

Management Commentary

Joint CMAC-GPF meeting
June 2019

Matt Chapman
Yulia Feygina
Jelena Voilo

The views expressed in this presentation are those of the presenter, not necessarily those of the International Accounting Standards Board or IFRS Foundation.

Objective of the session

2

- The objective of the session is to get CMAC and GPF members' views on describing in management commentary:
 1. an entity's strategy (slides 8–13);
 2. its culture (slides 14–17); and
 3. its funding and liquidity (slides 18–21).
- Background information on the Management Commentary project is provided on slides 3–7). Further details can also be found at <https://www.ifrs.org/projects/work-plan/management-commentary/>

Background information on the Management Commentary project

What is management commentary?

4

- A narrative report that gives context for the financial statements and additional insight into the company's long-term prospects
- Sits within the boundaries of financial reporting and is aimed at primary users of financial reports—existing and potential investors, lenders and other creditors

Environmental, social and governance (ESG) matters—normally part of wider corporate reporting—are discussed in management commentary if necessary for primary users to make economic decisions



Why revise?

Developments in narrative reporting



Gaps in current reporting practice



Increasing need for additional information



Focus of revision

Meet primary users' information needs

Retain a principles-based approach but expand the guidance to:

- consolidate innovations
- address gaps in reporting
- support rigorous application

Particular emphasis on:

- company-specific matters
- intangibles and ESG matters
- matters that underpin long-term success
- coherent discussion linked to strategy

Intended to be compatible with jurisdictional requirements and subject-matter frameworks (eg TCFD, SASB)

Topics for revision

6

- The revision of the guidance on management commentary will cover:

