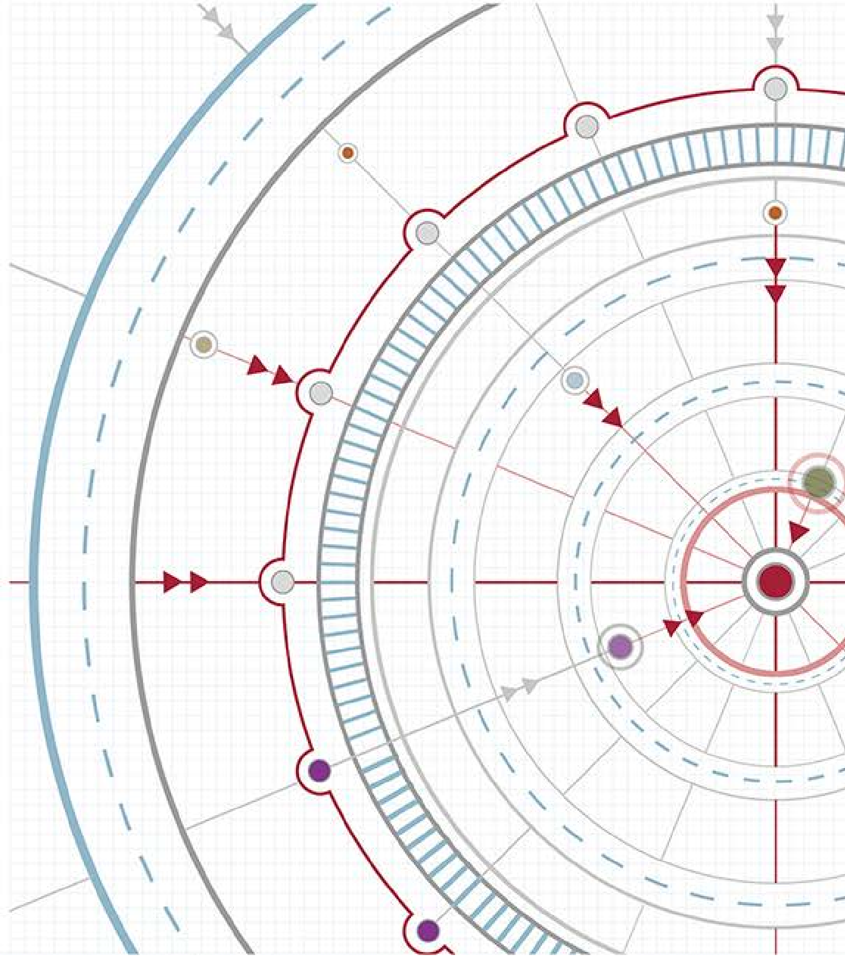
IFRS® Foundation



CMAC meeting, 21 March 2019

Agenda Paper 6

Management Commentary

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

Objective of the session

- To seek CMAC members' views on:

  1. Challenges with current practice on reporting performance and position in management commentary (slides 3–5)
  2. The interaction between management commentary and other reports (slides 6–11)
  3. Overview of performance and position (slides 12–15)
  4. Forward-looking information in management commentary (slides 16–19)
  5. Information about tax in management commentary (slides 20–23)

Note: Background information on the Management Commentary project can be found in Appendix A (slides 25–28). Further details can also be found at https://www.ifrs.org/projects/work-plan/management-commentary/

Challenges with current practice on reporting performance and position in management commentary

Challenges identified

Based on research, as well as feedback from the Management Commentary Consultative Group, the staff have identified the following challenges that users encounter when analysing performance and position as currently reported in management commentary**:**

Area	Challenge
Narrow focus of discussion	Focus tends to be on financial performance, with **limited information on operational performance**
	Focus tends to be on explaining current performance, with insufficient discussion of matters that would help users understand the entity's **long-term prospects**
	Insufficient discussion of **intangibles** that are not recognised in the financial statements
Measures included in management commentary	**Lack of neutrality** in the selection of measures included in management commentary – users often notice a **positive bias** which leads to an incomplete picture of performance
	Lack of comparability between entities, even in the same industry, as the basis of calculation of measures is often not clear
	Limited comparability of operational or **non-financial measures** from one period to the next as **corresponding measures for prior period(s) are often not provided**
	Difficulty in assessing the **verifiability** of operational or non-financial measures
Level of detail	Lack of conciseness through **duplication** of content
	Too wide a scope of discussed measures and issues – **failure to identify the material matters**

Questions to CMAC

1. Have you encountered the challenges identified on slide 4? How significant are they for you and for investors, in general?
2. Are there any additional challenges that the Board should be made aware of?

