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Paper topic	Performance and position

CONTACT[S]	Jelena Voilo	jvoilo@ifrs.org	+44 (0)20 7246 6914
	Yulia Feygina	yfeygina@ifrs.org	+44 (0)20 7332 2743

Purpose of this paper

1. This paper forms a part of the package of papers on reporting performance, position and progress in management commentary. This paper discusses what guidance should be included in the revised IFRS Practice Statement 1 *Management Commentary* (Practice Statement) on reporting performance and position of an entity. In particular, this paper discusses:

   (a) the disclosure objective for performance and position; and

   (b) possible guidance supporting that objective, including on identifying key facets of performance and position that need to be addressed in management commentary.

2. This paper asks the Board for decisions on the disclosure objective for performance and position and on describing the key facets of performance and position that need to be addressed in management commentary.

3. The paper does not ask the Board for decision on other aspects of the supporting guidance but invites comments from the Board. The staff will consider those comments and will either address them in drafting the forthcoming exposure draft or present further analysis to the Board at a future meeting.

4. This paper highlights the importance of measurement measures and indicators in discussing the entity's performance and position. Agenda Paper 15D *Management measures and indicators* discusses guidance on including management measures and indicators in management commentary.

Structure of this paper

5. This paper is structured as follows:

   (a) summary of staff recommendations (paragraph 6);

   (b) summary of staff's research on performance and position:

      (i) the existing Practice Statement (paragraphs 7–11);

      (ii) investors' and creditors' information needs and gaps in reporting practice (paragraphs 12–13);

      (iii) overview of other standard-setters' guidance (paragraphs 14–16); and

      (iv) feedback from the Board's consultative groups (paragraphs 17–21);

   (c) disclosure objective for performance and position, including:

      (i) headline objective (paragraphs 24–28);

      (ii) main assessments typically made by investors and creditors (paragraphs 29–33); and

      (iii) types of information that need to be provided (paragraphs 34–42);

   (d) possible guidance supporting the disclosure objective, including:

      (i) how to identify key facets of performance and position (paragraphs 44–51); and

      (ii) what information to provide about key facets of performance and position (paragraphs 52–77); and

   (e) Appendix A—Extracts from IFRS Practice Statement 1 *Management Commentary* on performance and position.

Summary of staff recommendations

6. The staff recommend that the revised Practice Statement:

   (a) specifies the disclosure objective for performance and position as follows:

Management commentary shall provide information to help investors and creditors understand the entity's performance and position that result from:

(i) operation of the entity's business model;
(ii) executing management's strategy;
(iii) deploying the entity's resources and relationships;
(iv) managing the entity's risks; and
(v) responding to factors and trends in the entity's external environment.

That information helps investors and creditors assess:

(i) the key drivers of an entity's performance and position;
(ii) the extent to which the entity's performance and position reported in its financial statements are indicative of the entity's ability to create value and generate cash flows in the future; and
(iii) how the entity's performance and position reported in its financial statements compare to previous expectations.

That information shall focus on the key facets of performance and position and cover:

(i) what the key facets of performance and position are and how management monitors those key facets;
(ii) what affected the entity's performance for the reporting period or could affect it in the future, including over the long term;
(iii) what affected the entity's position at the end of the reporting period or could affect it in the future, including over the long term;
(iv) how the entity's performance and position reported in its financial statements compare to previous expectations.

(b) specifies that the key facets of performance and position are those that reflect the entity's ability to create value and generate cash flows and that are monitored by the entity's management.

Summary of staff's research on performance and position

The existing Practice Statement

7. The existing Practice Statement highlights that management commentary should explain the performance and position depicted in financial statements by:

(a) providing management's perspective of the entity's performance, position and progress; and

(b) supplementing and complementing the financial statements with explanations of the amounts presented in the financial statements and the conditions and events that shaped that information.

8. Guidance on reporting performance and position is provided under the heading ‘results and prospects’. The Practice Statement states that management commentary should provide ‘information that is essential to an understanding of […] the results of operations and prospects and the critical performance measures and indicators that management users to evaluate the entity’s performance against stated objectives’.[1]

9. Useful information on ‘results and prospects’ is intended to help investors and creditors make their own assessments of the entity’s performance, position, progress and prospects. The Practice Statement specifies that this information should include:

(a) a description of financial and non-financial performance of the entity;

(b) insight into the main trends and factors affecting the business;

(c) a discussion of the extent to which that performance may be indicative of future performance;

(d) a description of the relationship between the entity’s results, management’s objectives and management’s strategies for achieving those objectives; and

(e) discussion and analysis of significant changes in financial position, liquidity and performance compared with those of the previous period or periods.

Note on terminology – ‘performance’ and ‘position’

- In the revised guidance the staff suggest referring to ‘performance’ and ‘position’ instead of ‘results’. This is because the term ‘results’ tends to be associated with positive outcomes. Also, the terms ‘performance’ and ‘position’ would provide a better link to the entity’s financial statements.
- The term ‘performance’ is used to capture an entity’s income and expenses and cash flows reported in the entity’s financial statements as well as changes in unrecognised resources and claims of the entity. This is

[1] See paragraph 24 of the Practice Statement included in Appendix A.

in line with the guidance on financial performance included in the *Conceptual Framework for Financial Reporting*, which talks about performance reflected by accrual accounting and performance reflected by past cash flows.[2]

- The term ‘position’ is used to capture financial position of the entity reported in its financial statements and unrecognised resources and claims of the entity.[3]

10. The Practice Statement also asks for management’s analysis of the entity’s prospects to help investors and creditors understand how management intends to implement its strategy over the long term. In the guidance on providing forward-looking information, the Practice Statement states that management commentary:

    (a) should communicate the entity’s direction, but does not predict the future;

    (b) should include forward-looking information when management is aware of the trends, uncertainties or other factors that could affect the entity’s liquidity, capital resources, revenues and the results of its operations; and

    (c) may (but is not required to) include forecasts and targets and should explain performance for the current reporting period in the context of past forecasts included in prior period management commentary.