Objective of management commentary, principles and cross-cutting issues

Content elements

Business model

Strategy

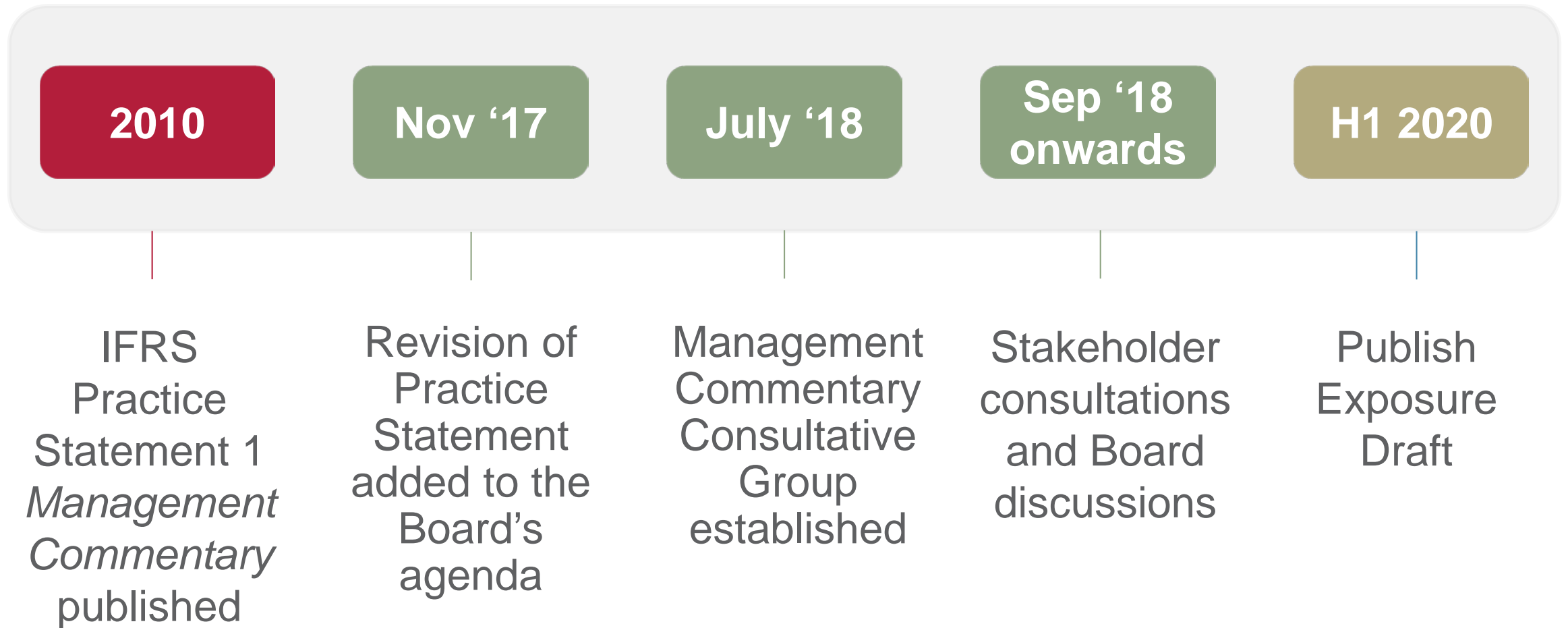
Operating environment
and risks

Performance, position
and progress

- The term ‘content element’ is used to refer to the *type of content that is expected to be included in management commentary*.** The revised guidance on content elements cannot prescribe what is important to the entity and is not intended to prescribe a rigid structure for management commentary. Instead, the goal is to provide a principles-based guidance that can be rigorously applied in the entity’s unique circumstances in determining what matters to address and what information about those matters to include in a management commentary.
- CMAC and GPF already discussed the objective of management commentary, principles for preparing it, particular cross-cutting issues (cross-referencing) and topics related to guidance on performance, position and progress. This session will focus on topics related to *strategy*.
- The input from CMAC and GPF members will be reported to the Board and considered by the staff in developing recommendations for the revised guidance on management commentary.

Timeline

7



Strategy

Question 1

Strategy

The staff propose a three-component description of strategy that is anchored in the entity's longer-term purpose, or mission, and explains how that purpose translates into the entity's medium-term objectives and shorter-term plans.

- **Users:** Do you think the proposed approach would promote provision of better information about an entity's strategy, in particular discussion of a longer-term view?
- **Preparers:** Would you be able to describe your entity's strategy based on the staff's proposed three-component approach and supporting guidance?

The following background information is provided to support the discussion:

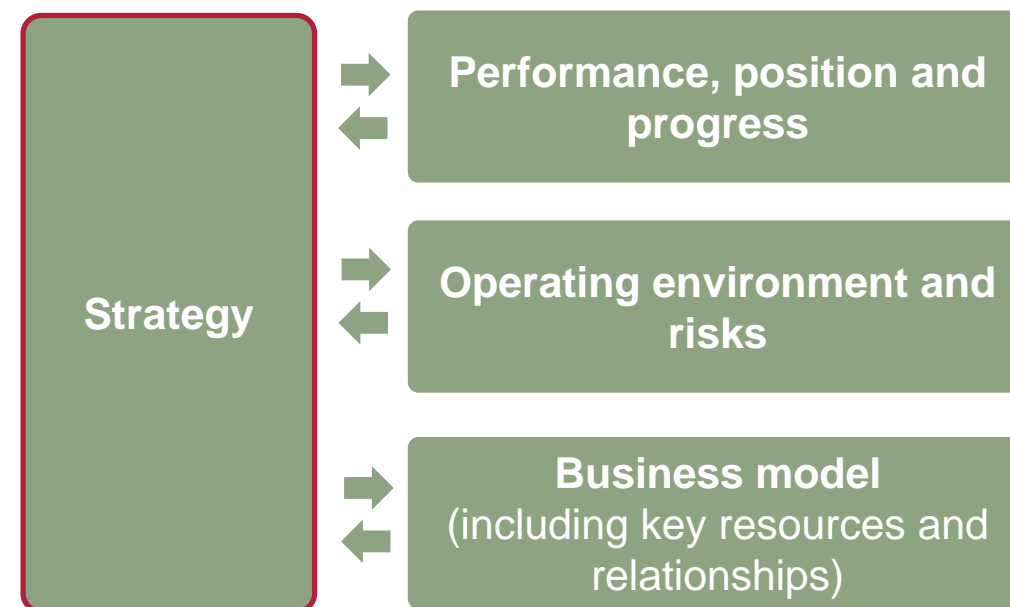
- Introduction to strategy content element
- The staff's proposed approach to strategy
- The staff's proposed guidance on strategy

Introduction to strategy content element

10

- The description of strategy in management commentary is important because it can provide primary users with insights into an entity's prospects for future net cash inflows and into management's stewardship.
- There is an important interaction between a description of strategy and other content elements in management commentary, for example:
 - management commentary is expected to focus on matters that are important to the entity's long-term success and discuss the strategy for monitoring and managing those matters in the context of the risks the entity faces and of its operating environment.
 - discussion of performance and performance measures should address financial and operational performance and explain progress in implementing the strategy.
 - discussion of management compensation should explain the link between compensation and the progress in implementing the strategy.

