

STAFF PAPER

April 2020

IASB[®] meeting

| Project | Management Commentary | | |
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| Paper topic | Cover paper | | |
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This paper has been prepared for discussion at a public meeting of the International Accounting Standards Board (Board) and does not represent the views of the Board or any individual member of the Board. Comments on the application of IFRS[®] Standards do not purport to set out acceptable or unacceptable application of IFRS Standards. Technical decisions are made in public and reported in IASB[®] *Update*.

Purpose of this paper

1. This paper:
 - (a) recaps the discussions to date in the Management Commentary project (paragraphs 2–3);
 - (b) introduces the papers to be discussed at this month’s meeting (paragraphs 4–8); and
 - (c) sets out next steps in the Management Commentary project (paragraph 9).

Recap

2. To date, the International Accounting Standards Board (Board) has discussed:
 - (a) the staff’s approach to revising IFRS Practice Statement 1 *Management Commentary* (Practice Statement) (May 2019);
 - (b) the objective of management commentary (November 2018 and March 2020);
 - (c) the characteristics of useful information in management commentary, including:
 - (i) relevance and materiality (July 2019);
 - (ii) completeness and neutrality (September 2019); and

- (iii) comparability, verifiability and understandability (October 2019);
 - (d) aspects of guidance on the business model (October 2019 and November 2019); and
 - (e) initial ideas on developing disclosure objectives on the main areas of content in management commentary (March 2020).
- 3. Appendix B to this paper provides more detail about the Board's previous discussions and tentative decisions to date.

Papers for this month's meeting

Agenda Paper 15A Introduction to disclosure objectives

- 4. Agenda Paper 15A introduces the disclosure objectives on three content areas: business model, strategy, and resources and relationships.
- 5. This paper is for information only and does not ask the Board for decisions.

Agenda Paper 15B Business model

Agenda Paper 15C Strategy

Agenda Paper 15D Resources and Relationships

- 6. Each of these three papers addresses one content area. Each paper discusses:
 - (a) the disclosure objective for management commentary on that content area;
 - (b) possible supporting guidance.
- 7. The papers ask the Board for decisions on the disclosure objectives and key areas of focus. The papers do not ask the Board for decisions on other aspects of the supporting guidance but invite comments from Board members. The staff will consider those comments and will either address them in drafting the document or present further analysis to the Board at a future meeting.

8. The staff have sought to develop consistent structures and wording for the disclosure objectives. To demonstrate the parallels, we have set out the individual disclosure objectives side-by-side in Appendix A to this paper.

Note on terminology

IFRS Practice Statements are not IFRS Standards. Consequently, financial statements can comply with IFRS Standards even if not accompanied by management commentary that complies with the Practice Statement.

However, some entities might be required to prepare management commentary that complies with the Practice Statement. And other entities might wish to state that their management commentary complies with the Practice Statement.

The revised Practice Statement will specify information that entities should include in management commentary. Because entities would be required to provide that information to claim that their management commentary complies with the revised Practice Statement, the staff think the requirements should be expressed in the same way as requirements in IFRS Standards, that is using the terminology ‘shall’.

This terminology is reflected in the staff recommendations in Agenda Papers 15B-D.

Next steps

9. The staff plan that the next Board discussion will cover management commentary on risks and operating environment.

Appendix A—Disclosure objectives and possible supporting guidance for the areas of content discussed at this meeting