11. Extracts from the Practice Statement on performance and position are included in Appendix A. The existing Practice Statements also provides guidance on management measures and indicators—see Agenda Paper 15D.

Investors’ and creditors’ information needs and gaps in reporting practice

12. The staff’s discussions with the Boards consultative groups, in particular the Management Commentary Consultative Group (MCCG) and Capital Markets Advisory Committee (CMAC), highlighted that in relation to the entity’s performance and position investors and creditors need information to help them understand:

    (a) the drivers behind an entity’s performance and position in the reporting period; and

[2] See paragraphs 1.17–1.20 of the *Conceptual Framework*.
[3] See paragraph 1.12 of the *Conceptual Framework*.

(b) how the entity's performance and position could change in the future, including over the long term.

This information is particularly important for investors because they use it to determine inputs into their discounted cash flows models.

13. MCCG and CMAC also highlighted gaps in reporting practice related to performance and position. The members of those group stated that management commentaries or similar narrative reports sometimes:

(a) fail to identify and discuss the key drivers affecting the entity's performance and position, including those drivers information about which could help investors and creditors understand the entity's long-term prospects;

(b) provide incomplete discussion and analysis of the entity's performance and position, for example, they:

   (i) discuss and analyse few measures and indicators beyond financial; and

   (ii) provide insufficient discussion of intangible resources and relationships not recognised in financial statements; and

(c) lack conciseness because they repeat the content in financial statements.

Overview of other standard-setters' guidance

14. The staff also reviewed other standard-setters' guidance on discussing performance and position in management commentary or a similar report.[4] Staff's research found that all standard-setters highlight the importance of information on performance and position with some guidance focusing mainly on such information.

15. The staff have identified the following broad categories of disclosures commonly included in other standard-setters' guidance:

[4] The staff's review covered responses from 24 national standard-setters to the staff's request for information about the requirements and commonly applied non-mandatory guidance on management commentary in their jurisdiction. The staff also reviewed the EU Non-financial Reporting Directive (2014/95/EU) and the related European Commission Guidelines on non-financial reporting, and the International Integrated Reporting <IR> Framework because some of the respondent jurisdictions either require or encourage management to use them in preparing a management commentary or a similar report.

(a) analysis of matters that affected the entity’s performance for the period and its position, including the entity’s liquidity position, at the end of the reporting period;

(b) disclosures related to items that are not indicative of future performance and position, including comparison to past periods and known or expected changes in trends;

(c) discussion of matters that could affect the entity’s performance and position in the future;

(d) explaining financial and non-financial measures and indicators used to monitor performance and position; and

(e) discussion of the entity’s performance in terms of achieving the entity’s strategy, including relative to previous forecasts and targets.

16. Other standard-setters’ guidance also commonly highlights the importance of consistency of information on performance and position between management commentary and the entity’s financial statements, including information provided on segments.

Feedback from the Board’s consultative groups

17. The staff discussed their initial ideas for guidance on performance and position with MCCG. The discussion focused on analysis of the financial statements and matters that could affect the entity’s future development.

18. In principle, members supported providing information to help investors and creditors assess the extent to which the current period performance is indicative of the entity’s ability to generate cash flows in the future, including information about unusual items, effects of macroeconomic factors or effects of changes in the structure of the reporting entity. However, some members highlighted possible challenges with reporting such information. For example, they argued that distinguishing the effects of acquisitions on the entity’s performance from the effects of entity’s ‘organic growth’ can be difficult.

19. The term ‘operational performance’ was used to refer to income and expenses that result from the entity’s main business activities. Members found that term confusing and commented that the discussion of operational performance should be broader than analysis of revenues and costs reported in the financial statements and variance analysis. They

emphasised that management commentary should also discuss drivers of the entity's performance and position and items not recognised in the financial statements.

20. Members also highlighted information of dividends and the performance of investments accounted for using the equity method as a topic that should be discussed and analysed in management commentary.

21. Members largely agreed with the staff's suggestions that management commentary should discuss matters that could affect the entity's future developments, and that it can include scenario and sensitivity analyses to support the discussion. Members of the MCCG, as well as members of the CMAC and the Global Preparers' Forum expressed various views on the inclusion of forecasts and targets in management commentary (see paragraph X).

Disclosure objective for performance and position

22. As mentioned in paragraph 9, the existing Practice Statement states that management commentary should include information on the entity's performance and position to help investors and creditors 'make their own assessments about the entity's performance, position, progress and prospects'. This statement can be seen as a broad objective for disclosure of performance and position. However, it may not be sufficiently prominent or specific to help preparers identify information needed to meet this implied objective.

23. Accordingly, as explained in Agenda Paper 15 *Cover paper*, the staff recommend that the revised Practice Statement should set out for each area of content in management commentary:

    (a) a headline objective (paragraphs 24–28);

    (b) the main assessments typically made by investors and creditors (paragraphs 29–33); and

    (c) types of information that need to be provided (paragraphs 34–42).

