 provides an illustration of applying the notion of narrative coherence at a lower level to identify material information about a matter (this approach can also be thought of as a 'matrix approach').

Table 1—Illustration of applying the notion of narrative coherence

Content element[8]	**Matter** Customer demographics influenced by social media and preference for online shopping
Business model	The clothes retail business currently has 60% of its sales from high street stores and 40% from its website. Its clothes designs are mainly targeted at the 18-35 age group.
Operating environment and risks	The market for clothes among the 18-35 age group is moving primarily towards online shopping and established online-only brands. Recommendations by social-media influencers are a direct driver for online sales.
Strategy	Management plans to shift its sales mix to 30% from high street stores and 70% online through its website within 3 years. 5 top social media influencers were identified to promote the brand and drive click-through sales to the website. Management is investing in a website upgrade to enhance the online shopping experience.
Performance, position and progress	Online sales increased by 35% during the year. 65% of this increase was from click-through sales from social media links. During the year, the company spent CUX of its marketing budget on social media. The company has spent CUY on upgrading the website.

[8] The Board has not yet confirmed content elements for the revised Practice Statement.

Question 2
The staff recommend that the guidance on identifying material information in the revised Practice Statement would: (a) recognise the guidance on content elements in the Practice Statement as a general source of identifying such information (paragraph 35); (b) provide the following guidance on considering primary users' common information needs in identifying material information: (i) make an explicit link between identification of material information and the objective of management commentary—ie providing information that is useful in assessing the prospects for future net cash inflows to the entity and in assessing management's stewardship of the entity's economic resources (paragraph 39); and (ii) describe practical sources that could help management identify matters that may need to be discussed in management commentary (paragraph 42); (c) explain how to consider what information about the matter needs to be provided in each content element to deliver a coherent narrative (paragraph 43). Do you agree with these recommendations?

Guidance on the other steps of the materiality process

48. The staff reviewed guidance on the other steps of the materiality process (Assess, Organise and Review) provided in paragraphs 40–65 of the Materiality Practice Statement. The staff think that this guidance is applicable to management commentary and suggest including cross-references to this guidance in the revised Practice Statement.

49. In addition, as indicated in Diagram A, the staff recommend including in the revised Practice Statement the following guidance specific to management commentary that would prompt management to:

   (a) consider the likelihood of the matter crystallising, not just the size of its impact, in assessing the quantitative factors when making materiality judgements (paragraphs 50–51);

   (b) consider the appropriate level of aggregation when assessing what information an entity needs to provide in management commentary (paragraphs 52–53); and

(c) highlight the links between different pieces of information when organising the information within management commentary (paragraph 54–55).

Considering the likelihood of the matter crystallising

50. The Materiality Practice Statement states that the quantitative assessment of materiality focuses on the size of the impact of a transaction on the entity's financial position, financial performance and past cash flows.[9] Management commentary is forward-looking and provides more information than financial statements about often uncertain future matters that could affect the entity's long-term success. To help management make materiality judgements on providing information about uncertain future matters, the staff recommend that the revised Practice Statement states that in assessing whether information is quantitively material, management should consider not only the size of the impact of a matter but also the likelihood of the matter crystallising.

51. The revised Practice Statement should explain that, normally, information about a matter is more likely to be considered material if both the likelihood of a matter crystallising and the potential size of its impact are high. However, in some cases, management would need to consider providing information about a matter even if the likelihood of that matter crystallising is low, for example, when the potential impact is very high.

Considering appropriate level of aggregation

52. The existing Practice Statement explains that management commentary should be consistent with its related financial statements. For example, if the financial statements include segment information, the information presented in the management commentary should reflect that segmentation.[10] So information in management commentary would in some cases be presented at a level of aggregation consistent with the level of aggregation in the related financial statements.

53. However, the staff recommend that the guidance in the revised Practice Statement should also explain that in some cases, a more granular discussion may be needed in management commentary, for example, if a discussion of a matter only at a segment

[9] See paragraph 44 of the Materiality Practice Statement.
[10] See paragraph 23(a) of the Practice Statement.

level has the result that a positive trend affecting a particular category of customers could obscure a negative trend affecting another category of customers.