| | Business model | Strategy | Resources and relationships |
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| DISCLOSURE OBJECTIVES | | | |
| Headline disclosure objective | Management commentary shall provide information and analysis to help investors and creditors understand how the entity’s business model creates value and converts that value into cash flows. | Management commentary shall provide information and analysis to help investors and creditors understand management’s strategy for sustaining and developing the entity’s ability to generate cash flows in the future. | Management commentary shall provide information and analysis to help investors and creditors understand the resources and relationships on which the business model and strategy depend. |
| Assessments investors and creditors make | That information and analysis helps investors and creditors assess: <ul style="list-style-type: none"> (a) how effective the entity’s business model is in creating value and converting it into cash flows; (b) how scalable the entity’s business model is; and (c) how durable, resilient and adaptable the entity’s business model is. | That information and analysis helps investors and creditors assess: <ul style="list-style-type: none"> (a) the potential impact of the strategy on the entity’s ability to generate cash flows; and (b) the entity’s ability to execute the strategy. | That information and analysis helps investors and creditors assess: <ul style="list-style-type: none"> (a) how much the entity depends on particular resources or relationships; and (b) whether those resources are likely to continue to be available and whether the relationships are strong enough to sustain the entity’s business model and strategy. |
| Information investors and creditors need | That information and analysis shall cover: <ul style="list-style-type: none"> (a) the range, nature and scale of the entity’s operations; (b) the entity’s cycle for creating and generating cash flows; and (c) the impacts of the entity’s operations that could affect the entity’s ability to generate cash flows. That information and analysis shall focus on the key features of the entity’s business model. | That information and analysis shall cover: <ul style="list-style-type: none"> (a) what drives management’s strategy; (b) what management sets out to achieve in the long term; (c) how management plans to achieve that; and (d) how management will monitor and measure success. That information and analysis shall focus on the key aspects of management’s strategy. | That information and analysis shall cover: <ul style="list-style-type: none"> (a) the nature of resources and relationships; (b) how resources and relationships are accessed; (c) how those resources are used; (d) what affects the availability of resources and the strength of relationships; and (e) how resources and relationships are managed. That information and analysis shall focus on the key resources and relationships. |

SUPPORTING GUIDANCE

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| <p>Key items</p> | <p>The key features of the entity’s business model are those that underpin the entity’s ability to create value and generate cash flows.</p> <p>Examples of possible key features of the entity’s business model are:</p> <ul style="list-style-type: none"> (a) features that underpin the entity’s value proposition (such as a product intended to meet a specific need of a particular consumer category); (b) features provide the entity with a competitive advantage (such as know-how in a particular area); (c) features that create uncertainty about the entity’s ability to generate cash flows (such as uncertainty over receiving a patent on a major new product developed by the entity); or (d) features that need to change, or did change during the reporting period, and affect the entity’s ability to generate cash flows (such as a process that needs to be changed to adhere to newly introduced environmental regulations or a new product designed over the reporting period that is expected to generate significantly higher revenue in the next period). | <p>The key aspects of management’s strategy are those that will significantly affect the entity’s ability to generate cash flows in the future.</p> <p>Examples of possible key aspects of management’s strategy are:</p> <ul style="list-style-type: none"> (a) important long-term objectives that explain how the entity intends to sustain and develop the entity’s ability to generate cash flows, for example how the entity intends to create a significant competitive advantage or seize a particular opportunity; (b) important milestones towards achieving the long-term objectives; (c) important plans that reflect priorities for action and enable an entity to measure progress against the important milestones and objectives; (d) allocation of resources to support execution of long-term objectives; or (e) a system of incentives to support execution of long-term objectives. | <p>An entity’s key resources and relationships are those on which operation of the entity’s business model or implementation of management’s strategy depend.</p> <p>Examples of possible key resources and relationships are those that:</p> <ul style="list-style-type: none"> (a) provide an entity with a competitive advantage—that is their nature makes them key, such as an in-house research and development team in a cutting-edge technology company, or an exclusive right; (b) are scarce, such as specialist employees or natural resources with a finite life, or whose continued availability is uncertain, due to factors like government intervention or climate change; or (c) create a concentration of risk, such as when the entity relies on a small number of customers or suppliers, when there is no viable alternative for a resource which is used as the main component in producing the entity’s product, or when a resource can only be sourced from one or a few countries. |
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Appendix B—Summary of the Board’s previous discussions

| Topic and discussion date | Board’s tentative decision(s) |
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| <p>Approach to revising the Practice Statement (May 2019)</p> | <p>The Board noted that 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. The revised Practice Statement will provide guidance that:</p> <ul style="list-style-type: none"> (a) consolidates innovations in narrative reporting; (b) addresses gaps in reporting practice; and (c) remains principles-based but contains sufficient detail to support rigorous application. <p>The Board was not asked to make any decisions.</p> |
| <p>The objective of management commentary (November 2018)</p> | <p>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.</p> <p>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.</p> <p>The Board asked the staff to consider whether it is possible to provide further clarity on:</p> <ul style="list-style-type: none"> (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. |
| <p>Objective of Management Commentary (March 2020)</p> | <p>The Board tentatively decided that the revised Practice Statement should:</p> <ul style="list-style-type: none"> (a) retain the statement that management commentary is prepared for existing and potential investors, lenders and other creditors and refer to them as ‘primary users’; and (b) explain that primary users are expected to have a reasonable knowledge of business and economic activities and to review and analyse the information diligently; but such users are not expected to have knowledge of the entity to which the management commentary relates. <p>The Board also tentatively decided that the revised Practice Statement should describe the objective of management commentary as supporting</p> |