Headline objective

24. In developing the disclosure objective for performance and position, the staff considered what investors and creditors need to understand about an entity's performance and position to help them make their assessments of the entity's prospects for future cash flows and of management's stewardship of the entity's economic resources.

25. To make those assessments, investors and creditors need to understand not just what the entity's performance and position is but also what affected its performance and position (see paragraph 12). Information provided in management commentary about the entity's business model, strategy, resources and relationships, risks and economic environment will provide essential context for understanding the entity's performance and position reported in the financial statements.

26. However, it is also important that management commentary describes how the key matters discussed in those areas of content 'translate' into the entity's performance and position reported in financial statements. Explaining the entity's performance and position by linking them to the operation of the entity's business model, execution of management's strategy, deploying the entity's resources and relationships, managing risks and responding to factors and trends in the external environment would provide investors and creditors with essential insights into the drivers of the entity's performance and position. That explanation would help them understand why the entity's performance and position exceeded or fell short of previous expectations and how they may change in the future.

27. For the reasons explained in paragraph 26, the staff recommend that the headline disclosure objective for performance and position should be to provide information to help investors understand the entity's performance and position that result from:

    (a) operation of the entity's business model;

    (b) executing management's strategy;

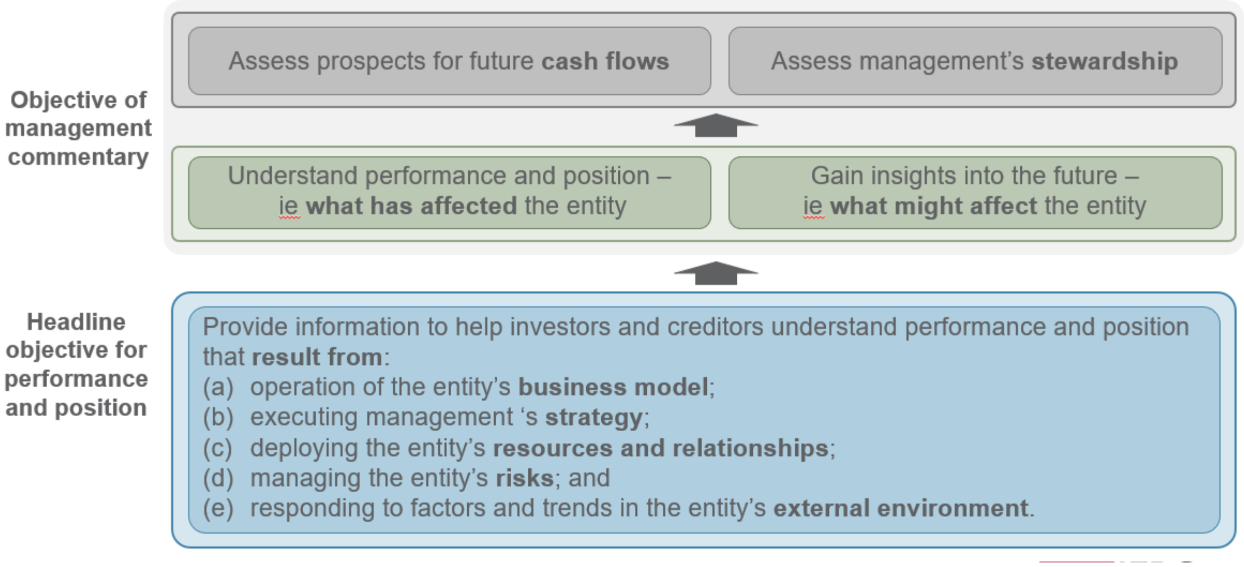
    (c) deploying the entity's resources and relationships;

    (d) managing the entity's risks; and

    (e) responding to factors and trends in the entity's external environment.

28. The relationship between the headline disclosure objective for performance and position and the overall objective of management commentary is illustrated in Figure 1.

Figure 1



Main assessments typically made by investors and creditors

29. As explained in Agenda Paper 15, disclosure objectives for each area of content include a description of the main assessments that investors and creditors typically make in relation to that area of content. The purpose of providing that description would be to support the headline objective and help preparers identify information that needs to be provided in management commentary.

30. The staff's research indicates that in relation to performance and position investors and creditors are looking to assess:

    (a) what drove performance and position in the reporting period;

    (b) whether performance and position in the reporting period are indicative of future performance and position; and

    (c) how performance and position in the reporting period relate to previous expectations.

31. The first step in assessing an entity's performance and position is understanding the drivers of performance for the reporting period and of the entity's position at the end of the reporting period. Investors and creditors then need to be able to assess the extent to which the entity's performance and position in the reporting period are indicative of the

entity's future performance and position. These two assessments contribute to investors' and creditors' assessments of the prospects for future cash flows to the entity.

32. Another assessment that investors and creditors make relates more to the assessment of management's stewardship of the entity's economic resources. A comparison of the entity's performance for the reporting period and its position at the end of the reporting period to previous expectations, including to those included in previously discussed forecasts and targets, would help investors and creditors assess how well management operated the entity's business model, executed strategy, deployed the entity's resources and relationships, managed risks and understood and responded to the entity's external environment.

33. For the reasons discussed in paragraphs 31–32, the staff recommend that the disclosure objective for performance and position should refer to information that helps investors and creditors assess:

    (a) the key drivers of an entity's performance and position;

    (b) the extent to which the entity's performance and position reported in its financial statements are indicative of the entity's ability to create value and generate cash flows in the future; and

    (c) how the entity's performance and position reported in its financial statements compare to previous expectations.

