

Management Commentary

IASB-EAA-EFRAG workshop
June 2021

Agenda

Introduction

Objectives-based approach

Selecting and presenting information

Reporting on sustainability matters



Introduction

What is management commentary?

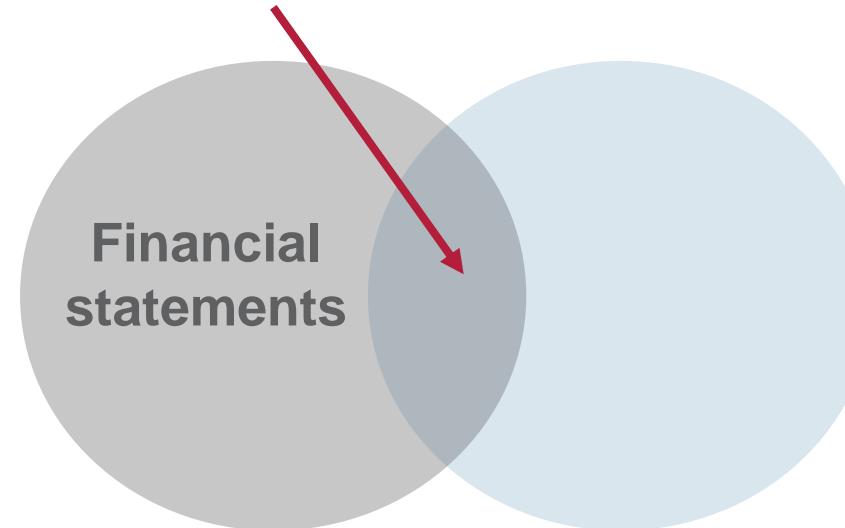


A financial report

- Complements financial statements
- Provides insights into a company's ability to create value and generate cash flows
- Aimed at investors and creditors
- May be useful for a wider range of stakeholders but is not aimed at them

IFRS Practice Statement 1
Management Commentary

Management commentary



General purpose
financial reporting

Wider corporate
reporting

Why is the IASB doing the project?

 Changing information needs
Increased demand for information about:
<ul style="list-style-type: none">• Long-term prospects• Intangibles• Environmental, social and governance (ESG) matters

 Gaps in current reporting practice
<ul style="list-style-type: none">• Too much generic information• Lack of focus on matters important to the entity's prospects• Short-term focus• Fragmentation• Lack of balance

 Developments in narrative reporting
<ul style="list-style-type: none">• Notions of 'enterprise value' and 'value creation'• Focus on resources and relationships, including intangibles• Developments in sustainability reporting

What is the IASB aiming to achieve?

Comprehensive framework focused on investors and creditors' information needs

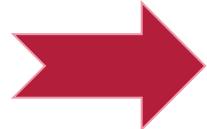
Provides an effective basis for:

- **preparers** to tell a coherent story joining financial, sustainability and other information in one report
- **regulators** to mandate the Practice Statement
- **auditors** to provide external assurance

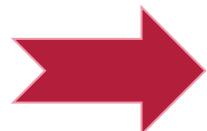
Can be applied alongside local laws and regulations and other narrative reporting requirements

Incorporates innovations in narrative reporting and addresses gaps in reporting practice

Who would apply the new framework?



Local lawmakers or regulators
may decide to require compliance



Companies may choose to
comply even if not required



A company's financial statements can
comply with IFRS Standards even if:

- they are not accompanied by management commentary
- management commentary does not comply with the Practice Statement



