

STAFF PAPER

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Project	Management Commentary		
Paper topic	Overview of the staff's approach to revision		
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Purpose of this paper

1. In November 2017, the Board added a project to its agenda to revise IFRS Practice Statement 1 *Management Commentary* issued in 2010 (Practice Statement). This project is one of the Board's Better Communication in Financial Reporting projects. These projects are designed to make financial information more useful and improve the way financial information is communicated to users of financial reporting. In making the decision to revise the Practice Statement, the Board noted that:
 - (a) its mission focuses on enhancing the international comparability and quality of information in *financial* reporting and concentrates on information needs of primary users of financial reports.¹ The *Conceptual Framework for Financial Reporting (Conceptual Framework)* defines those users as existing and potential investors, lenders and other creditors.
 - (b) in undertaking the project, the Board will focus on the role of management commentary as part of 'broader financial reporting', alongside financial statements prepared applying IFRS Standards (see paragraphs 4–7 explaining the meaning of 'broader financial reporting' and how it relates to other forms of reporting). The role of management commentary is to

¹ See the mission of the IFRS Foundation on <https://www.ifrs.org/about-us/who-we-are/>.

provide context for financial statements and additional insights into an entity's long-term prospects.

2. This paper provides an overview of the staff's approach to the revision of the guidance on management commentary in the Practice Statement. The paper is for information and does not ask the Board to make a decision. However, the staff would welcome any comments the Board may have on the proposed approach.

Structure of this paper

3. This paper:
 - (a) provides a reminder of how management commentary relates to other forms of reporting (paragraphs 4–7);
 - (b) describes the background to revision (paragraphs 8–16);
 - (c) provides an overview of the staff's approach to revision:
 - (i) discusses the starting point and considerations in developing proposals (paragraphs 17–18); and
 - (ii) explains the focus on principles supported by guidance (paragraphs 19–31); and
 - (d) sets out next steps (paragraph 32).

Management commentary in relation to other forms of reporting

4. As noted in paragraph 1(b), in revising the Practice Statement, the Board will focus on the role of management commentary as part of 'broader financial reporting'. The term 'broader financial reporting' is used in this project to emphasise that management commentary is part of general purpose *financial* reporting but its scope is broader than that of financial statements. Broader financial reporting focuses on the information needs of primary users, but unlike financial statements it is not limited to providing useful information about the reporting entity's assets, liabilities, equity, income and expenses.² It also provides information about matters that could affect the entity's

² Paragraph 3.2 of the *Conceptual Framework* states that the objective of financial statements is to provide

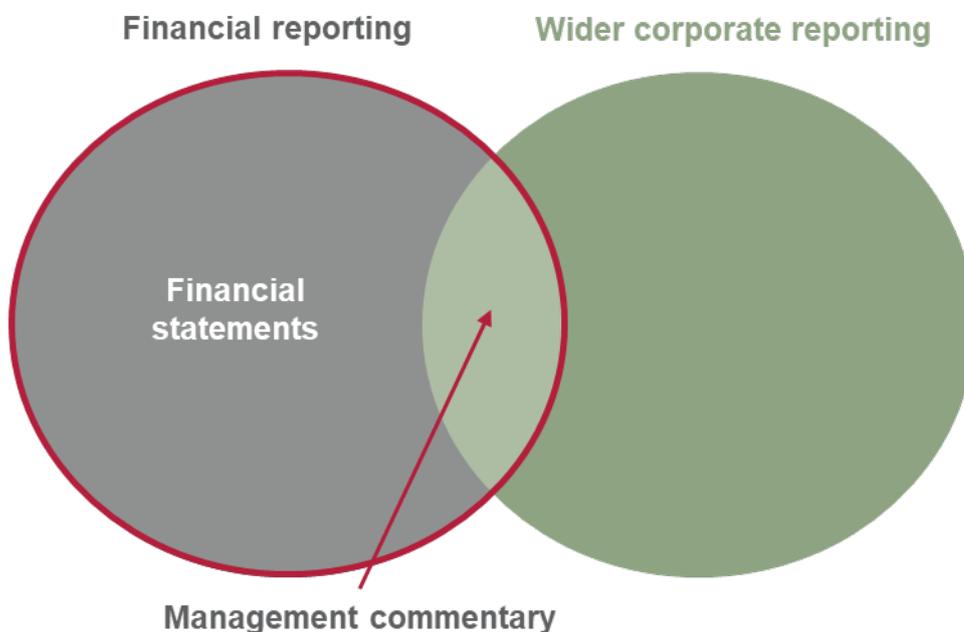
assets, liabilities, equity, income and expenses in the future. In the staff's view broader financial reporting includes, for example:

- (a) information about the reporting entity's business model, strategy, risks and operating environment that helps explain the entity's current financial performance and financial position as reported in financial statements and provide insight into the entity's long-term prospects.
 - (b) information that is not captured in financial statements but could ultimately affect the entity's financial performance, financial position and cash flows, such as information about intangible resources and relationships not recognised in financial statements or information about environmental matters important for the entity's long-term success. This information is sometimes referred to as 'non-financial information' or 'pre-financial information'. In materials developed so far, the staff have used the term 'operational information' to refer to this type of information but will consider whether it is the best label to use.
 - (c) non-financial performance metrics.
 - (d) forward-looking information such as forecasts and targets.
5. In this project, the Board has also discussed the interaction between management commentary and 'wider corporate reporting'.³ The staff have used the term 'wider corporate reporting' to refer to any reporting by entities outside the financial statements. Wider corporate reporting encompasses reports prepared for a wide range of objectives, including reports that focus on the contribution of entities to society at large and are therefore intended for a much broader range of stakeholders than the primary users of financial reports. That wider corporate reporting includes, for example, sustainability reporting, provision of other environmental, social and governance (ESG) information and public policy reporting.

financial information about the reporting entity's assets, liabilities, equity, income and expenses that is useful to users of financial statements in assessing the prospects for future net cash inflows to the reporting entity and in assessing management's stewardship of the entity's economic resources.

³ See November 2017 [Agenda Paper 28A Agenda proposal to revise and update the Management Commentary Practice Statement](#) and March 2017 [Agenda Paper 28A An initial survey of the landscape and implications for the Board](#).

6. Some information provided by wider corporate reporting may be useful to primary users of financial reports and some financial reporting information may be useful to users of wider corporate reports, so there is an overlap between financial reporting and wider corporate reporting. Management commentary is a form of financial reporting⁴ that sits within the overlap between financial reporting and wider corporate reporting. The staff expect that the revised guidance on management commentary will emphasise that information covered by wider corporate reporting, for example ESG information, needs to be included in management commentary only to the extent necessary to meet information needs of primary users of management commentary.
7. The diagram below shows how different forms of reporting relate to each other.



Background to revision

8. The Board issued the Practice Statement in December 2010 as a broad, non-binding framework for the presentation of management commentary that relates to financial statements that have been prepared in accordance with IFRS Standards. It describes management commentary as a narrative report that provides a context within which to interpret an entity's financial position, financial performance and cash flows.⁵

⁴ See paragraph IN4 of the Practice Statement.

⁵ See paragraphs IN1 and IN3 of the Practice Statement.

9. Many developments in wider corporate reporting have taken place since the Practice Statement was issued:
- (a) many national or supranational requirements for preparing management commentary or a similar report have been issued, for example, Directive 2014/95/EU of the European Parliament and of the Council on disclosure of non-financial and diversity information by certain large undertakings and groups. The level of guidance provided to support those requirements varies. For example, some may require an entity to describe its business model but not specify what the description should cover.
 - (b) innovative narrative reporting initiatives have been developed both nationally and internationally, for example, German Accounting Standard No. 20 *Group Management Report, Guidance on the Strategic Report* by the UK Financial Reporting Council and *International Integrated Reporting (<IR>) Framework* issued by the International Integrated Reporting Council (IIRC).
 - (c) specialised subject-matter or industry-specific frameworks have been developed by various organisations, for example, *Recommendations of the Task Force on Climate-related Financial Disclosures* by the Financial Stability Board Task Force on Climate-related Financial Disclosures (TCFD), *SASB Standards* by the Sustainability Accounting Standards Board (SASB), *GRI Sustainability Reporting Standards* by the Global Reporting Initiative and *Climate Change Reporting Framework* by the Climate Disclosure Standards Board.
 - (d) public policy reporting regulations have evolved, such as regulations on reporting on diversity, human rights, anti-corruption and bribery, and conflict minerals, and reporting initiatives relating to the Sustainable Development Goals set by the United Nations in 2015.
10. The developments in this evolving area of reporting have brought innovations, such as ‘value creation’ and similar concepts that emphasise longer-term aspects of performance, that may need to be reflected in the Practice Statement for it to be in

keeping with the needs of users and other members of the financial reporting community.