Types of information that need to be provided

34. The staff further considered what broad types of information need to be provided in management commentary to help investors and creditors make the assessments described in the previous section and to support the headline objective for performance and position as well as the overall objective of management commentary.

35. The overall objective of management commentary tentatively confirmed by the Board is that management commentary should provide information that:

    (a) enhances investors' and creditors' understanding of an entity's performance and position as depicted in its financial statements; and

    (b) provides insights into factors that could affect the entity's prospects for future cash flows.

36. The findings of the staff's research and outreach also highlight the importance of explaining the amounts in the financial statements (see paragraphs 12 and 15).

37. Based on this, the staff think that the starting point for the discussion of an entity's performance and position should be explaining the amounts included in the entity's financial statements. An entity's financial statements include various line items, subtotals and totals. As is the case for other areas of content, the discussion of performance and position should focus on material information—in this case, on information about the key facets of the entity's performance and position (paragraphs 44–51 provide guidance on identifying the key facets of performance and position). To help investors and creditors understand management's view of performance and position, the revised Practice Statement should, in the staff's view, require management to explain the facets of the entity's performance and position that management considers to be key and to describe how management monitors those facets of performance and position.

38. Furthermore, as noted in paragraph 12, investors and creditors need information about the drivers of the entity's performance and position, so the staff think that the revised Practice Statement should require management to discuss what affected the entity's performance for the reporting period and position at the end of the period. The staff think that such a requirement would help address the gap in reporting practice identified in paragraph 13(a), specifically insufficient information about the key drivers of the entity's performance.

39. As described in paragraph 35(b), management commentary also needs to provide information to help investors and creditors gain insights into factors that could affect the entity's prospects for future cash flows. With respect to the entity's performance and position, the revised Practice Statement could require information about matters that could affect the entity's performance and position in the future, including over the long term. This requirement could help address the gap in reporting practice identified in paragraph 13(a), specifically that management commentaries do not always provide explanations to help investors and creditors understand an entity's long-term prospects.

40. The requirements suggested in paragraphs 38–39 would also help investors and creditors make assessments recommended in paragraph 33(a)–(b).

41. Finally, to help investors and creditors make the assessment recommended in paragraph 33(c), the staff think that the revised Practice Statement should require management to

explain how the entity's performance and position reported in its financial statements compare to previous expectations.

42. To conclude, the staff recommend that the revised Practice Statement should require that the information on performance and position in management commentary focuses on the key facets of the entity's performance and position and cover:

(a) what the key facets of performance and position are and how management monitors those key facets;

(b) what affected the entity's performance in the reporting period or could affect it in the future, including over the long term;

(c) what affected the entity's position at the end of the reporting period or could affect it in the future, including over the long term; and

(d) how the entity's performance and position reported in its financial statements compare to previous expectations.

Question 1 for the Board

The staff recommend that the revised Practice Statement specifies the disclosure objective for performance and position as follows:

(a) management commentary should provide information to help investors and creditors understand the entity's performance and position that result from:
   (i) operation of the entity's business model;
   (ii) executing management's strategy;
   (iii) deploying the entity's resources and relationships;
   (iv) managing the entity's risks; and
   (v) responding to factors and trends in the entity's external environment.

(b) that information helps investors and creditors assess:
   (i) the key drivers of an entity's performance and position;
   (ii) the extent to which the entity's performance and position reported in its financial statements are indicative of the entity's ability to create value and generate cash flows in the future; and
   (iii) how the entity's performance and position reported in its financial statements compare to previous expectations.

(c) that information should focus on the key facets of performance and position and cover:
   (i) what the key facets of performance and position are and how management monitors those key facets;

(ii) what affected the entity's performance in the reporting period or could affect it in the future, including over the long term;

(iii) what affected the entity's position at the end of the reporting period or could reasonably be expected to affect it in the future, including over the long term; and

(iv) how the entity's performance and position reported in its financial statements compare to previous expectations.

Do you agree with these recommendations?

Possible guidance supporting the disclosure objective

43. To help preparers apply the disclosure objective for performance and position recommended above, the staff considered what supporting guidance could be included in the revised Practice Statement on:

(a) identifying key facets of performance and position (paragraphs 44–51); and

(b) each broad type of information identified in the disclosure objective:

(i) what the key facets of performance and position are and how management monitors those key facets (paragraphs 52–53);

(ii) what affected the entity's performance during the reporting period or could affect it in the future, including over the long term (paragraphs 54–63);

(iii) what affected the entity's position at the end of the reporting period or could affect it in the future, including over the long term (paragraphs 64–68); and

(iv) how the entity's performance and position reported in its financial statements compare to previous expectations (paragraphs 69–77).

How to identify key facets of performance and position?

44. In July 2019, the Board tentatively approved guidance on making materiality judgements in preparing management commentary. Information is considered material if it can reasonably be expected to affect investors' and creditors' assessment of the prospects for future cash flows and of management's stewardship of the entity's economic resources.

45. That guidance would apply to all information in management commentary. To help preparers apply that guidance in identifying material information about performance and position, the staff suggest providing guidance on identifying 'key' facets of performance

and position. Facets would be key because information about them is likely to be material to investors' and creditors' assessments.

