Meeting notes—Management Commentary Consultative Group

The Management Commentary Consultative Group (Consultative Group) held its second meeting on 11 January 2019 at the London office of the IFRS Foundation.

Recordings of meeting discussions, the agenda and related papers are available on the meeting page. For more information on the Management Commentary project please refer to the project page, and details of the Consultative Group can be found here.

Members discussed the following topics in relation to performance, position and progress:

- overall approach to reporting performance, position and progress (paragraphs 1–9);
- analysis of the financial statements (paragraphs 10–29); and
- matters that could affect the entity's future development (paragraphs 30–41).

Overall approach to reporting performance, position and progress

1. The staff provided an overview of their proposed approach to reporting performance, position and progress in management commentary and explained how, in developing the papers for the meeting, the staff had considered the feedback received at the September 2018 Consultative Group meeting on the objective of management commentary, materiality and principles for preparing management commentary. The staff also explained how the approach to reporting performance, position and progress interacts with reporting on business model, strategy and operating environment, including external trends and principal risks, that will be discussed at the next Consultative Group meeting.

2. Overall, members agreed that the staff had correctly identified the challenges in the area of reporting performance, position and progress that need to be addressed in revising IFRS Practice Statement 1 *Management Commentary* (Practice Statement). In addition, a few members commented on the need to address conciseness of management commentary and made suggestions on how conciseness could be improved, for example by using cross-referencing. A few members suggested that the revised Practice Statement should also emphasise the need for management commentary to address intangible assets which are not recognised in the entity's financial statements. A few members stated that the lack of comparability between entities is also a challenge that should be considered in revising the Practice Statement and suggested how comparability could be enhanced.

3. Some members raised questions about the interaction between developing management commentary to reflect what the management considers important (or 'through the eyes of management') and developing it to meet users' information needs. Some members suggested it may be challenging for management to identify what information is useful for users and some suggested that the Practice Statement may need to include prompts to help management identify the information, such as referring to what they were reporting to the entity's board, assessing what

other companies were reporting and whether they should also be reporting that information, and engaging in dialogue with their users. Some members commented on whether users of financial reports sometimes ask for more information than is necessary for their analysis and why they ask for that information. Some members explained that users may request more information to be able to determine whether they need it, as they do not have the same insights that management has.

4. Members discussed whether the ‘through the eyes of management’ approach to preparing management commentary is consistent with the principle of neutrality. Some of them argued that management would be biased and selective in what they include in management commentary and management commentary cannot be neutral. Others argued that management commentary can and must be neutral. Some suggested that the words ‘balance’ or ‘objectivity’ may be better ways of describing the idea of neutrality in the context of management commentary. Some members suggested ways of supporting neutrality in management commentary, for example, by distinguishing facts from opinions or by giving information appropriate prominence. A few members commented on whether management commentary should be ‘owned’ by management or by the entity’s board and suggested that a link to the board could support neutrality and balance in management commentary.

5. Members discussed the application to reporting performance, position and progress of the other principles discussed in the previous Consultative Group meeting:

    a. verifiability and auditability—a few members noted that different jurisdictions have different legislation and requirements on management commentary reporting and on audit or other forms of assurance over management commentary. They suggested that in revising the Practice Statement, the International Accounting Standards Board (the Board) should consider the position of management commentary within the overall reporting package. One member expressed the view that information in management commentary, for example, production figures or predictive information may be less verifiable than information provided in financial statements. Other members stated that verifiability of information in management commentary was important, in particular from the assurance point of view, and suggested ways of supporting verifiability, for example, by providing information on how figures were calculated, explaining any uncertainties that exist or discussing the governance and approvals over the management commentary.
    b. completeness—some members expressed the view that completeness can be easily understood for financial statements but may be more difficult to apply to management commentary. This is because financial statements are made up of defined elements, but this is not the case for management commentary. A suggestion was that for management commentary the notion of narrative coherence may be more important than completeness. One member noted the interaction between the principle of

completeness and identifying information that is relevant for users, but suggested that relevance should be highlighted as a separate principle.