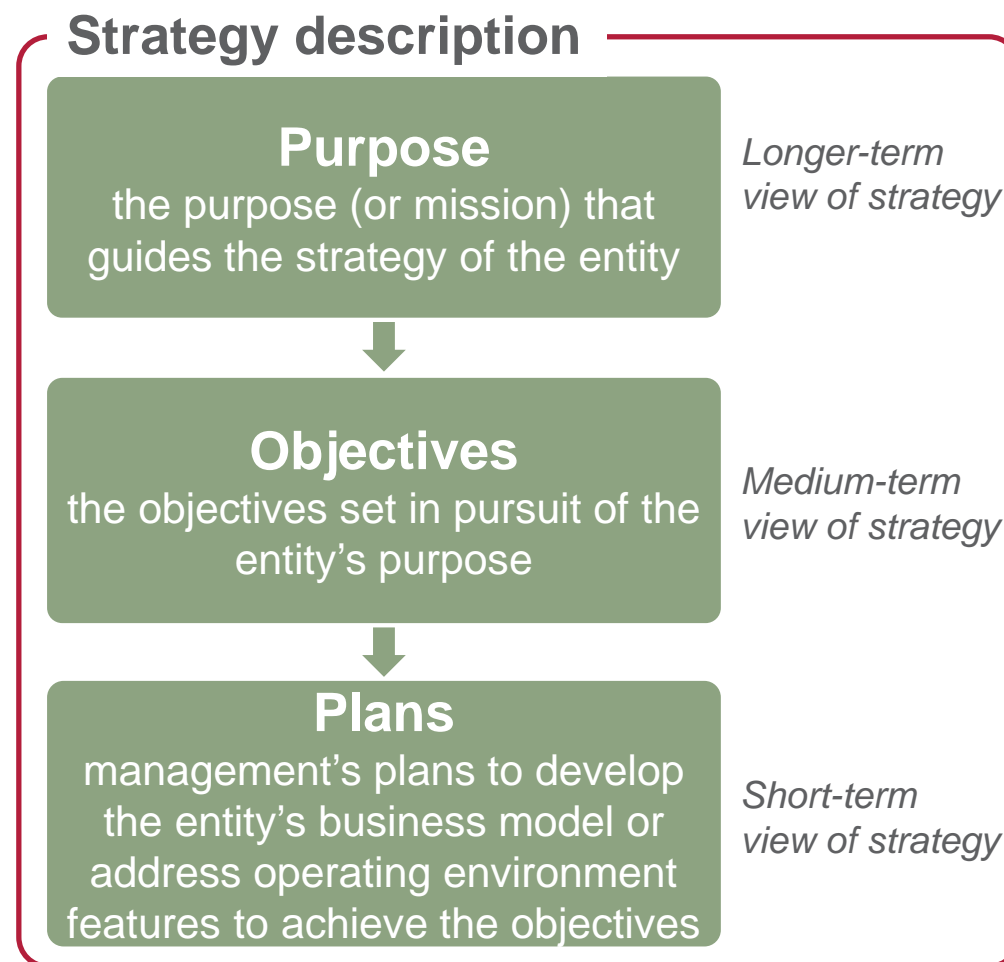
The description of strategy must interact with the other content in management commentary:



The staff's proposed approach to strategy

11

- Currently, management commentaries often focus on operational tactics and do not provide a longer-term view of the entity's strategy.
- The staff seek to promote a description of the entity's strategy that covers a range of time frames and provides insights into the entity's longer-term outlook.
- To achieve that, the staff propose a three-component description of strategy that is anchored in the entity's longer-term purpose, or mission, and explains how that purpose translates into the entity's medium-term objectives and shorter-term plans. For example, if the entity's purpose is to provide sustainable private transport, it might have an objective to halve its fleet emissions over five years, supported by plans to close its diesel engine plant. All these components of strategy would be expected to be described in management commentary with clear links of how they relate to each other.
- Slides 12-13 discuss the guidance proposed by the staff to support the proposed approach to strategy.



The staff's proposed guidance on strategy

12

Component	Staff's proposed guidance
1) Purpose	<ul style="list-style-type: none">• Anchor the strategy description around the entity's purpose that guides its strategy in order to support a longer-term perspective. <i>The entity's purpose can be described, for example, in terms of satisfying a market need or achieving a specified outcome for end-users.</i>
2) Objectives	<ul style="list-style-type: none">• Link discussion of objectives to the entity's purpose. Objectives can, for example, relate to the enhancement or maintenance of resources and relationships that the entity depends on for its future success. <i>For example, one of an entity's objectives may be maintaining a reputation for quality or building expertise in a new field.</i>• Link the description of objectives to other information in management commentary that helps users evaluate the entity's progress in achieving the objectives and potential implications of that progress for the prospects for future net cash inflows to the entity.• Indicate quantitative or qualitative milestones by which management intends to measure progress towards achieving an objective if that objective may take a number of years to achieve.