| Topic and discussion date | Board's tentative decision(s) |
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| | <p>primary users in assessing an entity's prospects for future cash flows and management's stewardship of the entity's economic resources by providing useful information and analysis that:</p> <ul style="list-style-type: none"> (a) enhance the primary users' understanding of the entity's performance and position as depicted in the related financial statements; and (b) give insight into factors that could affect the entity's prospects. <p>The Board also discussed a working draft of guidance on the objective of management commentary to be included in the revised Practice Statement, including guidance on:</p> <ul style="list-style-type: none"> (a) the notion of 'management's view'; (b) types of information in management commentary; and (c) the link between the notions of 'an entity's prospects for future cash flows' and 'value creation'. <p>The Board discussed initial ideas on developing disclosure objectives for the types of content expected to be included in management commentary. The Board was not asked to make any decisions</p> |
| <p>Approach to guidance on qualitative characteristics (July 2019)</p> | <p>The Board noted that the plan for the revised Practice Statement is to:</p> <ul style="list-style-type: none"> (a) include a brief description of each qualitative characteristic based on its description in the <i>Conceptual Framework for Financial Reporting (Conceptual Framework)</i>; and (b) provide specific guidance on considering particular qualitative characteristics where such guidance is needed due to the nature of information included in management commentary. <p>The Board was not asked to make any decisions.</p> |
| <p>Making relevance and materiality judgements (July 2019)</p> | <p>The Board tentatively decided to introduce in the revised Practice Statement guidance on making materiality judgements in preparing management commentary that would:</p> <ul style="list-style-type: none"> (a) incorporate key elements of the guidance from Practice Statement 2 <i>Making Materiality Judgements</i> (Materiality Practice Statement) supported, where necessary, by cross-references to further guidance in the Materiality Practice Statement; (b) provide additional guidance where it is necessary because the nature of management commentary differs from the nature of financial statements; and (c) focus on explaining the materiality process, in particular on identifying material information. |

| Topic and discussion date | Board’s tentative decision(s) |
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| | <p>Further, the Board tentatively decided that the guidance on identifying material information in the revised Practice Statement would:</p> <ul style="list-style-type: none"> (a) recognise the guidance in the Practice Statement on elements of management commentary (content elements) as a general source of identifying such information; (b) provide the following guidance on considering primary users’ common information needs in identifying material information: <ul style="list-style-type: none"> (i) make an explicit link between identification of material information and the objective of management commentary—that is providing information that is useful in assessing the prospects for future net cash inflows to the entity and in assessing management’s stewardship of the entity’s economic resources; and (ii) describe practical sources that could help management identify matters that may need to be discussed in management commentary. Those sources include the entity’s capital markets communications, information management uses in managing the business and information identified through engagement with the entity’ key stakeholders; and (c) explain how management would consider what information to provide about such matters in each content element to deliver a coherent narrative. <p>Finally, the Board tentatively decided to include in the revised Practice Statement guidance on the other steps of the materiality process that would prompt management to:</p> <ul style="list-style-type: none"> (a) consider the likelihood of a matter occurring, not just the size of the impact, in assessing the quantitative factors when making materiality judgements; (b) consider the appropriate level of aggregation when assessing what information an entity needs to provide in management commentary; and (c) highlight the links between different pieces of information when organising the information within management commentary. |
| <p>Faithful representation (September 2019)</p> | <p>The Board tentatively decided that the revised Practice Statement would:</p> <ul style="list-style-type: none"> (a) include guidance on the qualities that make up faithful representation—completeness, neutrality and freedom from error; and (b) explain that these qualities should be maximised to the extent possible. <p>The Board tentatively decided that the revised Practice Statement would include a description of completeness based on paragraph 2.14 of the <i>Conceptual Framework</i>. In particular, that description would explain that:</p> <ul style="list-style-type: none"> (a) a complete depiction of a matter should include material information about the nature of that matter and about factors and circumstances that might affect it. (b) completeness of a depiction of a matter is determined by reference to primary users’ information needs. To be complete, a depiction of a matter does not necessarily require management to provide all information it has about that matter. <p>The Board tentatively decided that the revised Practice Statement would:</p> <ul style="list-style-type: none"> (a) require that the management commentary be neutral. To facilitate that: <ul style="list-style-type: none"> (i) each matter that needs to be discussed in the management commentary should be given due prominence; and (ii) the overall tone and language used in management commentary should contribute to an unbiased depiction of the entity’s performance |