11. The developments have also created a complex and confusing reporting landscape. Preparers may be required to apply broadly specified national or supranational requirements but may not have enough guidance to help them prepare management commentaries or similar financial reports that meet those requirements. In addition, it may not be clear whether and how detailed subject-matter and industry-specific frameworks can be used in preparing management commentary or a similar financial report.
12. Management commentary reporting practice has also developed since the Practice Statement was issued. However, there are widely acknowledged gaps in narrative reporting practice,⁶ including:
 - (a) short-term focus in reporting. For example, in reporting their strategy entities often focus on the short term.
 - (b) lack of focus on matters that are important to the future of the business. For example, entities often provide only general descriptions of their business models and do not identify matters underpinning their long-term success.
 - (c) fragmented discussion that fails to ‘tell a story’. For example, entities often identify issues that affect their key resources but fail to provide the detail needed to help users understand implications of the issues for the entities’ prospects and understand the entities’ progress in managing the issues.
13. In addition, users increasingly need information that complements financial statements and provides an insight into an entity’s long-term prospects and into stewardship by management of resources that the entity depends on for its long-term success. Such information includes information on intangible resources and relationships not recognised in financial statements and ESG matters that could affect the entity’s long-term prospects.

⁶ The gaps in practice were confirmed in discussions of the Board’s Management Commentary Consultative Group in September 2018, January 2019 and April 2019 and the Capital Markets Advisory Committee in March 2019.

14. The revision of the Practice Statement is intended to promote preparation of management commentaries that better meet the information needs of the primary users of financial reports by providing guidance that:
 - (a) consolidates innovations in narrative reporting;
 - (b) addresses gaps in reporting practice; and
 - (c) remains principles-based but contains sufficient detail to support its rigorous application.

15. In the light of the gaps identified in reporting practice and the focus of users' needs discussed in paragraphs 12–13, in developing recommendations for revised guidance, the staff will give particular emphasis to:
 - (a) identifying and reporting matters that are specific to the circumstances of the entity;
 - (b) reporting matters that underpin the entity's long-term success, for example intangible resources or ESG matters that could affect the entity's long-term prospects; and
 - (c) encouraging a coherent discussion of matters identified (see paragraphs 29–30).

16. The staff envisage that the revised guidance could help management navigate the complex and confusing narrative reporting landscape. On the one hand, it could provide a basis for preparing management commentaries that meet broadly specified jurisdictional requirements. On the other hand, in the context of the revised guidance, management could be able to use detailed industry-specific or subject-matter-specific frameworks—for example those developed by the TCFD or SASB—to provide specific metrics or disclosures needed to meet the objective of management commentary.

Overview of the staff's approach to revision

Starting point and considerations in developing proposals

17. As discussed in November 2017 Agenda Paper 28A *Agenda proposal to revise and update the Management Commentary Practice Statement*, the Practice Statement has

influenced the development of other narrative reporting frameworks, for example, the <IR> Framework by the IIRC, German Accounting Standard No. 20 *Group Management Report* by the Accounting Standards Committee of Germany and *Guidance on the Strategic Report* by the UK Financial Reporting Council. The staff's work to date and discussions with stakeholders have shown that the Practice Statement covers all major topics that need to be discussed in management commentary, but in some aspects lacks detail and focus. Therefore, in developing recommendations for revising the guidance, the staff will use the Practice Statement as the starting point—filling in the gaps where it is incomplete, updating it to reflect innovations and clarifying it where it is unclear.

18. In addition, the staff will consider:
- (a) the following documents published by the Board after the publication of the Practice Statement:
 - (i) the *Conceptual Framework* revised in 2018, in particular, material on the objective of general purpose financial reporting and the qualitative characteristics of useful financial information; and
 - (ii) IFRS Practice Statement 2 *Making Materiality Judgements*.
 - (b) the findings of the staff's research into narrative reporting regulations and practice.
 - (c) input received from the Board's consultative groups:
 - (i) the Management Commentary Consultative Group (Consultative Group) established by the Board to support this project. The Consultative Group has met three times to discuss the staff's thinking on all main topics for the revised guidance (see paragraph 21). The staff provided oral updates about the key messages from these meetings at the Board's October 2018, February 2019 and April 2019 meetings. The staff will continue to seek input from the Consultative Group and plan a fourth meeting for December 2019.
 - (ii) other consultative groups—Accounting Standards Advisory Forum, Capital Markets Advisory Committee and Global Preparers Forum—on proposals for particular topics.

Focus on principles supported by guidance

19. In developing recommendations, the staff expect to retain the existing approach of providing guidance based on principles rather than prescribe a detailed list of requirements or industry-specific or subject-matter-specific disclosures or metrics. In developing guidance, the staff think the Board should not make assumptions about what is important to each entity's success. Information in management commentary should be specific to the entity, so setting out clear principles would enable entities to focus on the matters that are important in the particular circumstances of their business, including the legal and economic circumstances of individual jurisdictions.

