

Management Commentary

Stream 2 *Performance, position and progress*

Slide deck 1 *Overall approach*

Consultative group meeting - 11 January 2019

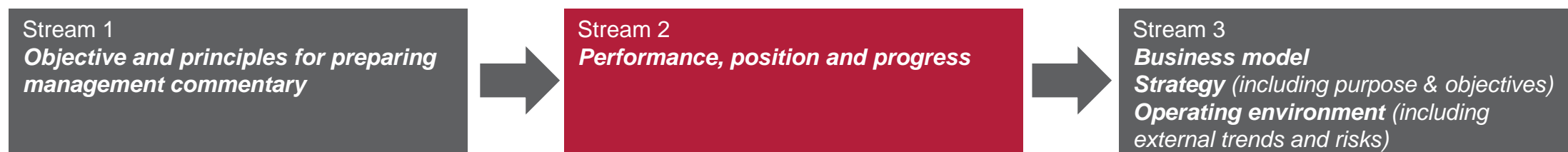
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Discussion approach and update (1/3)

The focus for Stream 2 *Performance, position and progress*

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Board discussion

We discuss revisions to the Practice Statement with the Board on an ongoing basis, reflecting our discussions with the Consultative Group and other stakeholders.

- This stream looks at reporting in the management commentary of the entity's performance, position and progress in delivering the entity's strategy and managing the matters that will drive the entity's future development and success.
- The entity's business model, strategy, and operating environment provide the basis for determining *which* matters need to be reported on – the staff plan to cover this in Stream 3. At this stage, the discussion focuses on *how* to report performance, position and progress in relation to those matters.
- Because the Practice Statement will remain principle-based, the staff do not expect that specific subject-matter disclosures will be required. The staff expect that the guidance in the revised Practice Statement will support the effective disclosure of all types of strategically relevant information about performance, position and progress in a manner that aligns with users' needs.

Discussion approach and update (2/3)

Feedback from discussing Stream 1

The summary of the Stream 1 discussion is available on the Management Commentary project webpage. However, the staff would like to highlight the points relevant to today's discussion:

- The discussion of *purpose* in the revised Practice Statement

The notion of '*purpose*' is integrated into the illustrative drafting of the objective of the management commentary (see Appendix A paragraph A3(c)). The staff expect that the notion of *purpose* will feature most prominently in discussing Stream 3, which will cover the entity's strategy in the context of its objectives and overall purpose.

In Stream 2, the staff propose including an explicit reference to *purpose* in discussing the progress in managing the key aspects of the entity's business model.

- The role of *forecast* information in the management commentary

The staff expect to retain the requirement that the management commentary should provide information to help users assess the entity's prospects for future net cash inflows. However, the staff noted the concern that the revised Practice Statement should not give the impression that management is required to include forecasts in management commentary to support that objective. The staff have clarified this in the illustrative drafting of the objective (see Appendix A paragraph A6).

In this stream, the staff will address situations where an entity has published a forecast (relating to either the current period or a future period).

- The importance of *verifiability* considerations

The staff noted the view that the management commentary should provide information that is (where possible) verifiable. The staff also note that verifiability is an enhancing characteristic of useful financial information discussed in the *Conceptual Framework for Financial Reporting (Conceptual Framework)*.

The staff think that management's estimates and interpretations can provide valuable insight for users, therefore should not be prohibited from inclusion in the management commentary. The staff think that *verifiability* can be supported by ensuring the management commentary clearly describes the sources and basis of such estimates and interpretations. In addition, the revised Practice Statement will specify that descriptions of fact and opinion must be clearly distinguished in management commentary.

Discussion approach and update (3/3)

Objective of the management commentary

Following our Stream 1 discussion with the Consultative Group, the staff discussed the *objective* of the management commentary with the Board, and provided illustrative drafting on the objective for the revised Practice Statement (see Appendix A). Key features of the objective that are important for today's discussion are summarised below:

- A focus on information useful in assessing:
 - the prospects for the entity's future net cash inflows; and
 - management's stewardship of the entity's economic resources.
- Coverage of matters from short to long term:
 - the trends and factors that arose in the current period;
 - the trends and factors that could affect future performance;
 - resources and relationships in the business model that are critical for success; and
 - opportunities and risks in relation to the above.
- Built around management's strategy:
 - set out the strategy for addressing the above matters;
 - describe the progress in implementing the strategy; and
 - provide information to help users assess the prospects for entity's future net cash inflows and assess management's stewardship of the entity's economic resources.