Highlighting the links between different pieces of information

54. Paragraph 42 presents the staff recommendations for identifying what information to provide about matters that need to be discussed in management commentary. However, the revised Practice Statement is not expected to prescribe the format for organising such information. Management will have to decide how to organise the information in management commentary, for example, whether to provide all information about a reportable matter in one place or talk about it in different parts of management commentary.

55. The staff recommend emphasising in the revised Practice Statement that, if the information about a matter is provided in different parts of management commentary, highlighting the links between these pieces of information would help primary users understand the implications of that matter for the entity’s prospects. Providing links between pieces of information about a matter would also contribute to providing a coherent narrative throughout management commentary.

Question 3

The staff recommend including in the revised Practice Statement the guidance on the other steps of the materiality process that would prompt the management to:

(a) consider the likelihood of the matter crystallising, not just the size of the impact, in assessing the quantitative factors when making materiality judgements (paragraphs 50–51);

(b) consider the appropriate level of aggregation when assessing what information an entity needs to provide in management commentary (paragraph 53); and

(c) highlight the links between different pieces of information when organising the information within management commentary (paragraph 55).

Do you agree with these recommendations?

Appendix A—Extract from the *Conceptual Framework*

Relevance

2.6 Relevant financial information is capable of making a difference in the decisions made by users. Information may be capable of making a difference in a decision even if some users choose not to take advantage of it or are already aware of it from other sources.

2.7 Financial information is capable of making a difference in decisions if it has predictive value, confirmatory value or both.

2.8 Financial information had predictive value if it can be used as an input to processes employed by users to predict future outcomes. Financial information need not be a prediction or forecast to have predictive value. Financial information with predictive value is employed by users in making their own predictions.

2.9 Financial information had confirmatory value if it provides feedback about (confirms or changes) previous evaluations.

2.10 The predictive and confirmatory value of financial information are interrelated. Information that has predictive value often also has confirmatory value. For example, revenue information for the current year, which can be used as the basis for predicting revenues in future years, can also be compared with revenue predictions for the current year that were made in past years. The results of those comparisons can help a user to correct and improve the processed that were used to make those previous predictions.

Materiality

2.11 Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial reports make on the basis of those reports, which provide financial information about a specific reporting entity. In other words, materiality is an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual entity's financial report. Consequently, the Board cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation.

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Appendix B—Staff commentary on how the Materiality Practice Statement applies in preparing management commentary

Section of the Materiality Practice Statement	Overview of the guidance	Staff comments on how the guidance applies in preparing management commentary[11]
General characteristics of materiality		
Definition of material (paragraphs 5–7)	The entity identifies the information necessary to meet the objective of financial statements by making appropriate materiality judgements. Material information is defined as follows: Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial reports make of the basis of those reports, which provide financial information about a specific reporting entity. In other words, materiality is an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual entity's financial report.[12]	• 'Material information' is defined for all financial reports, therefore the same definition applies in preparing management commentary. • The staff recommend including the latest definition of 'material information' in the revised Practice Statement to emphasise that: (a) material information cannot be omitted, misstated or obscured; (b) materiality decisions are made considering how information could influence primary users' decisions; and (c) decisions are made in the context of a specific reporting entity.
Materiality judgements are pervasive (paragraphs 8–10)	An entity can apply the Materiality Practice Statement to make materiality judgements when making decisions about recognition, measurement, presentation and disclosure.	The staff do not intend to provide explicit guidance on this in the revised Practice Statement but note that because of the nature of management commentary, materiality judgements made by management in preparing management commentary mostly concern disclosure of information, and to some extent presentation and measurement, but not recognition.
Judgement (paragraphs 11–12)	(a) When applying judgement, the entity considers both its specific circumstances and how the information provided in the financial statements responds to the	The guidance on applying judgement will be incorporated in the revised Practice Statement.

[11] In all guidance, references to 'financial statements' should be read as references to 'management commentary'.
[12] The definition of material as amended by *Definition of Material* (Amendments to IAS 1 and IAS 8), issued in October 2018.