c. comparability—some members suggested that management should explain calculation of measures included in management commentary. They noted that measures with the same label, such as Return on Capital Employed (ROCE) are often calculated differently among entities, even within the same industry. Another member suggested that although prescription in the revised Practice Statement is not desirable and there may be tension between enhancing comparability and providing management's view on performance and prospects, management should explain why they have chosen to present a measure.

d. assumed level of knowledge—a few members suggested that in revising the Practice Statement the Board should clarify the assumed level of knowledge of users of management commentary and whether it is the same as, or lower than, the level of knowledge that the primary users of financial reports defined in the *Conceptual Framework for Financial Reporting* are assumed to have. One member commented that various users may have different levels of knowledge, for example, institutional investors and retail investors.

6. A few members suggested other principles that should be applied in preparing management commentary, including understandability, accuracy and conciseness.

7. Some members agreed with the staff's proposal that it was not necessary to discuss the application of all principles in the Practice Statement's discussion of every content element. However, one member suggested that the revised Practice Statement would be more helpful if it explained how principles for preparing management commentary specifically applied to performance reporting.

8. Members discussed filing requirements for financial statements and management commentary and whether they are viewed as a single reporting package or as separate reports. Some suggested this may affect, for example, what information is included in management commentary and what information is provided only by cross-reference to financial statements. One member noted that in their jurisdiction, management commentaries are filed separately from financial statements, but acknowledged they are generally prepared together. Another member suggested that the Board should be clear that the term 'financial statements' refers to primary financial statements and notes as a whole, not just to primary financial statements. Some members expressed the view that information in management commentary should not duplicate what is already included in the notes to the financial statements. One member suggested emphasising the role of cross-references in avoiding duplication. A few members suggested that the aim of financial statements is to show *what* has happened, and management commentary should explain the management view on *why* those developments happened and their forward-looking implications. A few members also

emphasised it is important for management commentary to discuss items not recognised in the financial statements such as intangibles.

9. A few members commented on the interaction between management commentary and other reports and asked for clarification on whether cross-referencing to other reports is permitted. One member noted it can be challenging for users to reconcile management commentary to other information provided by management.

Analysis of the financial statements

Overview of the entity's performance and position

10. Members generally agreed that providing an overview of the entity's performance and position in management commentary would be helpful and that the revised Practice Statement should not be overly prescriptive on what such an overview should include and how it should be provided. One member questioned whether it is possible for the revised Practice Statement to require an overview but not require it to be provided as a separate section. Another member suggested that users need relevant information about the entity, such as adjusted performance measures, to be provided in such a way that it can be compared to information provided by other entities but the location of that information in management commentary is not critical. One member said that the complexity of the entity could influence whether an overview was necessary or not. A few members emphasised the need for an overview to be concise. One member suggested that if particular performance measures were included both in the overview and elsewhere in management commentary, this could unnecessarily expand management commentary. A few members suggested that the overview should be clearly linked to the entity's past strategy and future plans and outlook as well as to the entity's purpose, and not just explain current performance. One member emphasised it is important for an overview to provide balanced information.

11. Members discussed the treatment of adjusted performance measures (APMs), particularly their inclusion in the overview:
    a. members expressed varying views on the location of the reconciliations of APMs included in the overview to their unadjusted equivalents. One view was that it is generally preferable to have the reconciliations within the overview. Others argued that including reconciliations in the overview would unnecessarily expand it, so cross-referring to elsewhere in management commentary or the financial statements is preferable.
    b. one member suggested that explaining both why a particular APM is provided and why particular adjustments were made was as important as simply providing a reconciliation to unadjusted equivalents. However, the member did not suggest that such information should be provided within the overview.

c. with regard to prominence, one member expressed the view there were instances of undue prominence in the presentation of APMs in the overview. Another suggestion was that the revised Practice Statement should provide guidance on prominence of APMs in management commentary, especially because non-professional users may be affected by undue prominence in presenting such measures. A member suggested that the guidance and Q&A on APMs issued by the European Securities and Markets Authority (ESMA) could be referred to on the notion of prominence.

d. a few members said that there was too much emphasis on APMs in the proposed guidance and not enough consideration of other types of measures (eg 'non-financial' measures) which give context to and supplement financial performance measures, with one member suggesting that little guidance is currently available on such measures. The member also suggested that guidance on measures that address position, and not just performance, should also be provided in the revised Practice Statement.

e. a few members stated that the overview should include the measures reported to the governance body as well as those used to manage the business, and then explain why those measures have been chosen. However, one member argued that management of an established business should not need to explain every year why the performance measures have been chosen, but instead only explain changes to chosen measures.