The staff would like to build on these features in today's discussion, recognising that more detailed guidance is required in order to apply them consistently to reporting performance, position and progress.

The emphasis is on provision of information relevant to users' assessments of the prospects for the entity's future net cash inflows and of stewardship, not on making predictions of future outcomes.

In summary, the key features of the existing Practice Statement on performance, position and progress are:

Scope of information

- Includes information on the entity's performance, position, and progress (§15) and complements the financial statements (§16).
- Includes information that is essential to an understanding of the results of operations and prospects; and the critical performance measures and indicators that management uses to evaluate the entity's performance against stated objectives (§24).
- Provides discussion and analysis of significant changes in financial position, liquidity and performance compared with those of the previous period or periods (§35).

Management's interpretation

- Provides management's view of the extent to which the entity's financial position, liquidity and performance may change in the future (§18), and management's assessment of prospects in light of current results.
- Includes a clear description of the entity's financial and non-financial performance, the extent to which that performance may be indicative of future performance and management's assessment of the entity's prospects (§34).

- Provides users of the financial reports with insight into the main trends and factors affecting the business, describing the relationship between the entity's results, management's objectives and management's strategies for achieving those objectives (§35).

Forward-looking information

- Communicates the entity's direction (§17) but does not predict the future.
- Includes forward-looking information when management is aware of trends, uncertainties or other factors that could affect the entity's liquidity, capital resources, revenues and the results of its operations (§18).
- May, but is not required to, include forecast information (§18). Explains performance in the context of past forecasts where disclosed (§19).

Other features

- Provides performance measures and indicators that will usually reflect the industry in which the entity operates (§38).
- When financial performance measures are derived or drawn from the financial statements, those measures should be reconciled to measures presented in the financial statements (§40).

In summary, the staff see three broad areas of challenge in relation to reporting performance, position and progress. The staff cover these in more detail in slide decks 2 and 3:

1. The scope and relevance of information being reported does not fully address users' needs. Specifically the staff note:
 - Failure to discuss aspects of performance that help users understand the long term prospects of the entity;
 - Incomplete picture of performance provided due to narrow scope of measures and analysis beyond financial performance; and
 - Limited relevance of operational measures included in management commentary.
2. Questionable verifiability and selective identification and discussion of measures in management commentary.
3. Reporting of measures on a basis that does not help users to make decisions, for example providing measures without comparatives.

The existing Practice Statement approaches the reporting of performance, position and progress at a relatively high level. The staff think further guidance is needed to help preparers meet the objective of management commentary. In many areas the staff expect to build on developments in other management commentary frameworks.

We do not think there is one single solution to each of these challenges. Instead, the staff aim to address them by proposing additional guidance for the Practice Statement.

During today's discussion, the staff would like you to bear these three challenges (and any other concerns you may have) in mind when commenting on the staff's proposals.

The staff's proposed approach – structure of guidance (1/2)

Structure of guidance for the revised Practice Statement

The staff propose the following structure for the guidance on reporting performance, position and progress in the revised Practice Statement:

1. Set out what the discussion of performance, position and progress needs to achieve.
2. Address the principles that have particular importance to the reporting of performance, position and progress, together with considerations that apply to providing particular types of information in a management commentary.
3. Address each component of the discussion of performance, position and progress, providing specific guidance on each, and covering analysis and explanations of:
 - i. the amounts included in the financial statements; and
 - ii. the matters that:
 - a. affected the entity's current period financial and operational performance and its position at the end of the current period;
 - b. could affect the future development of the entity's financial and operational performance; and
 - c. could affect the aspects of the entity's business model that the entity depends on for its future success.

Deck 2

Deck 3

The proposed approach is intended to provide a structure for determining what to include in the discussion of performance, position and progress, together with guidance that supports each component of discussion. The aim is to support the effective telling of the entity's complete performance story, rather than to prescribe a structure that should be followed in a published management commentary.

The components described in 3 (ii)(a)-(c) align with the discussion of the objective of management commentary in Stream 1. The staff recognise that some may question whether a particular matter falls into 3 (ii)(b) or 3 (ii)(c). The staff don't think this should be problematic for preparers, but would welcome your views on this.

The proposed structure of the revised Practice Statement is intended to take preparers through the different aspects of information about performance, position and progress that needs to be provided to support completeness and relevance of information in the management commentary. It is not intended to provide a structure for the management commentary. The staff's view is that preparers should have flexibility to structure the management commentary in the manner they consider to be most appropriate.