Section of the Materiality Practice Statement	Overview of the guidance	Staff comments on how the guidance applies in preparing management commentary[11]
	information needs of primary users. (b) Because an entity's circumstances change over time, materiality judgements are reassessed at each reporting date in the light of those changed circumstances.	
Primary users and their information needs (paragraphs 13–15)	(a) Primary users are identified as existing and potential investors, lenders and other creditors. (b) When making materiality judgements, an entity also considers that primary users are expected to have a reasonable knowledge of business and economic activities and to review and analyse the information included in the financial statements diligently.	The description of the primary user group in the existing Practice statement is the same as in the Materiality Practice Statement, that is, the primary user group for management commentary is the same as for financial statements.
Decisions made by primary users (paragraphs 16–20)	The primary users make decisions about providing resources to the entity. Those decisions involve: buying, selling or holding equity and debt instruments; providing or settling loans and other forms of credit; and exercising rights while holding investments. Such decisions depend on the returns that primary users expect from an investment in those instruments. The primary users' expectations about returns depend on their assessment of the amount, timing and uncertainty of (the prospects for) the future net cash inflows to an entity and their assessment of management's stewardship of the entity's resources. Consequently, an entity's primary users need information about: (a) the entity's resources(assets), claims against the entity (liabilities and equity) and changes in those resources and claims (income and expenses); and (b) how efficiently and effectively the entity's management and governing board have discharged	The proposed objective of management commentary, as discussed by the Board in November 2018, also emphasises that management commentary needs to provide information for the primary users' assessments of the prospects for future net cash inflows to the entity and of management's stewardship of the entity's economic resources. Consequently, materiality judgements in preparing management commentary should be made in a way intended to provide information needed for those assessments (see paragraphs 39–40 of this Agenda Paper).

Section of the Materiality Practice Statement	Overview of the guidance	Staff comments on how the guidance applies in preparing management commentary[11]
	their responsibility to use the entity's resources.	
Meeting primary users' information needs (paragraphs 21–23)	The entity aims to meet the common information needs of its primary users. To meet those needs, an entity separately identifies the information needs that are shared within each of the three categories of primary users (ie existing and potential investors, existing and potential lenders and existing and potential creditors). The total of the information needs identified is the set of common information needs the entity aims to meet.	The staff recommend that the revised Practice Statement cross-refers to this guidance on identifying the primary users' common information needs (see paragraph 39 of this Agenda Paper).
Impact of publicly available information (paragraphs 24–26)	The financial statements are required to be a comprehensive document. Consequently, the entity assesses whether information is material to the financial statements, regardless of whether such information is also publicly available from another source.	The staff's discussions with the Board's consultative groups suggest that there is preference for management commentary to be comprehensive as well, so it should include all information needed to achieve the objective of management commentary. (For example, an entity's management commentary should provide information about the entity's business model even if such information is already provided on the entity's website). However, management commentary is intended to provide context for financial statements, so there is no need to duplicate information already included in the entity's financial statements unless this information is necessary to meet the objective of management commentary. The staff plan to discuss how to avoid duplication and use cross-referencing in management commentary in a future Board paper.
Interaction with local laws and regulations (paragraphs 27–28)	Local laws and regulations may specify requirements that affect what information is provided in the financial statements. In such circumstances, providing information to meet local legal or regulatory requirements is permitted by IFRS Standards, even if that information is not material according to the materiality requirements in the Standards. However, such information must not obscure information that is material according to IFRS Standards.	As noted in May 2019 Agenda Paper 15, many national or supranational requirements for preparing management commentary have been issued since the Materiality Practice Statement was issued. The staff envisage that the revised Practice Statement could provide a basis for preparing management commentaries that meet jurisdictional requirements. Therefore, to avoid any inconsistencies with the local laws and regulations, the revised Practice Statement should include a statement—similar to the statement in paragraph 28 of the Materiality Practice Statement—that providing information to meet local or regulatory requirements is not