46. In discussing key matters to be addressed in other areas of content in management commentary, the Board concluded that the key matters are those that relate to the entity's ability to create value and generate cash flows. This definition is consistent with investors' and creditors' focus on the entity's prospects for future cash flows, including over the long term. The staff think that the same principle applies to performance and position and recommend that the revised Practice Statement defines key facets as those that reflect the entity's ability to create value and generate cash flows.

47. As discussed in Agenda Paper 15, the Board also noted that key matters that relate to the entity's ability to create value and generate cash flows would typically be monitored and managed by an entity's management. The staff think that this observation is also applicable to the key facets of performance and position. In particular, the staff think that management will use measures and indicators to monitor the key facets of performance and position (see Agenda Paper 15D for guidance on management measures and indicators).

48. The revised Practice Statement could also provide additional guidance to help preparers identify those key facets of performance and position.

49. As explained in paragraph 37, the starting point for discussing performance and position is the amounts included in an entity's financial statements. Existing IFRS Standards require minimum line items and subtotals that should be presented in financial statements because they are expected to reflect aspects of performance and position that are important for investors and creditors. For example, these include operating profit or loss, share of the profit or loss of associates and joint ventures accounted for using the equity method or cash flows arising from operating activities.[5] Management would need to apply judgement, in the light of the entity's specific circumstances, to identify which of those facets are key because they most reflect the entity's ability to create value and generate

[5] 2019 Exposure Draft *General Presentation and Disclosures* proposes to define 'integral associates and joint ventures' and 'non-integral associates and joint ventures' and to require entities to provide information about integral associates and joint ventures separately from that for non-integral associates and joint ventures.

cash flows and, therefore, which line items and subtotals should be explained in management commentary.

50. In addition to facets reflected by minimum line items and subtotals required in an entity's financial statements, management could select other facets of performance and position that it may consider to be important for understanding the entity's performance and position in the reporting period and in the future. These can include, for example, facets of performance and position reflected by:

(a) other line items reported in an entity's financial statements or items discussed in the notes to the financial statements if information about them is important for the entity in a particular industry, for example 'research and development expenses' might be identified as a key facet of performance for a pharmaceutical company.

(b) adjusted subtotals of performance and position that, in the management's view, best communicate a facet of the entity's performance and position. For example, these can include adjusted operating profit or free cash flow.[6]

(c) measures and indicators related to items not recognised in financial statements, including unrecognised intangible resources and relationships. For example, these can include indicators related to an entity's customer base.

51. Management may monitor multiple facets of performance and position. The staff think that the revised Practice Statement could suggest that depending on the entity's structure and the complexity of its operations, management may choose to provide an overview of the entity's performance and position in addition to a detailed discussion of the key facets of its performance and position. Many MCCG participants agreed that such an overview could be useful to investors and creditors.

What information to provide about key facets of performance and position

What the key facets of performance and position are and how management monitors those key facets

52. As explained in paragraphs 48–50, the key facets of performance and position would differ from entity to entity. Information about those key facets and about how they are

[6] 2019 Exposure Draft *General Presentation and Disclosures* defines 'management performance measures' and discusses when and how they can be included in an entity's financial statements.

monitored could provide an insight into management's view of an entity's performance and position.

53. The description of key facets of performance and position and how they are monitored may need to cover what measures or indicators are used by management to monitor that facet of performance or position.

Link to management measures and indicators

- Agenda Paper 15D provides guidance on including management measures and indicators in management commentary. For example, it suggests that management should:
  - (a) explain the relevance of the measure or indicator;
  - (b) provide sufficient information to help investors and creditors identify the trend related to that measure or indicator; and
  - (c) explain whether the measure or indicator is monitored as part of measuring management's success and, if so, explain the link between executive compensation and the management measure or indicator.

What affected the entity's performance in the reporting period or could affect it in the future including over the long term

54. This section covers:

(a) explanation of key matters that affected the entity's performance in the reporting period (paragraphs 55–59); and

(b) explanation of key matters that could affect the entity's performance in the future (paragraphs 60–63).

Explanation of key matters that affected the entity's performance in the reporting period

55. Performance and position is the area of content bringing together all other areas of content because the entity's performance and position are the result of management operating the entity's business model, executing strategy, deploying resources and relationships, managing risks and responding to factors and trends in the operating environment. Key

matters discussed in those areas of content are those that relate to the entity's ability to create value and generate cash flows, and so affect the entity's performance and position. Accordingly, the staff think that the guidance on matters that affect an entity's performance and position should explain that those matters would be matters identified and discussed in other areas of content in management commentary. For example, matters that affect an entity's revenue could relate to:

(a) the entity's business model, for example, to an increase in productivity of the entity's manufacturing process;

(b) management's strategy, for example, to a successful implementation of a plan to enter a new market during the reporting period;

(c) resources and relationships, for example, to a shortage of raw materials;

(d) risks, for example, to a successful mitigation of an exchange rate risk; and

(e) factors and trends in the external environment, for example, to changes in legislation affecting the entity's products.

56. As explained in Agenda Paper 15B *Progress*, it is expected that management will use management measures or indicators to monitor progress in managing the key matters. An explanation of matters that affect key facets of the entity's performance and position may need to include analysis of measures and indicators that are used to monitor the progress in managing those matters. For example, an important driver for a multimedia company could be its subscriber base. Management may use indicators such as the number of subscribers and the level of their satisfaction to monitor the subscriber base. In this case, an analysis of matters that affect the key facets of the entity's performance, for example, revenue, may need to include the analysis of those indicators used to monitor the subscriber base.