The staff's proposed guidance on strategy (cont'd)

13

Component	Staff's proposed guidance
3) Plans	<ul style="list-style-type: none">• Link the discussion of plans to the entity's objectives or to trends or factors in the operating environment the plan is intended to address.• Provide an overview of the features of the business model that are expected to be changed and the investment required to deliver the plan. Address positive and negative impacts on the entity's resources and relationships.• Link the description of plans to other information in management commentary that helps users evaluate the entity's progress in achieving the plans and potential implications of that progress for the prospects for the future net cash inflows to the entity.

Culture

Question 2

15

Culture

The staff have identified different views on providing information about culture in management commentary.

- **Users:** Is it important for you to get insights into an entity's culture? (yes/no)
 - If yes, should management commentary include a separate description of culture, or is it enough for insights into culture to be discernible from other content in management commentary?
- **Preparers:** Would you be able to describe your entity's culture based on the three components proposed by the staff (see slide 17)?

The following background information is provided to support the discussion:

- Views on culture in management commentary
- Potential components of culture description

Views on culture in management commentary

16

- An entity's culture relates to the values, attitudes and behaviours demonstrated in the entity's activities and relationships. Culture can be seen as an aspect of an entity's strategy or of its business model.
- There are different views on how culture should be reflected in management commentary:
 - some think there is **no need for an explicit requirement to describe culture** in management commentary because it may result in boilerplate disclosure or because culture descriptions fit better in an entity's governance disclosures;
 - some think that although there is no need for a separate description of culture, **insights into an entity's culture should be discernible from other content** in management commentary (see opposite what indicators could give meaningful insights into culture);
 - some think that **a separate description of culture in management commentary would provide useful information**, stating that even a boilerplate description may in itself have information value for users.

Indicators on culture identified by the UK FRC*

Good explanations of some features of the business model and key risks

Discussion of management actions which shows whether management means what it says

Reporting on human capital, employee engagement and retention, and investment in training

Remuneration practices, incentivisation structures, and whether management's focus is short or long-term

Compliance and health and safety indicators

Customer satisfaction

* In 2016, the UK Financial Reporting Council (FRC) published its report *Corporate Culture and the Role of Boards* which recognised that investors see 'a need for companies to improve reporting on culture and communicate openly about the impact of culture on the business'. The report discussed a number of indicators that could give meaningful insights into culture.

Potential components of culture description

17

- If a separate description of culture in management commentary were to be required, the staff think such a description could include three potential components, as listed opposite.
- Regardless of whether such a requirement is introduced, the staff highlight that the revised guidance on other areas of management commentary may result in insights into an entity's culture being provided. For example, the following discussion can provide such insights:
 - discussion of performance measures that relate to the entity's key relationships, such as measures of staff retention or satisfaction; or
 - description of how features of management compensation align with the entity's strategy.

- **Potential components of a description of culture:**

Description of the entity's culture

A healthcare provider might discuss how its focus on end-user satisfaction provides a competitive advantage and explain how its end-user incentive programme supports this focus

Discussion of how the entity's plans and objectives relate to its culture

A service provider that transitions to online-only service might discuss what steps it is undertaking to maintain its 'personalised service' culture

Discussion of operational performance metrics that provide insight into the entity's culture

A technology business might provide an analysis of its design-team staff retention or satisfaction

Description of funding and liquidity

Funding and liquidity

The staff propose that the description of funding and liquidity in management commentary should address both the entity's funding and liquidity position and strategy as summarised on slide 21.

- **Users:** Do you agree with the proposed scope of the description of funding and liquidity position and strategy?
- **Preparers:** Do you anticipate operational challenges with providing information as proposed on slide 21?
 - If so, how can they be alleviated?

The following background information is provided to support the discussion:

- Introduction to description of funding and liquidity
- The staff's proposals on funding and liquidity

Introduction to description of funding and liquidity

20

- The existing Practice Statement includes a high level requirement to provide discussion and analysis of significant changes in liquidity, but does not provide any further guidance on this topic:

35 ... In addition, management should provide discussion and analysis of significant changes in financial position, liquidity and performance compared with those of the previous period or periods, as this can help users to understand the extent to which past performance may be indicative of future performance

- The Investment Association's *Long Term Reporting Guidance* (May 2017)¹ emphasises the need for information on the entity's funding strategy:

34. Investors need to understand the approach taken by a company to fund its capital management strategy, the company's appetite for risk, and the potential opportunities for further investment.