Section of the Materiality Practice Statement	Overview of the guidance	Staff comments on how the guidance applies in preparing management commentary[11]
		prohibited, even if that information is not assessed as material as a result of applying the materiality process, if such information does not obscure information that is material for the management commentary. However, it would also be helpful to emphasise in the revised Practice Statement that providing information to meet local or regulatory requirements is not sufficient to ensure that the objective of management commentary is met. Management would need to consider whether additional information is needed to meet the objective.
Overview of the materiality process and a four-step materiality process (paragraphs 29–65)	Discussed in paragraphs 24–55 of this Agenda Paper.	Discussed in paragraphs 24–55 of this Agenda Paper.
Specific topics		
Prior-period information (paragraphs 66–71)	An entity makes materiality judgements on the complete set of financial statements, including prior-period information provided in the financial statements. IFRS Standards require an entity to present information in respect of the preceding period for all amounts reported in the current-period financial statements. Assessing whether prior-period information is material to the current-period financial statements might lead an entity to provide more or less prior-period information than was provided in the prior-period financial statements.	The staff think that this guidance is appropriate in preparing management commentary but do not intend to include specific guidance on prior-period information in the guidance in the revised Practice Statement on making materiality judgements.
Errors (paragraphs 72–80)	IFRS Standards require entities to correct all material errors, as well as any immaterial errors made intentionally	In a future Board paper, the staff plan to discuss guidance on freedom from error (one of the components of faithful representation). The staff believe that explaining freedom from error in the revised Practice Statement would

Section of the Materiality Practice Statement	Overview of the guidance	Staff comments on how the guidance applies in preparing management commentary[11]
	to achieve a particular presentation of the entity's financial position, financial performance or cash flows. An entity assesses whether an error is material by applying the same considerations as outlined in the description of the materiality process.	be sufficient to highlight that management commentary should have no material errors.
Information about covenants (paragraphs 81–83)	In assessing the materiality of information about the existence and terms of a covenant, or of a covenant breach, an entity considers both the consequences of a breach occurring and the likelihood of a covenant breach occurring.	The staff recommend considering the likelihood of occurring for a wider population of matters, not just for covenants (see paragraph 50 of this Agenda Paper).
Materiality judgements for interim reporting (paragraph 84)	For its interim financial report, the entity considers the same materiality factors as in its annual assessment. However, it takes into consideration that the time period covered and the purpose of the interim report differ from those of the annual financial statements.	Management commentary is normally provided annually, so the staff think that there is no need for management to refer to this guidance in preparing management commentary.

Appendix C—Overview of the input on materiality and narrative coherence received from the Board's consultative groups

The staff discussed their proposals for guidance on materiality and narrative coherence with the Management Commentary Consultative Group (MCCG), Accounting Standards Advisory Forum (ASAF), Capital Markets Advisory Committee (CMAC) and Global Preparers Forum (GPF).

Staff's proposals discussed with consultative groups	Feedback	Staff's response
Develop guidance on making materiality judgements in preparing management commentary. The guidance would be based on: • the *Conceptual Framework for Financial Reporting* (*Conceptual Framework*); and • IFRS Practice Statement 2 *Making Materiality Judgements* (Materiality Practice Statement).	In general, the consultative groups agreed that the *Conceptual Framework* and the Materiality Practice Statement should be the basis for developing guidance on making materiality judgements in preparing management commentary. Some members asked the Board to provide examples and supplemental guidance applicable to management commentary to avoid management commentaries of excessive volume.	The staff have developed recommendations for guidance on making materiality judgements using the Materiality Practice Statement as a starting point. The staff also recommend providing additional guidance where it is necessary because the nature of management commentary differs from the nature of financial statements (see paragraphs 21–22 of this Agenda Paper).
	Some GPF members asked for more guidance on qualitative considerations in making materiality judgements due to the narrative nature of management commentary.	The Materiality Practice Statement provides guidance on considering qualitative factors in making materiality judgements in preparing financial statements. The staff think that this guidance can help preparers make materiality judgements in preparing management commentary so the staff recommend including in the revised Practice Statement cross-reference to this guidance.
	A few MCCG members emphasised that guidance was needed on materiality considerations for forward-looking information.	Because management commentary provides more information on uncertain future matters than financial statements, the staff recommend explaining in the revised Practice Statement that in assessing whether information is material, management should consider not only the size of the impact of a matter but also the likelihood of a matter crystallising (see paragraphs 50–51 of this Agenda Paper).