57. As noted in paragraph 37, the starting point for analysis of performance and position would be explaining the amounts included in an entity's financial statements. Accordingly, the Practice Statement could suggest that the analysis of key facets of performance could relate to categories of income and expenses and cash flows identified in the related financial statements, that is the entity's operating, investing and financing activities.

Analysis of the entity's operating activities

58. Explanation of matters related to the operation of the entity's business model is normally central to explaining the entity's income and expenses and cash flows related to operating activities. Therefore, the staff suggest that the revised Practice Statement could include guidance on analysing income and expenses and cash flows related to an entity's operations. Such guidance could suggest that management commentary provides:

    (a) analysis of an entity's revenue which could cover:

    - (i) analysis of key drivers of revenue by products or services or by region or currencies; and
    - (ii) explanation of how revenue is affected by price and volume factors and by the products and services mix;

    (b) analysis of the entity's expenses which could cover:

    - (i) split of costs into fixed and variable costs. For example, this information would be useful to help investors and creditors assess the implications of revenue growth on the entity's cost base.
    - (ii) discussion of costs related to enhancing key features of an entity's business model, for example, expenses related to improving efficiency and productivity or research and development expenses. Information about such costs may indicate to investors and creditors that there have been changes in the entity's ability to create value and generate cash flows during the reporting period.

Link to information in financial statements

- Information about the entity's revenue and expenses should be reconcilable with information provided in the entity's financial statements on its operating segments. As already discussed by the Board in July 2019 in relation to aggregation of information (see the Board's tentative decision in Appendix B of Agenda Paper 15), the guidance could also state that the analysis of revenue and expenses may need to be provided at a more granular level than the entity's operating segments reported in the financial statements, for example, if the matters that affect revenue from main categories of customers within a segment vary.

(c) explanation of the specifics of the entity's business model that affect income and expenses and cash flows from the entity's operating activities. The explanation could cover:

  (i) whether the entity generates stable or cyclical revenue. This information could help investors and creditors understand whether any shortages in cash flows are related to the cyclical nature of the entity's operations.

  (ii) working capital changes during the period, especially if the entity's working capital position at the end of the reporting period is unrepresentative of the entity's working capital during the reporting period.

  (iii) where the entity is in its life cycle. This information could be useful in providing context because entities in different stages of their life cycles could demonstrate different patterns of generating cash flows. For example, start-ups are likely to generate less cash flows from operating activities and require financing from sources other than their own operations; in contrast, mature companies are more likely to generate stable cash inflows from operations.

  (iv) the typical time lag between earning revenue and converting it into cash. This information could help investors and creditors better understand information in the entity's statement of financial performance and in the statement of cash flows.

Analysis of the entity's financing and investing activities

59. As explained in Agenda Paper 15A *Financial resources*, in addition to the matters identified in paragraph 55, the entity's performance and position may also be driven by management's approach to obtaining financial resources and to allocating financial resources, including those generated by the entity's operations. That Agenda Paper discusses possible guidance on explaining management's approach to obtaining and allocating financial resources and the results of their decisions made in the reporting period on obtaining and allocating those resources. In addition, the guidance on analysing the entity's financing and investing activities could suggest that management could explain how the entity's income and expenses and its cash flows from financing and investing activities contributed to, and were affected by, management's decisions made on obtaining and allocating financial resources and progress in managing those resources.

Explanation of key matters that could affect the entity's performance in the future

60. As noted in paragraph 33, investors and creditors need information to help them assess the extent to which financial performance for the reporting period is indicative of future performance. To help investors and creditors make that assessment, the revised Practice Statement could ask management to:

(a) identify significant changes in drivers of performance or in potential implications of those drivers on performance from the previous reporting period and explain those changes.

(b) explain significant changes in performance related to changes in the structure of the entity, ie acquisitions and disposals of businesses. This information would help investors and creditors distinguish an entity's so-called 'organic growth' from changes related to the entity's structure and help them assess the implications of the changes in performance over the period for the entity's ability to create value and generate cash flows in the future.

(c) identify income and expenses and cash flows that are not indicative of future performance, for example those related to unusual items.

Link to another project—Primary Financial Statements

- In 2019 Exposure Draft *General Presentation and Disclosures* the Board proposed a definition of 'unusual income and expenses' and a requirement to disclosure unusual income and expenses in a single note.[7]

(d) provide information about any known or reasonably expected changes in matters that could affect the entity's performance in the future. For example, if a matter, or a change in the matter, is expected to significantly affect an entity's performance in the future management would need to explain that matter even if the effect of the matter, or the change in the matter, in the current period has not been significant.

[7] Paragraph 100 of ED GPD: 'Unusual income and expenses are income and expenses with limited predictive value. Income and expenses have limited predictive value when it is reasonable to expect that income or expenses that are similar in type and amount will not arise for several for several future annual reporting period.'

(e) identify and provide information about key matters arising after the end of the reporting period (but before the management commentary is authorised for issue) that could affect the entity’s future performance. The discussion could include:

  (i) explanation of events that occurred after the end of the reporting period and could affect the entity’s future performance, for example, a global pandemic;

  (ii) discussion of management measures and indicators used by management as indicators of future performance, for example, analysis of the order book or pipeline.