Financial performance

12. When discussing items that may not be indicative of the entity's ability to generate cash flows in the future, a few members stated that changes in accounting policies and estimates are already addressed in the notes to the financial statements. In their view, to avoid duplication, that discussion should not be repeated in management commentary unless such changes had a pervasive effect on the entity's reported financial performance. That could be the case, for example, upon adoption of a new IFRS Standard. One member also noted that changes in accounting policies and changes in accounting estimates are different in nature and suggested that they should be treated differently in management commentary.

13. On explaining the effect on performance of changes to the structure of the reporting entity, some members expressed the view that it could be challenging to distinguish the effects of acquisitions from the entity's 'organic growth', and questioned whether it would be possible for the Board to develop guidance to address such a distinction. They commented that it could be possible to identify and explain cost synergies expected from an acquisition but it would be difficult to discuss revenue synergies since revenue is impacted by many different factors. However, one member stated that users generally need more commentary on the expected synergies than is currently provided.

14. A few members noted that items described as ‘non-recurring’ or ‘one-off’ are often reported for several years, and suggested that such the terms should not be used at all. One member also noted that currently there is a lack of symmetry in reporting positive and negative one-off items. One member expressed the view that if such items were reported, management commentary should discuss how often they occur.

15. Some members commented on information about transactions whose economic characteristics might not be inferred from the entity’s description of its business model. Some of them expressed the view that if such transactions were material enough to have affected performance and warrant explanations, then they should be included in the description of the business model. One member expressed the view that a description of the business model provided at a higher level of aggregation may not capture all types of transactions that could have affected current period performance. One member suggested that explaining the effect of such transactions on performance may be appropriate for significant transactions outside the strategy, eg sale of surplus assets.

16. In commenting on the methods of explaining the entity’s performance, one member suggested that the revised Practice Statement should not only provide examples of methods that could be used in management commentary but also require management commentary to provide the types of analysis that management uses internally, eg bridge analysis. One member cautioned against using the term ‘pro forma’ to refer to a method of explaining the effect on performance of changes to the structure of the reporting entity because the term is already used with a specific meaning in particular jurisdictions.

17. On management compensation, some members suggested more detail on management incentivisation in management commentary, not just explanation of the link between APMs and management compensation. It was suggested that where APMs are used as a basis for management compensation, a reconciliation between the APM and the equivalent unadjusted IFRS number should be included. One member suggested that the measures used to determine management performance are not just financial, and that the use of other such measures should also be explained in management commentary. The member also suggested that explanations of compensation should be expanded to cover other employees and cover incentivisation more broadly, eg for the entity’s sales force or research and development team. However, a few other members suggested that detailed discussion on management compensation could be better placed in a separate report such as a remuneration report. The staff noted that the discussion of compensation more broadly will be addressed in the discussion on strategy at the next Consultative Group meeting. Finally, one member suggested that APMs should be explained not only in terms of their impact on compensation, but also in terms of how they affect other contracts, eg debt covenants.

18. A comment raised was that the discussion of performance in management commentary should also address risks and opportunities and in particular those that materialised and affected performance in the reporting period.

19. A few other members emphasised it is important for the discussion of performance in management commentary to provide the context for information included in the financial statements, not duplicate it.

Operational performance

20. Members who commented on operational performance expressed the view that they expected the discussion to be broader than analysis of revenues and costs reported in the financial statements and a variance analysis. Instead, they expected to see a discussion of drivers of success and other factors affecting performance. Staff explained that these matters are discussed in the proposed guidance on matters that could affect the entity's future development. A member expressed support for the staff's proposal to link the discussion of operational performance to metrics used by management to monitor the business.