Staff's proposals discussed with consultative groups	Feedback	Staff's response
	Some MCCG members recommended avoiding the use of 'significant' as it could cause confusion with 'material' and translation issues.	The guidance proposed in this paper was updated to avoid the use of 'significant'.
Emphasise that materiality judgments should be made to provide information needed for users' assessments of: the prospects for future net cash inflows to the entity and of management's stewardship of the entity's economic resources.	A few ASAF members expressed concern about identifying material information by reference to cash flows because they felt that this approach could: • be understood as requiring the use of discounted cash flow methodology; and • result in omitting from management commentary issues which are not material today (and therefore would lead to information with a short-term focus).	The staff propose to retain the link to future cash flows in the guidance on identifying potentially material information. The link to users' assessments of future net cash inflows remains necessary to focus on the information needs of the primary users. That link is intended to be forward looking and capture cash flows over short, medium and long terms. In a future paper, the staff plan to address the perception that the link to cash flows can lead to a short-term focus, and to explain the link between cash flows and 'value creation' which was suggested by some MCCG participants as a more effective way to promote a long-term view.
Explain the need for a coherent narrative of significant matters affecting the business across the content elements of a management commentary (referred to as the 'linkage approach'). This proposed approach was intended to promote completeness of management commentary so that primary users are not left with unanswered questions.	MCCG and ASAF members generally agreed with the notion of narrative coherence to promote coherence throughout the 'story' presented in the management commentary. Some MCCG members suggested that the guidance on narrative coherence would fit better in the guidance on materiality. Some MCCG members and a few ASAF members suggested that clearer terminology may be needed in the revised guidance, as coherence could be interpreted to only mean understandability or it could be associated with comparability or consistency (within management commentary and with the financial statements).	The staff have further developed their recommendations on narrative coherence. To emphasise that the notion of narrative coherence is intended to be broader than just a way to present information and that it can also help identify what information to include in management commentary, the staff recommend explaining the notion of narrative coherence in the guidance on identifying potentially material information (see paragraphs 43–47 of this Agenda Paper). However, the staff also recommend emphasising in the revised Practice Statement that highlighting in management commentary the links between different pieces of information about a matter would contribute to narrative coherence and help the

Staff's proposals discussed with consultative groups	Feedback	Staff's response
		primary users understand the impact of the matter (see paragraph 46 of this Agenda Paper).
To help management assess the completeness of information included in management commentary, the guidance should suggest that management considers: (a) information used to manage the business, including: (i) internal reporting; and (ii) information on internal and external factors, including from engagement with stakeholders. (b) users' information needs, taking into consideration the entity's capital market communications.	A few MCCG members thought there was an overlap between the guidance on narrative coherence in relation to completeness and that for materiality, and suggested that some parts of the discussion would fit better in the guidance on materiality.	The staff have moved the explanation of sources to guidance on identifying potentially relevant information. This is because the staff consider that considering these sources can be a practical tool to help management identify matters that may need to be included in management commentary (see paragraphs 41–42 of this Agenda Paper).
	Some members of MCCG suggested that matters discussed by an entity's board should be discussed in management commentary. However, some GPF members disagreed with this saying, that sosme matters discussed by a board may not be suitable for disclosure in management commentary.	The staff's proposed guidance suggests that management needs to consider whether information discussed with an entity's board should be included in management commentary, but does not require including in management commentary all information discussed with the board.
	A GPF member expressed concern that the suggested guidance included reviewing internal metrics as a way to identify information to include in management commentary and to test whether a management commentary is complete.	The staff's draft guidance refers to internal information (including internally reported metrics) as a possible source for identifying information to include in management commentary. The guidance does not prescribe that such metrics are always included in management commentary.