Interaction between management commentary and other reports

Issue and existing guidance

Issue

- At the January 2019 meeting the Consultative Group discussed the interaction (1) between management commentary and financial statements, and (2) between management commentary and other reports. The members questioned whether:

  (a) management commentary and financial statements should be viewed as a single reporting package or as separate reports;

  (b) cross-referencing could be used to avoid duplication and encourage conciseness;

  (c) allowing cross-referencing to financial statements and other reports could have any negative implications, eg for audit.

Existing Practice Statement

- The Practice Statement discusses management commentary as being supplementary to financial statements (see Appendix B – slide 30). The Practice Statement does not explicitly refer to cross-referencing but discusses avoiding duplication.
- The Practice Statement does not discuss the link between management commentary and other reports provided by the entity.

Staff’s proposed approach (1/3)

Staff’s proposed approach

- In November 2018, the Board broadly agreed that the objective of management commentary should be to **give context for the financial statements** […].
- The staff do not suggest specifying in the revised Practice Statement whether management commentary and financial statements are a single reporting package because this is likely to depend on jurisdictional requirements. Furthermore, specifying whether they are a single reporting package is unlikely to make management commentary more useful to users.
- Instead, the staff suggest introducing:

(a) a **principles-based approach** to the interaction between management commentary and financial statements and incorporation of information by cross-referencing (see slide 9). The staff suggest that similar principles should apply when incorporating information in management commentary by cross-referencing to other reports.

(b) **restrictions on providing cross-references** between management commentary and financial statements and other reports (see slide 9).

(c) a requirement that where information is included by cross-referencing to other reports, the specific section being referenced will be considered to form **part of management commentary** and subject to all the requirements of the Practice Statement.

Staff's proposed approach (2/3)

Principles-based approach to the interaction between management commentary and other reports and incorporation of information by cross-referencing
(to avoid duplication and encourage coherent and understandable discussion)

(a) management commentary should include ***all relevant information*** needed to meet the objective of management commentary, either directly or by cross-referencing;
(b) information provided, either directly or by cross-referencing, should ***faithfully represent the substance*** of the relevant matter;
(c) management commentary can incorporate information by cross-referencing to financial statements or other reports to provide a ***coherent discussion*** and ***avoid duplication*** of information in these reports;
(d) incorporation of information by cross-referencing should not be done in a way that hinders ***understandability*** and ***neutrality*** of management commentary.

Restrictions on providing cross-references
(to avoid excessive cross-referencing that may lead to fragmentation of information)

(a) the reference should be to a ***precisely specified part*** of the document;
(b) the referenced document should be available:
(i) at the same (or approximately the same) ***time*** as management commentary;
(ii) on the same ***terms**** as management commentary; and
(iii) ***for as long as*** the management commentary is available.
(c) the referenced document ***cannot be changed*** after the management commentary has been issued, unless the change is highlighted in an updated management commentary.

* Ie, users should have access to the referenced material on the same basis as they have for accessing management commentary

Staff's proposed approach (3/3)

Examples of when cross-references could be used

Example 1—cross-reference to notes to financial statements

IFRS 7 *Financial Instruments: Disclosures* requires entities to disclose breaches of loan agreements during the reporting period.

If information about a breach is material to understanding the entity's financial position, management commentary should include information about the breach and its implications.

Such information could be provided by identifying the issue (ie the breach of a loan agreement) and cross-referencing the specific note in the financial statements. However, it would not be sufficient to simply include a general cross-reference saying 'Note X to financial statements discusses the entity's loan agreements' because that would not help users understand the substance of the issue.

Example 2—cross-reference to other reports required in local jurisdiction

Local regulation might require an entity to provide a sustainability report. If the report discusses issues that may materially affect the entity's future operations (for example, a change in CO2 emissions requirements), management commentary should inform the users that such issues exist and may provide the further information that users need through a cross-reference to the precisely specified part of the sustainability report.