The staff's proposed approach – structure of guidance (2/2)

Illustrations

Explanations and analysis of performance, position and progress to be addressed in the management commentary

Explanations of the amounts included in the financial statements

provides a base from which users can distinguish the ongoing operation of the business model from other matters reflected in the financial statements

Matters that affected the entity's current period financial and operational performance and position

analysis of the factors affecting the operation of the business model that impacted on the current period financial statements

Matters that could affect the future development of financial and operational performance

insight into (but not prediction of) the potential impact of known matters and the progress in managing them

Matters that could affect the aspects of the business model that the entity depends on for its success

insight into progress in managing the resources and relationships the business depends on for its success

Covered in *slide deck 2*

Covered in *slide deck 3*

Illustrations:

Analysis of unusual / non-recurring items
Constant currency revenue trends; Pro forma
Financial impact of transactions whose characteristics might not be inferred from the entity's description of its business model

Maintenance / Growth capex

Operating variances
Like for like sales growth
Performance against past forecasts
Effective tax rate

Order book
Analysis of revenue drivers – e.g. customer retention
Explanation of published forecasts
Market share

Key staff retention
Customer satisfaction scores
Scenario analysis

The staff's proposed approach – narrative coherence (1/2)

The role of narrative coherence in reporting performance, position and progress

- In Stream 1, we discussed the notion of 'narrative coherence'. The staff expect this notion to form the basis for determining which matters to provide information on.
- We discussed the idea that:
 - Linkages exist where either:*
 - a) *information in one content element is needed to give insight into matters discussed in another element—for example, if product quality is a principal risk, a related KPI may be appropriate; or*
 - b) *information in one content element is needed as context to interpret matters discussed in another element—for example, if a strategic opportunity to grow a particular market is identified, the discussion of the business model may need to explain the characteristics of that market.*
- The notion is applicable to all content elements of the management commentary. Applied to the reporting of performance, position and progress:
 - (a) if the management commentary identifies a matter as important (an aspect of strategy, a feature of the business model, a principal risk etc,) then the entity should report its performance, position and progress in relation to that matter
 - (b) information about performance, position and progress should be supplemented by information about their implications.

The revised Practice Statement cannot prescribe what is strategically important to an entity, so the staff do not plan to prescribe specific requirements.

The staff are also mindful that if lists of example disclosures are included in the revised Practice Statement, they could be applied as a substitute for covering more relevant aspects of performance, position and progress.

Therefore, the aim in today's discussion is to support the provision of information about performance, position and progress that aligns with:

- (i) what the entity itself considers important; and
- (ii) users' information needs.

The staff's proposed approach – narrative coherence (2/2)

How today's Stream 2 discussion will fit with Stream 3 discussion

- In Stream 3, the staff plan to discuss the following content elements of a management commentary:
 - i. business model

The staff expect this discussion will address both the activities undertaken within the business and the resources and relationships on which the business depends.
 - ii. strategy

The staff expect this discussion will cover strategy in the context of the entity's overall purpose and the objectives that support the entity's purpose, addressing how the entity is responding to this, and the specific opportunities and risks that it faces.
 - iii. operating environment, including external trends and principal risks

The staff expect this discussion will cover the external trends affecting the entity (both positively and negatively) and the principal risks the entity faces from internal or external sources.
- The role of the management commentary in complementing the financial statements will also be an important consideration in today's discussions. The starting assumption is that the management commentary will be included in the same reporting package as the financial statements.

The definition, scope, and disclosure requirements over these aspects of content will be covered in our next stream.

Today's discussion will focus on how the entity reports performance, position and progress once it has identified matters about which information is required.

The staff's proposed approach – Application of principles discussed in Stream 1

In Stream 1, we discussed principles that apply to the management commentary as a whole. In general, the staff do not plan to duplicate the discussion of principles within the guidance on reporting performance, position and progress. However, the staff expect to do so where either (i) it is important to include a reminder that a particular principle needs to be considered; or (ii) there is a specific aspect of the principle that needs to be explained in the context of performance, position and progress.