21. Members who commented on terminology expressed their concern about the use of the term 'operational' performance and questioned how it relates to the term 'operating' used in the Board's Primary Financial Statements project and the term 'non-financial' used in the existing Practice Statement and other narrative reporting frameworks, and suggested that terminology may need to be revisited.

Other aspects of performance and position

22. Some members expressed concern about reference to 'tax strategy' in the proposed guidance. One member noted that tax expense is a consequence of transactions rather than a matter of strategy. Others stated however that users are interested in understanding the entity's overall philosophy and risks related to taxes. Some members suggested that the heading 'tax expense' was not the right label and that the section on tax in management commentary could instead refer to 'tax planning' or 'tax commentary'. One member suggested that discussion of tax could be embedded in the discussion of business model and strategy and cover the risks related to taxes and the implications on the entity's business model and strategy. Another member agreed with that view and stated that a separate section on tax could become boilerplate instead of providing useful information.

23. Some members, notably users of financial statements, emphasised that information about tax was important to their analysis. They stated that tax is a significant expense which is in their view often underanalysed in the financial statements and that tax has significant effects on net present value. One member, a user of financial statements, stated that users need information about two-year and perpetuity effective tax rates as inputs for modelling. One member noted that information

about uncertain tax positions is also useful to users. Other members, notably preparers of financial statements, stated that tax is a volatile number that is often outside management control and that effective tax rates are difficult to predict, especially in a large company with complex multinational structure. One member stated that explaining the difference between nominal tax rate and effective tax rate is also challenging for preparers.

24. Members also commented on potential overlap with disclosures about tax in the notes to financial statements and suggested that management commentary should cover not only the 'what' but also the 'why'. A few members emphasised that information about tax in management commentary should not be intended to address public policy matters, but should provide useful information to investors.

25. Other suggestions included:
    a. information on cash outflows related to tax may be more useful to users than the discussion of tax strategy;
    b. it is difficult for users of financial statements to understand tax by the main jurisdictions in which a multinational entity operates;
    c. users need information about when deferred tax assets will unwind; and
    d. management commentary should cover other payments to government, not just income tax.

26. In discussing the staff's proposals on financing position and financing requirements, some members expressed the view that the idea of discussing viability in management commentary should not be dismissed and should be further considered at the next Consultative Group meeting, for example in the context of discussing risks. They said that it would be helpful to identify in management commentary the disruptive factors that could put the entity out of business. One member suggested that providing guidance on time frames for assessing viability could be useful and noted that in the United Kingdom, where the viability statement is required, entities often limit the discussion of viability to a three-year time horizon. One member expressed the view that providing a discussion of viability may be more necessary for some industries which depend on resources with a finite life, and therefore management need to explain their plans for when the resources' life is expected to end.

27. One member suggested that information about off-balance sheet commitments, contingent liabilities and dispute resolution should be included in management commentary. The member emphasised that discussion of commitments in management commentary should be broader than the discussion in the notes to the financial statements and include, for example, wage commitments. Another member suggested that the discussion of financing should provide information not only about the group as a whole but also about the parent entity, in particular if

there are restrictions on transferring cash out of subsidiaries. Another member emphasised the need for information about dividends.

28. In discussing the staff's proposals on investment activities, some members expressed support for those proposals but highlighted the need for information about capital allocation and reallocation decisions in management commentary and emphasised that discussion of investment activities in management commentary should be linked to strategy. One member stated that more clarity was needed in the staff's proposals on investment activities, in particular on how 'capital expenditure' and 'operating expenditure' terminology tallies with what is included in the financial statements.

29. One member expressed the view that management commentary should also include information about investments accounted for using the equity method. Users tend to have less insight into those parts of the business and they need to understand how the entity engages with its equity-accounted investees and how those investees are integrated in the entity's business. The member further suggested that management commentary should also discuss non-controlling interests and earn-out clauses.

Matters that could affect the entity's future development

30. Some members expressed the view that the staff's proposals for forward-looking information, particularly the discussion of forecasts and targets in management commentary, were not aspirational enough. They suggested that management commentary is a forward-looking document and that the revised Practice Statement should encourage including forecasts in management commentary. One member stated that the emphasis on the forward-looking role of management commentary in the staff's proposals is less than in the existing Practice Statement. The member noted that the existing Practice Statement requires an entity to discuss in management commentary relevant trends that the entity is aware of. One member highlighted that there is no need for a management commentary to look too far into the future or to provide quantitative analysis, but at least a narrative discussion of the foreseeable future, for example, in the context of strategy, is important. Members also emphasised the need for forward-looking information over various time frames, including short, medium and long terms.