Example 3—cross-reference to other published reports

Management may decide to provide in management commentary information about customer satisfaction based on a survey. In this case, management commentary may include directly a summary of the results but include the information on the methodology and a more detailed breakdown of the survey results by cross-referencing to the publicly available report on the survey (for example, when published on the entity's website).

Questions to CMAC

3. Where you have come across information incorporated into management commentary by cross-referencing, has this been helpful or has it caused any issues?
4. To help provide coherent discussion and avoid duplication and fragmentation of information in management commentary, the staff propose to introduce:

   (a) a principles-based approach to the interaction between management commentary and other reports;

   (b) restrictions on providing cross-references; and

   (c) a requirement to treat the incorporated information as part of management commentary.

   Do you agree with these proposals described on slides 8-10? If not, why and what would you propose instead?

Overview of performance and position

Issue and staff's proposed approach

Issue

- Currently, it is common practice to include in management commentary an overview of the entity's performance and position. This acts as an executive summary of management's view of the most important aspects of the entity's performance and position. In many countries it appears as a CEO's report or review.
- Including such an overview aligns with users' need to understand management's view of the most important aspects of the entity's performance and position. However, the existing Practice Statement does not discuss whether and how such an overview should be provided.

Proposals discussed with the Consultative Group

- The staff propose that:

  (a) management should identify and highlight the most important aspects of the entity's performance and position but such an overview need not be in a separate section;

  (b) the overview should be based on the performance measures and ratios that management considers the most important for understanding the entity's performance; and

  (c) if the overview contains Adjusted Performance Measures (APMs), they should not have greater prominence than their unadjusted equivalents, ie the most directly comparable measures included in the financial statements.

Feedback from the Consultative Group

Feedback from the Consultative Group

- There was general agreement by the members that there is a need for an overview and that the revised Practice Statement should not be overly prescriptive on what the overview should include and how it should be provided.
- Other suggestions received included that:
  - (a) the overview should not just explain current performance but it should link to strategy and outlook;
  - (b) the overview needs to also include non-financial measures and measures on position; and
  - (c) when APMs are included in the overview, the reconciliation to their unadjusted equivalent, as well as an explanation for their selection, are needed in management commentary but not necessarily in the overview.

Questions to CMAC

5. Do you agree with the staff's proposal that management commentary should include an overview of the entity's performance and position?
6. Do any specific matters need to be covered in the overview?

Forward-looking information in management commentary

Existing guidance and proposed approach

The existing Practice Statement states that forward-looking information is ‘information about the future (for example, information about prospects and plans) that may later be presented as historical information (ie results). It is subjective and its preparation requires the exercise of professional judgement’.

At this session, **the staff would like to discuss whether the revised Practice Statement should provide more guidance on provision of forward-looking information, in particular forecasts and targets, in management commentary.**

The table below includes the key points on providing forecasts and targets from the existing Practice Statement (the related paragraphs can be found in Appendix B – slide 31), and the corresponding staff proposals:

Existing Practice Statement	Staff’s proposed approach
Management should provide forward-looking information through narrative explanations or through quantified data, which may—but are not required to—include projections or forecasts, and disclose the assumptions used	Maintain the existing guidance of not requiring forecasts, but add a requirement to include forecasts or targets in management commentary if these have already been published elsewhere
Management should explain how and why the performance of the entity varies from forward-looking disclosures made in the prior period management commentary, as well as the implications of those variances for the entity’s future performance	Extend the existing requirement to provide comparisons of the entity’s actual performance to past forecasts and targets included in the prior period’s management commentary to forecasts and targets that were previously published elsewhere

Feedback from the Consultative Group

Feedback from the Consultative Group

- The Consultative Group members expressed varying views about including forecasts in management commentary:

  (a) some suggested that the revised Practice Statement should encourage the provision of forecasts;

  (b) others expressed concerns related to legal liability risks arising from including forecasts in management commentary.

- One member commented that the proposed requirement to include forecasts published elsewhere in management commentary and provide comparisons to the entity's actual results may deter entities from publishing any forecasts.

Questions to CMAC

7. Do you find forecasts and targets (be it financial or non-financial) included in management commentary useful, and why?
8. Is there other forward-looking information that you need that is currently not provided in management commentary, and why?

Information about tax in management commentary

IFRS®

Issue and existing requirements

Issue

- Taxation and the sustainability of tax rates have become high-profile issues. Users may need more information than that required by IAS 12 *Income Taxes* to assess whether an entity's tax rate is sustainable.