Statement of compliance

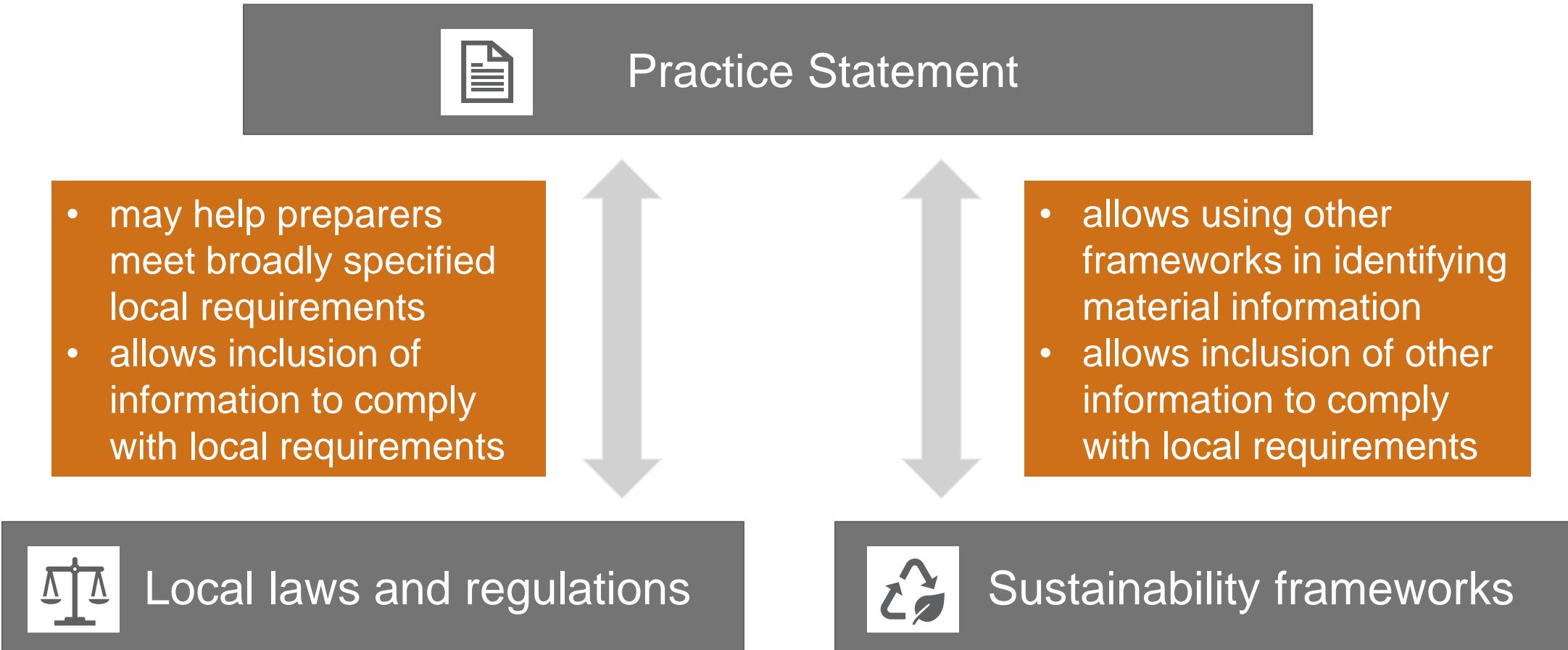
Unqualified

- Complies with all requirements

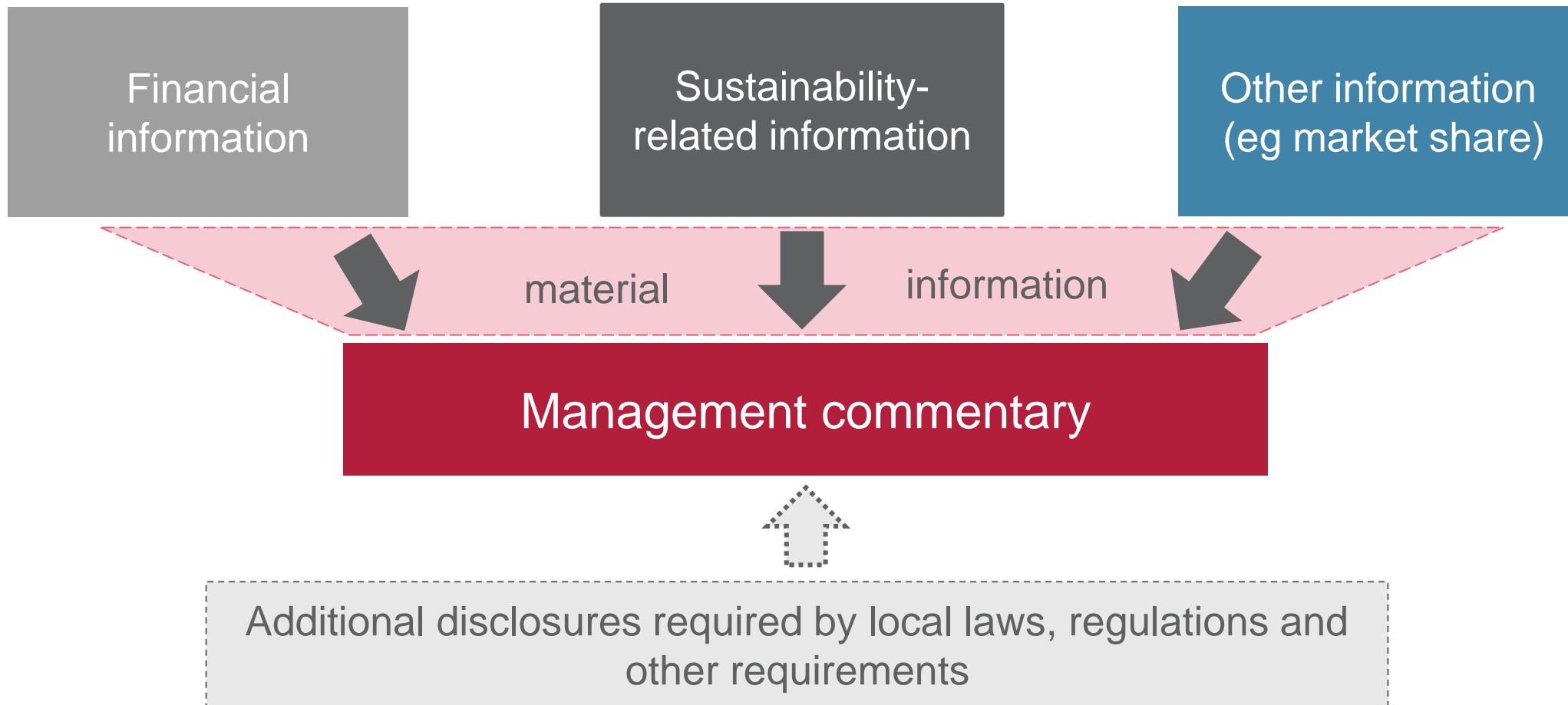
Qualified

- Complies with some, but not all, requirements
 - must identify departures and reasons for them

Compatibility with other reporting requirements



Focal point for connectivity



Next steps and how can you help?



Introduction- EU Perspective

In the EU, similar to 2010 Practice Statement, the revised Practice Statement will not be endorsed

Although the EU has relatively robust requirements for the preparation of management commentary (Accounting Directive and Country-specific requirements), EFRAG will submit a comment letter:

- Cross-pollination of best practices and global convergence of management commentary reporting requirements; and
- The MCPS may be useful in jurisdictions that do not have management commentary reporting requirements and improve the quality of financial reporting in those jurisdictions.

EFRAG, ESMA participated in MCCG as observers; European preparer, standard setter and regulator were members of the MCCG

Introduction- Overarching observations

STRENGTHS

- Will contextualise financial statement information
- Enhances linkage and connectivity of information outside and within financial statements,
May have a role for IFRS sustainability standards
- Emphasis on enterprise value creation (that said, the term is sparsely used through the ED)
- Proposals on unqualified and qualified statements of compliance would encourage uptake

Introduction- Overarching observations

POSSIBLE AREAS TO BE FURTHER CONSIDERED

- Potential ambiguities on scope (e.g., on so-called pre-financial information)
- Clarify boundaries of MC information
- Clarify constraints (regulatory constraints on forward looking information)
- While correct not to be prescriptive on time horizon, should require entities to clarify what they mean by short, medium and long-term. That would align with objective of reporting on long-term prospects discussed in Appendix B
- Assessment of stewardship as an objective should be included as a key objective
- Challenges may arise with use of new and different terminology (Key matters versus material; investors and creditors instead of primary users; resources and relationships versus IR six capitals)-
- There is need to assess the assumptions around adoption and enforceability of a voluntary framework such as MCPS; uptake of voluntary guidance (e.g., TCFD) occurs on the back of extensive outreach to policy makers, market actors and not by a “Field of Dreams” approach

Introduction – General comments and suggestions

■ IFRS PSMC (2010): A look back

- Practice Statement as a new type of pronouncement
- Aimed at international harmonization and improving the quality of management reporting
- Rather low adoption internationally – management reporting regulation continues to be fragmented

■ ED IFRS PSMC (2021): A good step forward...