35. To help achieve this, our members seek information regarding company's funding arrangements and the nature of funding...

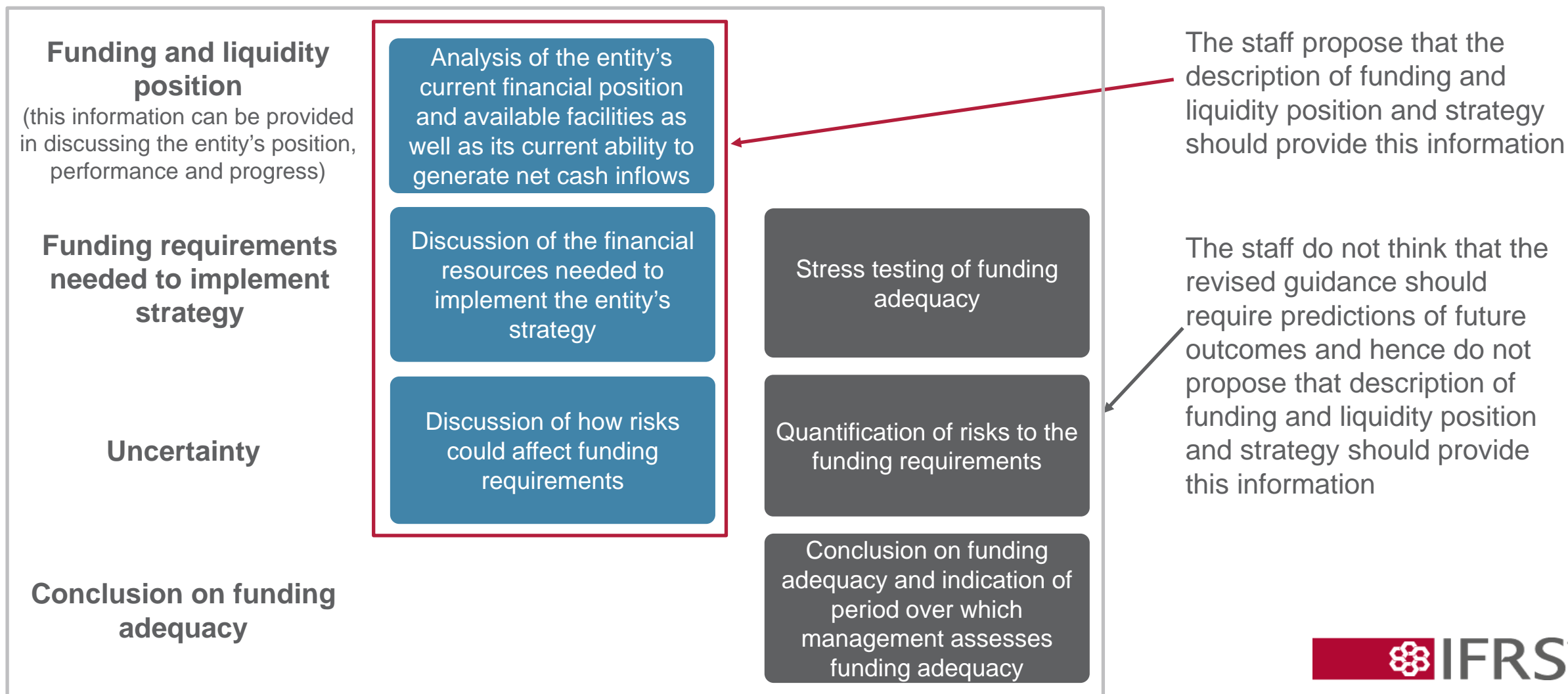
- The staff propose expanding the guidance on description of the entity's funding and liquidity to address the entity's funding and liquidity strategy (see slide 21).

1. [https://www.theinvestmentassociation.org/assets/files/press/2017/Long%20Term%20Reporting%20Guidance%20\(v1\).pdf](https://www.theinvestmentassociation.org/assets/files/press/2017/Long%20Term%20Reporting%20Guidance%20(v1).pdf)

The staff's proposals on funding and liquidity

21

Proposed scope of description of the entity's funding and liquidity position and strategy in management commentary:



Get involved

22

Find out more: www.ifrs.org

Follow us:



@IFRSFoundation



IFRS Foundation
International Accounting Standards Board



IFRS Foundation



IFRS Foundation

Join our team: go.ifrs.org/careers