Principle	Application to reporting performance, position and progress	How the staff expect to reflect this in revised Practice Statement
Materiality	All disclosures are made subject to materiality. The staff think that separating materiality considerations into 'matters' and 'information' should support a focused approach to materiality, but the staff do not think that needs repeating for this content element.	No specific guidance on materiality is proposed for reporting performance, position and progress. However, the staff expect to clarify the purpose of providing information about performance, position and progress in the revised Practice Statement to support materiality assessments.
Completeness	Throughout Stream 2, the staff build on the notion of narrative coherence to support completeness of information about performance, position and progress.	The staff expect to discuss the principle of narrative coherence in the guidance on the reporting performance, position and progress in the revised Practice Statement. In addition, the staff expect to cover in the revised Practice Statement how reporting performance, position and progress links to the entity's strategy, operating environment, and business model.
Neutrality	Specific neutrality considerations apply in relation to analysis of performance, position and progress. Accordingly, the staff think these need emphasising in this content element.	The staff expect the revised Practice Statement to provide specific guidance on applying neutrality in discussing adjusted performance measures and ratios.
Aggregation	The staff think providing information at the right level of aggregation is a particularly important consideration for reporting performance, position and progress, so the staff plan to emphasise this consideration in this content element.	The staff expect the revised Practice Statement to address aggregation in discussing reporting performance, position and progress.
Assumed knowledge	The assumption that the reader starts from a general level of business knowledge is relevant across the content elements of the management commentary – the staff have not identified specific considerations related to reporting performance, position and progress.	The staff do not expect to address in the revised Practice Statement assumed knowledge in discussing reporting performance, position and progress.
Comparability	The staff think the Practice Statement should emphasise the need for comparative information on performance, position and progress, in particular in relation to the entity's longer-term prospects.	The staff expect the revised Practice Statement to emphasise comparability considerations in reporting performance, position and progress, in particular in relation to the entity's longer-term prospects.
Verifiability	The staff think verifiability considerations are applicable in reporting performance measures.	As stated on slide 4, the staff expect the revised Practice Statement to require clear description of the sources and basis of management's estimates and interpretations, and to specify that descriptions of fact and opinion must be clearly distinguished in management commentary.

1. Do you agree with the main challenges related to reporting performance, position and progress identified by the staff on slide 7 that the revised Practice Statement should seek to address? Are there any other challenges that the staff need to consider?
2. Do you agree with the staff's overall proposed approach to:
 - a. the structure of the guidance on reporting performance, position and progress to be included in the revised Practice Statement (slides 8-9);
 - b. addressing narrative coherence in the context of reporting performance, position and progress (slide 10); and
 - c. application of principles for preparing management commentary to reporting performance, position and progress (slide 12)?
3. Do you have any other comments on the staff's overall proposed approach to reporting performance, position and progress?

Appendix A

Objective of the management commentary

Objective: Illustrative drafting discussed with the Board

A1 The objective of management commentary is to give context for the financial statements by providing primary users of the management commentary with the historical financial and operational information and analysis that is useful in assessing the prospects for the entity's future net cash inflows, and management's stewardship of the entity's economic resources.

A2 The primary users of management commentary are the same as the primary users of financial statements, that is existing and potential investors, lenders and other creditors, as defined in the *Conceptual Framework for Financial Reporting*.

A3 The management commentary addresses those matters that management considers could reasonably be expected to influence assessments by primary users of the amount, timing and uncertainty of (the prospects for) the entity's future net cash inflows, and their assessments of management's stewardship of economic resources, including:

- a. the trends and factors that affected the entity's financial and operational performance for the reporting period and its position at the end of the reporting period;
- b. the trends and factors that could affect the future development of the entity's financial and operational performance;
- c. the features of the entity's business model that it depends on for future success, including:
 - the tangible and intangible economic resources needed to achieve the entity's purpose and strategy, irrespective of whether it is appropriate to recognise them in the entity's financial statements;
 - the relationships that affect the entity's ability to achieve its purpose and strategy, together with the impact of the entity's activities on those relationships; and
- d. the opportunities and risks in relation to the matters identified in (a)-(c).

A4 To meet its objective, management commentary sets out management's strategy for the developing and sustaining of the entity's future net cash inflows in the context of the matters identified in paragraph A3, the entity's progress in implementing that strategy, and the potential implications for the entity's prospects of future net cash inflows.

A5. The decision on what information to include in management commentary takes account of the primary users' need to assess the uncertainty of the entity's net cash inflows, its ability to develop and sustain them in the long term, and management's stewardship of the entity's economic resources to support this.

A6. Although management commentary includes information that could reasonably be expected to be capable of influencing users' assessment of the prospects for the entity's future net cash inflows, compliance with the Practice Statement does not require management to prepare forecast or projected performance information for inclusion in the management commentary.

The Board met on 14 November 2018 to discuss the objective of management commentary and guidance supporting the objective.

The Board did not formally vote at this 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:

- the roles that historical information and forward-looking information play in management commentary; and
- the difference between the objective of management commentary and the objective of financial statements.

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