- Considers recent developments in narrative reporting
- More detailed requirements and guidance
- Defines minimum requirements for contents and is open for additional local reporting requirements
- Considers assurance for MC

Issues to be considered (1)

■ Type of pronouncement: Practice Statement?

- Adoption will most likely remain low in the EU (not endorsed)
- Assurance and enforcement?
- Image: Management commentary less relevant than financial statements?

- 
- **Suggestion:** Develop an **IFRS Standard** that – like IAS 34 on Interim Reporting – is applicable only to those entities that are required by local law to prepare a management commentary complementing IFRS financial statements or do so voluntarily.
 - Endorsed by the EU
 - Member state option to mandate or allow adoption of IFRS MC; additional requirements by EU Directive
 - Dual reporting according to IFRS MC and national standards (e.g. GAS 20 on Group Management Reporting)

Issues to be considered (2)

- Is the reporting entity the same as for the related IFRS financial statements?

- Is it possible to prepare a “combined management commentary” according to ED PSMC?
(Note: local laws may allow to combine the MC of the parent company with the MC of the group)

- Is PSMC also applicable for interim management reports? If so, is compliance with all requirements necessary?

- Distinguish more clearly between requirements (e.g. bold letters) and guidance (e.g. normal letters).



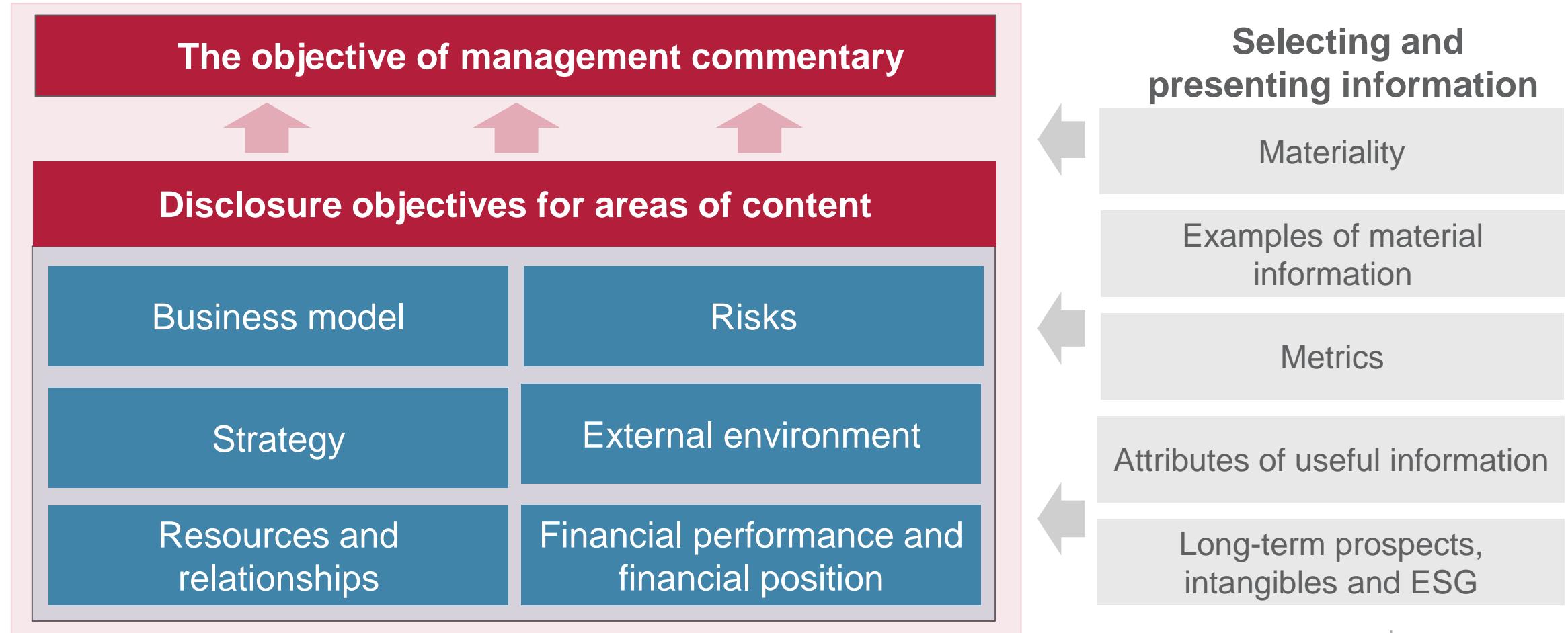
Questions?