Existing requirements

- The existing Practice Statement does not explicitly require any disclosures in management commentary related to tax.
- IAS 12 requires an entity to disclose an explanation of the relationship between tax expense and accounting profit and of significant effects of enacted or announced tax changes.

> [The entity shall disclose]:
> 81(c) an explanation of the relationship between tax expense (income) and accounting profit in either or both of the following forms:
>
> (i) a numerical reconciliation between tax expense (income) and the product of accounting profit multiplied by the applicable tax rate(s), disclosing also the basis on which the applicable tax rate(s) is (are) computed; or
>
> (ii) a numerical reconciliation between the average effective tax rate and the applicable tax rate, disclosing also the basis on which the applicable tax rate is computed;
>
> 81(d) an explanation of changes in the applicable tax rate(s) compared to the previous accounting period;
>
> 88 […] where changes in tax rates or tax laws are enacted or announced after the reporting period, an entity discloses any significant effect of those changes on its current and deferred tax assets and liabilities.

Staff's proposed approach and feedback from the Consultative Group

Staff's proposed approach

- The required explanation of the relationship between tax expense and accounting profit in IAS 12 should provide users with useful information if it is sufficiently granular. If it is not granular enough in practice, it is not the role of management commentary to remedy that defect.
- However, there are some factors that may affect an entity's tax expense *in the future* that may not be captured by IAS 12 disclosures, information on these factors would be necessary for users to assess whether an entity's effective tax rate is sustainable. The staff propose that management commentary should discuss factors such as:
  - (a) known or expected future changes in applicable tax rates or in tax law; and
  - (b) known or expected factors that could reasonably be expected to result in the relationship between tax expense and accounting profit for future periods differing from the relationship for the current year (for example, if a tax break or incentive is expected to expire).

Feedback from the Consultative Group

- Some members suggested that the entity's discussion of risks should include any material information about tax risks, and any implications for strategy.
- Some cautioned against duplication of information with the financial statements.
- Some suggested they would like management commentary to include information on the expected future tax rate.
- Some commented that tax is a sensitive topic and caution should be exercised in prescribing requirements.

Questions to CMAC

10. What information on tax would you find useful in management commentary and why?
11. Is such information provided today? If not, what, if anything, should the Board include in the Practice Statement to promote the provision of such information?

Appendices

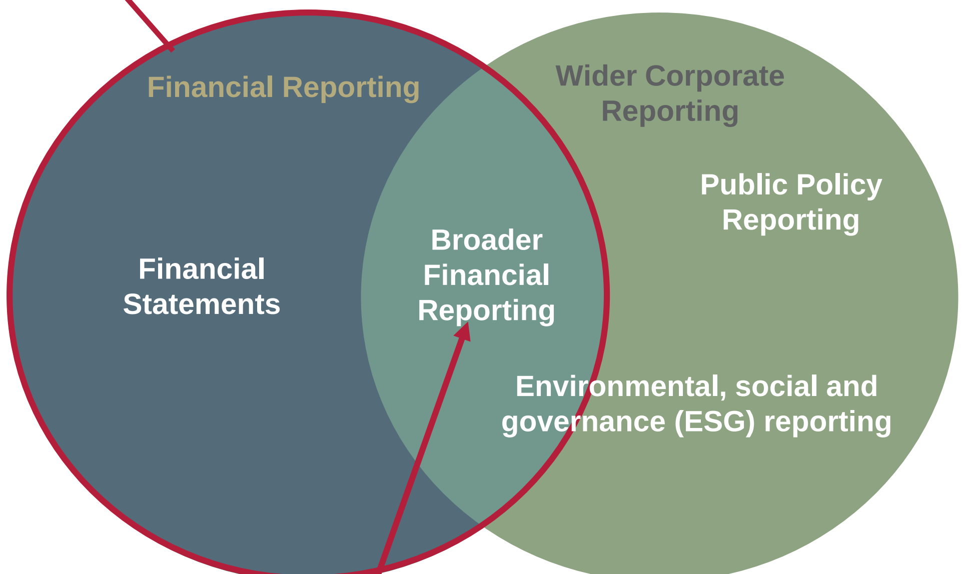
Appendix A – Background

Appendix A – Background
Project scope

- The objective of revising IFRS Practice Statement 1 *Management Commentary* is to:

improve guidance on preparation of management commentary that complements financial statements to support users' assessments of entities' sustainable prospects and stewardship, including guidance on provision of information about their intangible resources and relationships and ESG issues.