31. Other members, notably preparers, expressed concerns about the legal implications in some jurisdictions of including forecast information in management commentary rather than in other reports issued by the entity. One member suggested there is a fine line between publishing a forecast and 'front-running' the results. However, another member, also a preparer, supported including forecasts in management commentary.

32. Some members were of the view that the revised Practice Statement should incentivise the provision of forecasts rather than requiring forecast information *only if* forecasts have already been

published by the entity. One member stated that users do not penalise entities if their forecasts or projections do not materialise. They stated that users are not only interested in how the entity performed relative to the forecast but seek to understand changes in the entity's performance over time and how the entity's performance compares to the market. They emphasised that users appreciate both qualitative and quantitative information and if quantitative information is not available the entity should at least provide qualitative information. Another member suggested that information about governance over preparing forecasts should also be provided. Other members expressed nervousness about publishing forecasts due to the danger of being perceived to front-run results and potential legal liabilities. Others suggested that the staff's proposal to include in management commentary forecasts already published by the entity may discourage entities from publishing forecasts.

33. A few members stated that there are different interpretations of terms such as 'forward-looking information', 'forecasts' and 'projections', the meanings of which vary by jurisdiction, and suggested that the revised Practice Statement should explain the intended meaning of those terms. One member suggested that even historical information can be seen as forward-looking and suggested that the term 'future-oriented information' may be more appropriate, while another suggested the term 'prospects' already used in the existing Practice Statement.

34. A few members questioned the use of the term 'critical' in 'critical features of the business model' and suggested that a different qualifier such as 'relevant' or 'material' could be more appropriate, if they implied the same notion. One member expressed a concern that the term 'critical' can be interpreted too narrowly due to the colloquial uses of that term, for example to refer to emergency situations. One member suggested that the Practice Statement should include guidance on how to identify material information for inclusion in management commentary to support its auditability.

35. One member suggested that the staff's proposals on reporting progress in managing the critical features of the business model need more structure and specificity. The member suggested leveraging the ideas in the International Integrated Reporting Framework. The member also stated that the staff's discussion of the distinction between measures addressing management *actions* and measures addressing the *effects* of those actions was unclear.

36. On scenario analysis, one member was of the view that if such analysis is used internally for managing the business, it should be included in the management commentary but in less detail. Another member highlighted the difference between scenario analysis used for budgetary purposes and that used for long-term planning. They also commented that if management is unable to quantify an outcome, they should not be silent but at least provide qualitative information on the issue.

37. Some members agreed that forecasts and scenario analysis reported in the management commentary should be based on assumptions consistent with those used in preparing financial

statements, eg for meeting the requirements of IAS 36 *Impairment of Assets*. One member, however, emphasised that the purpose and precision of forecasts prepared to meet the requirements IAS 36 may be quite different from those used for business planning purposes, but agreed that the underlying assumptions should be directionally consistent.

38. One member expressed the view that survey information is not useful for users for financial reports. Another member stated that such information is useful and that it must be linked to the entity's strategy. For example, if the entity's strategy is to provide excellent customer service, then information about customer satisfactions surveys is relevant for users.

39. One member stated that the Board should consider providing an exemption in the revised Practice Statement from including in management commentary commercially sensitive information in certain circumstances and stated that such an exemption is provided in some jurisdictions' legislation.

40. One member stated that there is an overlap between explaining the matters that affect the entity's current performance and matters that affect the entity's future development and that both need to be linked to the entity's strategy. That member suggested that focussing analysis and discussion on the business model and strategy could be a more appropriate approach than making a distinction between current performance and future development.

41. A few members commented on the staff's proposals on matters arising after the end of the reporting period and questioned how they relate to the requirements in IAS 10 *Events after the Reporting Period*. They said they would expect the period reviewed to be the same as for the financial statements.