Objectives-based approach

What is the IASB proposing?

Comprehensive objectives-based framework



The objective of management commentary



Management commentary provides information that:

- enhances understanding of the company's **financial statements**

what has affected the company

- provides insight into the company's **ability to create value and generate cash flows**

what might affect the company,
including in the long-term



Information is provided if **material** for investors and creditors' assessments of:

- the company's prospects for future cash flows
- management's stewardship of the company's resources

Disclosure objectives: the design

Disclosure objectives for each area of content

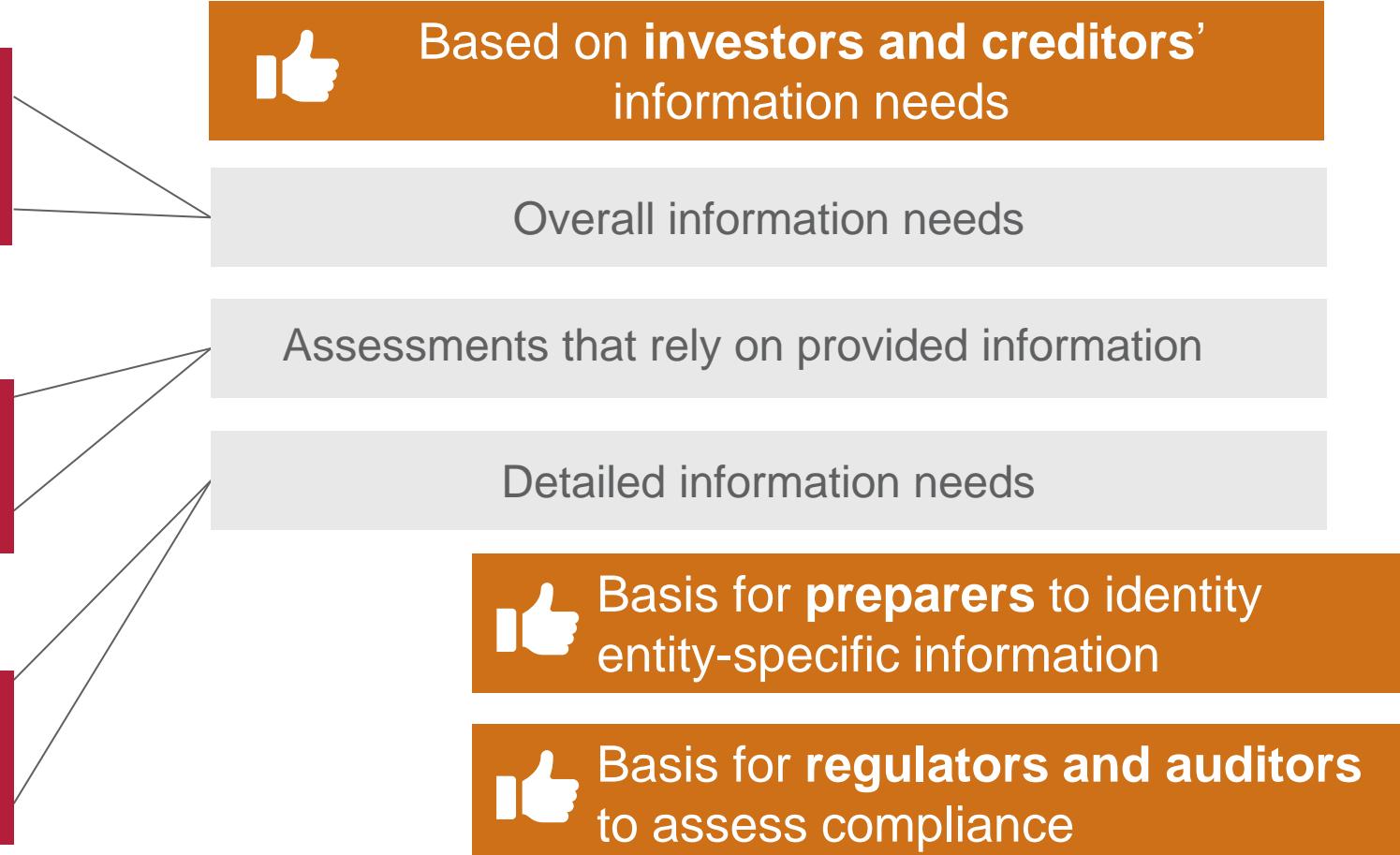
A headline objective



Assessment objectives



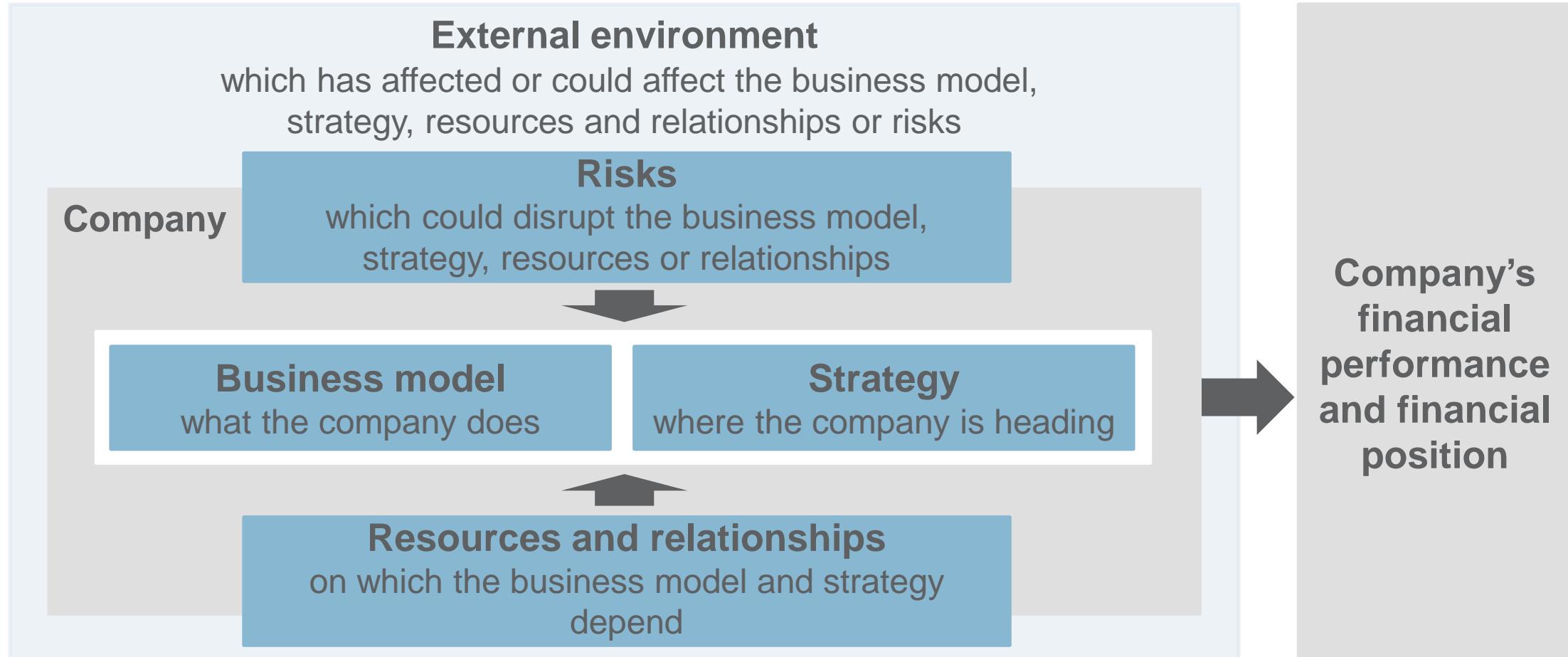
Specific objectives



Areas of content



Financial, sustainability and other material information about the company



Disclosure objectives: Business model as an example

Disclosure objectives

A headline objective

Assessment objectives

Specific objectives

Business model

Enable investors and creditors to understand:

- How the company's business model creates value and generates cash flows

Provide a sufficient basis for investors and creditors to assess:

- How effective the company's business model is
- How scalable and adaptable it is
- How resilient and durable it is

Enable investors and creditors to understand:

- The range, nature and scale of the company's operations
- The cycle of creating value and generating cash flows
- Environmental and social impacts of the company's activities
- Progress in managing the company's business model

Strategy

Disclosure objectives

A headline objective

Strategy

Enable investors and creditors to understand:

- Management's strategy for sustaining and developing the company's business model

Assessment objectives

Provide a sufficient basis for investors and creditors to assess:

- How effective the strategy is likely to be in developing the company's ability to create value and generate cash flows
- Management's ability to implement the strategy

Specific objectives

Enable investors and creditors to understand:

- The drivers of the strategy, including the opportunities pursued
- The aims of strategy
- Milestones on the path towards those aims
- Plans for reaching the milestones and aims
- The financial resources required to implement the strategy and management's approach to allocating financial resources
- Progress in implementing the strategy

Resources and relationships

Disclosure objectives

A headline objective

Resources and relationships

Enable investors and creditors to understand:

- The resources and relationships on which the company's business model and management's strategy depend

Assessment objectives

Provide a sufficient basis for investors and creditors to assess:

- The extent to which the business model and management's strategy depend on particular resources and relationships
- The company's ability to obtain the resources and maintain the relationships needed

Specific objectives

Enable investors and creditors to understand:

- The nature of the company's resources and relationships and how the company deploys them
- How the company obtains its resources and maintains its relationships
- Factors that could affect the availability or the quality of the resources and relationships in the future, including in the long term
- Progress in managing the resources and relationships

Risks

Disclosure objectives

A headline objective

Risks

Enable investors and creditors to understand the risks that could disrupt:

- The company's business model
- Management's strategy
- Resources and relationships

Assessment objectives

Provide a sufficient basis for investors and creditors to assess:

- The extent of the company's exposure to risks
- How effectively management monitors and manages the exposure to risks