61. Information provided for various matters affecting performance may need to vary. For example, in some cases, income tax may be identified as a key matter that affects the entity’s profit or loss. To enhance investors’ and creditors’ understanding of the effects of income tax and to help them assess how the relationship between that tax and the entity’s profit or loss might change in the future, management commentary could discuss income tax reconciliation required by IAS 12 *Income Taxes*, for example:

(a) indicate whether the reconciling items are likely to recur;

(b) discuss known and expected changes to tax rates or law, or planned changes to management’s tax strategy;

(c) identify other factors expected to affect the future relationship between tax expense and profit or loss; and

(d) explain the implications of deferred tax liabilities and deferred tax assets for the entity’s future cash flows.

62. The revised Practice Statement could also provide examples of methods that can be used to explain matters that affect an entity’s performance. Such examples could include:

(a) so called ‘bridge analysis’ that compares performance for the reporting period with the previous period and explains the nature of variances;

(b) so called ‘constant currency calculations’ that aim to eliminate the effect of currency fluctuations when calculating performance numbers; and

(c) so called ‘pro-forma’ calculations that aim to enable hypothetical like for like comparisons.

63. In addition, the revised Practice Statement could also provide examples of methods that can be used to help investors and creditors assess the implications of matters that could affect the entity's performance and position. Examples of such methods could include:

(a) scenario analysis that analyses possible future events by considering alternative possible outcomes; and

(b) sensitivity analysis that analyses how future outcomes could vary with future changes in input variables.

Link to guidance on qualitative characteristics of useful financial information

- The guidance on methods described in paragraphs 62–63 may benefit from a reminder that if analysis using such methods is provided, it should:

  (a) be prepared in a balanced way. For example, it should address not only unusual losses but also unusual gains.

  (b) include explanation of the reason for using the method chosen, the methodology used, assumptions made and limitations of the analysis.

Link to guidance on matters that could affect the entity's position in future

- The suggested guidance on explaining matters that could affect the entity's performance, including the guidance on methods of explaining the matters and their implications, is equally applicable to analysing matters that could affect the entity's position in the future. The staff will consider in drafting the best way to include this guidance in the revised Practice Statement.

What affected the entity's financial position at the end of the reporting period or could affect it in the future?

64. As with matters affecting performance, management would need to exercise judgement in determining what matters affecting the entity's position should be described in management commentary. The guidance in the revised Practice Statement could highlight that management commentary may need to:

(a) provide information needed to help investors and creditors assess the entity's ability to meet its obligations, including over the long term (paragraph 65); and

(b) explain the entity's unrecognised assets and liabilities, and other unrecognised resources and relationships (paragraphs 66–68).

65. To help investors and creditors assess the entity's ability to meet its obligations, including over the long term, the revised Practice Statement could ask management to:

(a) provide analysis of the entity's liquidity and leverage measures and indicators, including explanations of variances from previous reporting period and any known or reasonably expected changes in future periods;

(b) discuss mitigating actions taken by management to address any liquidity issues that arose during the period or are anticipated in the future period;

(c) provide information on the entity's capital structure and financing arrangements (whether or not recognised in the statement of financial position);

(d) provide analysis of measures that could help investors and creditors understand the entity's compliance with financing covenants; and

(e) discuss any claims of non-controlling interests on the entity's resources.

Link to information in financial statements

- IFRS 7 *Financial Instruments: Disclosures* sets out requirements for disclosures on liquidity risk arising from the entity's financial instruments.
- IAS 1 *Presentation of Financial Statements* sets our requirements for disclosures on the entity's capital.
- In its project on Financial Instruments with Characteristics of Equity the Board may explore enhanced disclosure requirements about financial liabilities and equity instruments.

  Entities may choose to incorporate some information from financial statements by cross-reference and provide any additional information and analysis needed to help users understand the entity’s current financing facilities and give insight into their future availability.

Link to financial resources and risks

- To assess the entity’s current and future ability to meet its obligations investors and creditors would also need information provided in other areas of content, for example:
  (a) information on obtaining and allocating the entity’s financial resources (see Agenda Paper 15A); and
  (b) information about risks.

66. Given the gap in practice identified in paragraph 13(b)(ii), the staff think that the revised Practice Statement should also ask management to explain items not recognised in the entity’s financial statements because such explanation would help investors and creditors gain a better understanding of the entity’s position not reported in financial statements and of possible implications of those unrecognised items for the entity’s ability to create value and generate cash flows in the future.

67. In April 2020, the Board already discussed guidance on reporting resources and relationships, including on unrecognised ones. For example, a description of the entity’s resources may include a description of internally generated brands and the progress in managing those brands (see Agenda Paper 15B for this meeting). The guidance on analysing position could ask management to explain how those unrecognised resources and relationships affected or could affect the entity’s ability to create value and generate cash flows.

68. In addition, the guidance could ask for a discussion of the entity’s unrecognised commitments, for example, some guarantees. There may be additional considerations for some intra-group commitments and for commitments to related parties.

How an entity's performance and position reported in financial statements compare to previous expectations?

69. As noted in paragraph 32, information about whether performance and reported in financial statements is short of, meets or exceeds management's previous expectations helps investors and creditors assess management's stewardship.

70. The existing Practice Statement allows but does not require an entity to include forecasts or targets in its management commentary (paragraph 10). However, if they were included, the Practice Statement requires a comparison of actual performance for the period or position at the end of the reporting period to the forecast or target and to analyse and explain significant variances.

71. The staff considered whether the existing guidance in the revised Practice Statement should be extended to address forecasts and targets included in *public communications other* than management commentary. That guidance could specify that:

    (a) actual performance and position should be compared to such previous forecasts and targets for the period that is already finished; and

    (b) management commentary should provide information about such forecasts and targets if they cover the period that is not yet finished.