The Board's interest lies in financial reporting



Management commentary is part of broader financial reporting, and is a narrative report aimed at primary users of financial reports that provides context for and additional insight into an entity's financial statements.

Appendix A – Background
Project timeline

Nov 2017

Revision of the Practice Statement added to the Board's agenda

Jul 2018

The Board establishes the Consultative Group (CG)

The group will advise the Board in developing proposals for revision of the Practice Statement

Sep 2018

CG meeting - Stream 1

Objective, materiality and principles

October 2018 onwards

Meetings with other advisory bodies

Board deliberations

Jan 2019

CG meeting - Stream 2

Performance, position and progress

Apr 2019

CG meeting - Stream 3

Business model, risk, strategy, and operating environment

H1 2020

Publish Exposure Draft

Appendix A – Background
Update since last CMAC meeting

In November 2018, the staff discussed with CMAC the following topics:

- the objective of management commentary;
- application of materiality to management commentary; and
- principles for preparing management commentary.

The feedback on the objective of management commentary from that meeting was reported to the Board at its November 2018 meeting. The remaining feedback will be included in the staff's analysis in the Board Papers for the Board's upcoming discussions. The feedback was also considered in preparing the materials for the Stream 2 and Stream 3 discussions with the Consultative Group.

The Consultative Group's Stream 2 discussion on performance, position and progress was held in January 2019. The discussion covered:

(i) analysis of the financial statements; and

(ii) matters that could affect the entity's future development.

The papers supporting that discussion, including a summary of the meeting, as well as papers for other meetings, can be found at https://www.ifrs.org/projects/work-plan/management-commentary/#meetings

Appendix B – Extracts

Appendix B – Extracts
Extract from IFRS Practice Statement 1 *Management Commentary* on link to financial statements

5. When management commentary relates to financial statements, an entity should either make the financial statements available with the commentary or identify in the commentary the financial statements to which it relates.

6. Management should identify clearly what it is presenting as management commentary and distinguish it from other information.

9. Management commentary…provides a context for the related financial statements…

16. Management commentary should supplement and complement the financial statements with explanations of the amounts presented in the financial statements and the conditions and events that shaped that information...

23. (b) When practicable, management should avoid duplicating in its management commentary the disclosures made in the notes to its financial statements.

The Basis for Conclusions explains that the Board decided to link management commentary to the financial statements because:

BC20 …management commentary is designed to supplement and complement information provided in a related set of financial statements. The Board observed that providing management commentary without (at minimum) identifying the related financial statements might be misleading for users. Consequently, the Board decided that when an entity presents management commentary that relates to IFRS financial statements, it should either make the financial statements available with the commentary or identify the financial statements to which the commentary relates.

Appendix B – Extracts
Extract from IFRS Practice Statement 1 *Management Commentary* on forward-looking information

Forward-looking information

17. Management commentary should communicate management's perspective of the entity's direction. Such information does not predict the future, but instead sets out management's objectives for the entity and its strategies for achieving those objectives. The extent to which management commentary looks forward will be influenced by the regulatory and legal environment within which the entity operates.

18. Management should include forward-looking information when it is aware of trends, uncertainties and other factors that could affect the entity's liquidity, capital resources, revenues and the results of its operations. Such information should focus on the extent to which the entity's financial position, liquidity and performance may change in the future and why, and include management's assessment of the entity's prospects in the light of current period results. Management should provide forward-looking information through narrative explanations or through quantified data, which may—but are not required to—include projections or forecasts. Management should disclose the assumptions used in providing forward-looking information.

19. Management should explain how and why the performance of the entity is short of, meets or exceeds forward-looking disclosures made in the prior period management commentary. For example, if management stated targets for future performance in previous reporting periods, it should report the entity's actual performance in the current reporting period and analyse and explain significant variances from its previously stated targets as well as the implications of those variances for management's expectations for the entity's future performance.

Prospects

36. Management should provide an analysis of the prospects of the entity, which may include targets for financial and non-financial measures. This information can help users of the financial reports to understand how management intends to implement its strategies for the entity over the long term. When targets are quantified, management should explain the risks and assumptions necessary for users to assess the likelihood of achieving those targets.

Get involved

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