| Topic and discussion date | Board's tentative decision(s) |
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| | <p>and position.</p> <p>(b) include a description of neutrality based on paragraph 2.15 of the <i>Conceptual Framework</i>. In particular, that description would explain that, for the depiction of a matter to be neutral, information about it cannot be omitted, obscured, given undue prominence or otherwise be manipulated to influence primary users' view of the matter favourably or unfavourably.</p> <p>(c) require explanatory information to help primary users understand the likelihood of outcomes within a range when the range of possible outcomes is given.</p> <p>The Board also discussed what guidance on freedom from error should be included in the revised Practice Statement but did not make a decision on this topic. The Board also highlighted the importance of using plain language in describing the qualitative characteristics of useful financial information in the revised Practice Statement.</p> |
| <p>Enhancing qualitative characteristics (October 2019)</p> | <p>The Board tentatively decided that the revised Practice Statement would:</p> <p>(a) include a description of comparability reflecting paragraphs 2.24, 2.26 and 2.28 of the <i>Conceptual Framework</i>;</p> <p>(b) explain that although comparability with other entities is desirable, it should not override the requirement to provide relevant entity-specific information;</p> <p>(c) state that in preparing management commentary, an entity's management should consider the fact that primary users need to make comparisons with information provided by other entities, with information reported in management commentary in previous periods and with other information published by the entity; and</p> <p>(d) require an entity's management to:</p> <ul style="list-style-type: none"> (i) explain the assumptions made and methods of calculation used in producing a performance measure, and state whether the performance measure in question is a commonly used metric; (ii) explain any changes since the previous year in those assumptions and methods, and the reason for them; (iii) highlight where new information is provided on a matter reported in previous management commentary; (iv) provide comparative information for each performance measure over a period that is long enough to show the emergence of trends; and (v) consider whether information presented in management commentary is consistent with information reported in the entity's financial statements, in investor presentations, in other reports in the public domain, and on the entity's website. <p>The Board tentatively decided that the revised Practice Statement would:</p> <p>(a) include in its discussion of understandability the current guidance in the Practice Statement on presentation;</p> <p>(b) explain that making management commentary concise is an important part of making it understandable;</p> |

| Topic and discussion date | Board’s tentative decision(s) |
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| | <p>(c) permit the incorporation of information in management commentary by cross-reference, subject to the overarching principle that the information incorporated by cross-reference is part of management commentary and, therefore, must possess the qualitative characteristics of useful financial information. To help management apply the overarching principle, the revised Practice Statement should include guidance:</p> <ul style="list-style-type: none"> (i) on enhancing the understandability of management commentary when information is incorporated by cross-reference; and (ii) on conditions that must be met by a report when management commentary incorporates information by cross-reference to that report. <p>The Board tentatively decided that the revised Practice Statement would:</p> <ul style="list-style-type: none"> (a) include a description of verifiability based on paragraphs 2.30 and 2.32 of the <i>Conceptual Framework</i>; (b) require management to: <ul style="list-style-type: none"> (i) distinguish information based on judgement from factual information; and (ii) explain the process and sources used to produce the information, describe the assumptions and methods used to calculate it, and state the information’s limitations; and (c) retain the statement that it does not mandate the level of assurance to which management commentary should be subjected. <p>The Board tentatively decided that the revised Practice Statement would not include guidance on timeliness.</p> |
| <p>Business model (November 2019)</p> | <p>The Board tentatively decided that the revised Practice Statement should, in explaining ‘business model’, refer to:</p> <ul style="list-style-type: none"> (a) value the entity creates for itself. The Practice Statement should also make clear that the notion of value created for an entity is related to the entity’s ability to generate cash flows. (b) the link between an entity’s business model and the entity’s stated purpose. (c) the elements of the business model—that is, inputs, processes and outputs. (d) a business model being a matter of fact and observable through an entity’s actions. <p>The Board also tentatively decided that the Practice Statement should require an entity’s management to discuss indirect wider consequences or impacts of the operation of the entity’s business model if those impacts could affect the entity’s ability to generate cash flows in the future.</p> |