Link to another project—Primary Financial Statements

- 2019 Exposure Draft *General Presentation and Disclosures* refers to 'public communications outside financial statements' in defining management performance measures. The staff will continue following the developments in the Primary Financial Statements project to ensure that the reference to 'public communications' is used with the same meaning in both projects.

72. The staff think that benefits of including the requirements mentioned in paragraph 71 in the revised guidance would be that:

    (a) the same information about forecasts and targets would be provided to all investors and creditors in one place—management commentary (for example, investors that did not participate in capital markets days would be aware of any forecasts or targets discussed at that public event without having to look for that information in other sources, for example, in a transcript for that event).

(b) requiring a comparison with forecasts and targets published in other communications would help ‘close the loop’ and help investors and creditors assess management’s success in achieving its past forecasts and targets and so assess management’s stewardship of the entity’s economic resources.

(c) information about ‘forecasts and targets that cover the period that is not yet finished may provide investors and creditors with an insight into management’s view of the entity’s future performance and position. In particular, the staff heard that investors and creditors find information about management’s assumptions related to forecasts and targets helpful for their own assessments of prospects of future cash flows to the entity.

73. In discussions with the MCCG, CMAC and GPF some investors supported the suggestion for extending the existing requirements. However, some preparers of financial reports expressed concern that including in management commentary forecasts and targets that cover the period that is not yet finished could, for example, expose entities to litigation risks or be restricted by legal or regulatory requirements that constrain or prohibit forecasts or that require an extensive process to justify publishing a forecast or updated forecast.

74. On balance, the staff think that requirements related to forecasts and targets published in public communications could lead to provision of useful information for investors and creditors. The staff do not expect preparers to incur significant costs in meeting the extended requirements because they relate to forecasts and targets that entities have already prepared and chosen to include in public communications.

75. To ensure that the extended requirements do not place excessive burden on preparers, the staff suggest specifying the scope of forecasts and targets covered by the extended requirements. The staff suggest that forecasts and targets that need to be discussed in management commentary should relate to management measures and indicators included in management commentary (see Agenda Paper 15D). This is because those measures and indicators are used to report progress in managing key matters in respect of an entity’s

business model, strategy, resources and relationships, risks and external environment and to report the key facets on the entity's performance and position.

76. As mentioned in paragraph 71(b), the requirement related to forecasts and targets that cover the period that is not yet finished asks management to inform investors and creditors in management commentary that such forecasts and targets exist. The staff considered how broad this requirement should be. It could ask management to state:

(a) the fact that a forecast or target exists, for example 'on 29 November 20XX, in [name of the report] we published an earnings forecast for the next financial year'.

(b) the fact that a forecast or target exists and that it has not been updated since the publication date, for example 'on 29 November 20XX, in [name of the report] we published an earnings forecast for the next financial year. The forecast has not been updated since then'.

(c) the fact that such forecast or target exists and provide explicit negative assurance in relation to the forecast or target, for example 'on 29 November 20XX, in [name of the report] we published an earnings forecast for the next financial year. The forecast has not been updated since then. However, we are not aware of any factors that would lead us to significantly change the forecast.'

77. The staff's research has shown that the requirement in (c) could be seen as a regulatory function, so the staff do not suggest including it into the revised guidance. However, the staff think that the requirement in (b) asks for a statement of fact and would give investors and creditors information for their assessment of the credibility of the forecast or target. For this reason, the staff suggest that the requirement to state the fact that a forecast or target has not been updated since the publication date should be included in the revised guidance.

Question 3 for the Board
Paragraphs 52–77 provide staff's discussion of possible guidance supporting the disclosure objective for performance and position that could be included in the revised Practice Statement. Do you have any questions or comments on that discussion?

Appendix A—Extracts from IFRS Practice Statement 1 *Management Commentary* on performance and position

Principles

Management's view

15 Management commentary should provide management perspective of the entity's performance, position and progress. Management commentary should derive from the information that is important to management in managing the business.

Supplement and complement the financial statement information

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. Management commentary should also include information about the entity and its performance that is not presented in the financial statements but is important to the management of the entity.

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 or, 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.

Elements of management commentary

24 Although the particular focus of management commentary will depend on the facts and circumstances of the entity, management commentary should include information that is essential to an understanding of:

(a) the nature of the business;
(b) management's objectives and its strategies for meeting those objectives;
(c) the entity's most significant resources, risks and relationships;
(d) the results of operations and prospects; and
(e) the critical performance measures and indicators that management uses to evaluate the entity's performance against stated objectives.

Resources, risks and relationships

Resources

30 Management commentary should set out the critical financial and non-financial resources available to the entity and how those resources are used in meeting management's stated objectives for the entity. Disclosure about resources depends on the nature of the entity and on the industries in which the entity operates. Analysis of the adequacy of the entity's capital structure, financial arrangements (whether or not recognised in the statement of financial position), liquidity and cash flows, and human and intellectual capital resources, as well as plans to address any surplus resources or identified and expected inadequacies, are examples of disclosures that can provide useful information.

Results and prospects

34 Management commentary should include 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. Useful disclosure on those matters can help users to make their own assessments about the entity's performance, position, progress and prospects.

Results

35 Management commentary should include explanations of the performance and progress of the entity during the period and its position at the end of that period. Those explanations provide users of the financial reports with insights into the main trends and factors affecting the business. In providing those explanations, management should describe the relationships between the entity's results, management's objectives and management's strategies for achieving those objectives. 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.

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 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.