20. However, the staff suggest expanding the guidance in the Practice Statement to help management identify information for inclusion in management commentary and determine how to report that information. This is likely to make the revised guidance longer, but the staff emphasise that this will not necessarily make management commentaries longer—what the staff intend to achieve is improving the focus of information included in management commentary to better meet information needs of primary users. The staff envisage the revised guidance as a practical tool that would support preparers in providing such information in management commentary. It would also provide a better basis for parties such as regulators and assurers in assessing whether an entity's management commentary meets its objective.

21. Based on our research to date and discussions with the Consultative Group, the staff expect to recommend that the Board provide additional guidance on:
 - (a) the objective of management commentary (paragraphs 22–24);
 - (b) considering qualitative characteristics of useful financial information in preparing management commentary (paragraph 25); and
 - (c) content elements of management commentary (paragraphs 26–30).

Objective of management commentary

22. In November 2018 the Board discussed how to clarify the objective of management commentary and what guidance to include to support the objective.

23. The staff recommended that the objective of management commentary should be to give context for the financial statements by providing primary users with historical financial and operational information and analysis that is useful in assessing the

prospects for the entity's future net cash inflows, and its management's stewardship of the entity's economic resources.

24. The Board did not formally vote at that meeting but agreed in broad terms with that objective, and with the staff's recommendations for guidance to support it. However, the Board asked the staff to consider whether it is possible to provide further clarity on:
- (a) the roles that historical information and forward-looking information play in management commentary; and
 - (b) the difference between the objective of management commentary and the objective of financial statements.

Qualitative characteristics of useful financial information

25. As discussed in paragraph 23, the objective of management commentary focuses on provision of useful financial information to primary users of financial reports. Thus, to be useful to the primary users, and because management commentary is a form of financial reporting, information in management commentary needs to possess the qualitative characteristics of useful financial information, as explained in the *Conceptual Framework*. At a future Board meeting, the staff plan to present recommendations for explaining how to consider the qualitative characteristics of useful financial information in preparing management commentary.

Content elements

26. The Practice Statement states that the particular focus of management commentary will depend on the facts and circumstances of the entity and identifies only the type of content ('content elements') that is expected to be included in management commentary.⁷
27. In the discussions with the Consultative Group, the staff proposed to retain this approach and suggested four content elements that need to be discussed in management commentary:
- (a) business model;

⁷ See paragraph 24 of the Practice Statement and paragraph BC47 of the Basis for Conclusions on the Practice Statement.

- (b) strategy;
 - (c) risks and operating environment; and
 - (d) performance, position and progress.
28. The Practice Statement already includes guidance on each of these topics but that guidance is organised into content elements in a different way. The staff discussed with the Consultative Group restructuring of the guidance on the content elements as set out in paragraph 27 and will present its analysis and recommendations in future Board papers on specific content elements. The staff also note that content elements are interrelated and therefore in management commentary they can be reported in different ways. The staff emphasise that the guidance on the content elements is intended as a basis for determining what to include in management commentary rather than how to structure it.
29. The Practice Statement provides only limited guidance on what information management should consider reporting for each content element. Therefore, the staff has discussed with the Consultative Group suggestions for additional guidance on each content element. The staff expect to recommend that the guidance should not prescribe which particular matters entities should report on. Instead, the guidance would be intended as a basis for helping an entity to identify and report matters that underpin the entity's long-term success. Although the staff are planning to discuss with the Board the guidance on each content element separately, that guidance will be intended to promote a narrative that is coherent throughout management commentary and provides a basis for management to:
- (a) set out what is important to the business over the long-term, including intangible resources and relationships and ESG matters;
 - (b) discuss how these matters can be affected by risks the entity faces and by its operating environment;
 - (c) explain the strategy for managing those matters; and
 - (d) discuss the entity's performance in the context of the entity's strategy, and its progress in implementing the strategy.

30. For example, suppose that an entity identifies that its business model is heavily reliant on a constant stream of innovation from its design team. The discussion of operating environment identifies the market shortage of design talent, and the consequent risk to the entity’s competitive advantage. The entity then needs to explain its strategy for developing and maintaining the right skill set in the face of market conditions, and report on its performance in retaining skilled design staff.

Format and style of guidance

31. Some members of the Consultative Group highlighted that management commentaries are often prepared by a wider group of people than only people involved in preparing financial statements and that some of those individuals may not be familiar with the principles and language used in IFRS Standards. Therefore, in developing the guidance, the staff will not assume knowledge of IFRS Standards and will consider how best to present the guidance in a user-friendly way, for example by including application guidance, illustrative examples, signposting, flowcharts or similar features.

Next steps

32. In discussing the project with the Board, the staff next plan to ask the Board to consider how the qualitative characteristics of useful financial information apply in preparing management commentary in the light of the objective of management commentary.

Question for the Board

Question

Do you have any comments or suggestions on the staff’s proposed approach to the revision?