Specific objectives

Enable investors and creditors to understand:

- The nature of the risks to which the company is exposed
- The company's exposure to those risks
- How management monitors and manages the risks
- How management will mitigate disruption if it occurs
- Progress in managing risks

External environment

Disclosure objectives

A headline objective

External environment

Enable investors and creditors to understand how the company's external environmental has affected or could affect:

- The company's business model
- Management's strategy
- Resources and relationships
- Risks

Assessment objectives

Provide a sufficient basis for investors and creditors to assess:

- How factors and trends in the external environment have affected or could affect the company
- How effectively management monitors and responds to those factors and trends

Specific objectives

Enable investors and creditors to understand:

- The nature of factors and trends in the company's external environment
- How those factors and trends have affected or could affect the company
- How management monitors and plans to respond to those factors and trends
- Progress in responding to those factors and trends

Financial performance and financial position

Disclosure objectives

A headline objective

Financial performance and financial position

Enable investors and creditors to understand:

- The company's financial performance and position reporting in the company's financial statements

Assessment objectives

Provide a sufficient basis for investors and creditors to assess:

- Drivers of the company's financial performance and position
- How performance and position compare with investors' previous expectations, and the extent to which they are indicative of the company's future ability to create value and generate cash flows
- The company's financial resilience

Specific objectives

Enable investors and creditors to understand:

- What factors have affected the company's financial performance and position in the reporting period or could affect them in the future
- How management has allocated financial resources in the reporting period
- How the company's financial performance and position compare with forecasts and targets

Overall Objective- Disclosure Objectives

An approach combining headline and specific disclosure objectives complemented with non-binding examples is sensible – **Key matters are entity specific and dynamic**

However, some of the terminology can be confusing- struggled to distinguish between assessment and specific objectives; furthermore similar notions use different language across consultation documents

- Headline objective (MCPS) versus Overall objectives (Pilot project)
- ‘Could include’ (MCPS) Versus ‘While not mandatory, the following information may enable an entity to meet [the specific disclosure objective].’ (DI Pilot)
- Assessment objectives (MCPS) Versus ‘explanation of what the information is intended to help users do (DI Pilot)

As noted in EFRAG’s response to the Disclosure initiative pilot project, by nature, objective-based requirements are more prone to create applicability, enforceability and auditability which ought to be field tested by the IASB.

Overall Objective- Six Areas of Content

STRENGTHS

- Provides much needed strengthening of guidance around business model and resources and relationships including intangibles reporting. European Lab work shows such guidance is much needed
- Relative to 2010 MCPS, resources and relationships and factors from external environment are a separate topic

AREAS FOR POSSIBLE CONSIDERATION

- Should the guidance for strategy and business model remain separated or be combined?
- Governance disclosures needed to assess stewardship: Although aspects of governance may be part of the discussion on strategy, progress in managing key matters and metrics used for management's incentives)- Governance is not addressed as a separate content element in the ED
- Should give equal prominence to risks and opportunities

Objectives-based approach

■ Overall: balance between entity-specific information (flexibility) and standardization (comparability)

- However, consider more emphasis of management approach (e.g. quantitative metrics if used by management)
- Approach suited for external assurance? Check with audit profession.

■ Unclear Wording

- “insight into the company’s *ability to create value and generate cash flows*”: value creation = present value of future cash flows
- Headline, assessment and specific objectives?  Hierarchy?

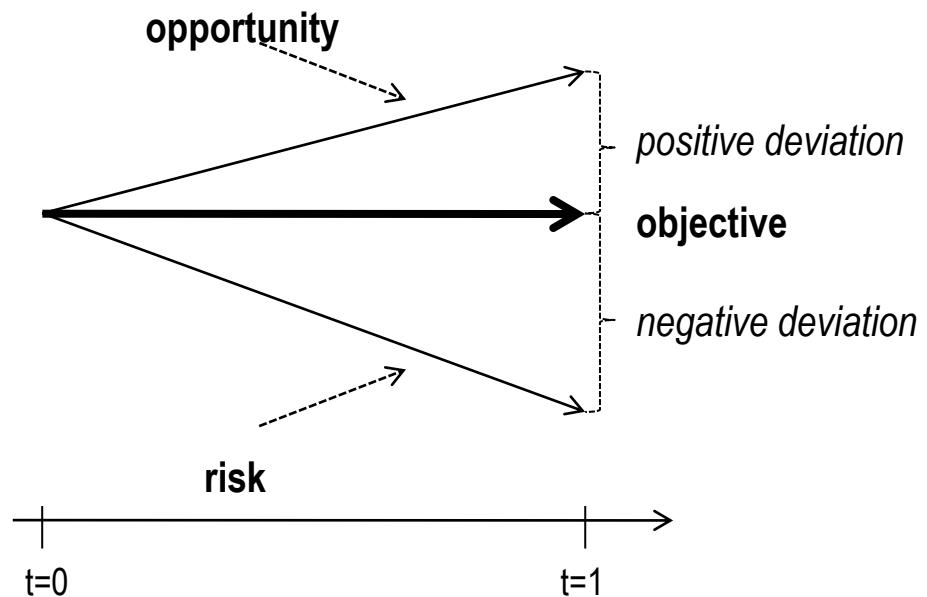
■ Six content areas

- Cover relevant topics
- Missing: management’s view on the entity’s future development (prospects); despite not being a requirement, consider it as an (optional) content area (or a content area that local laws could mandate)

Objectives-based approach

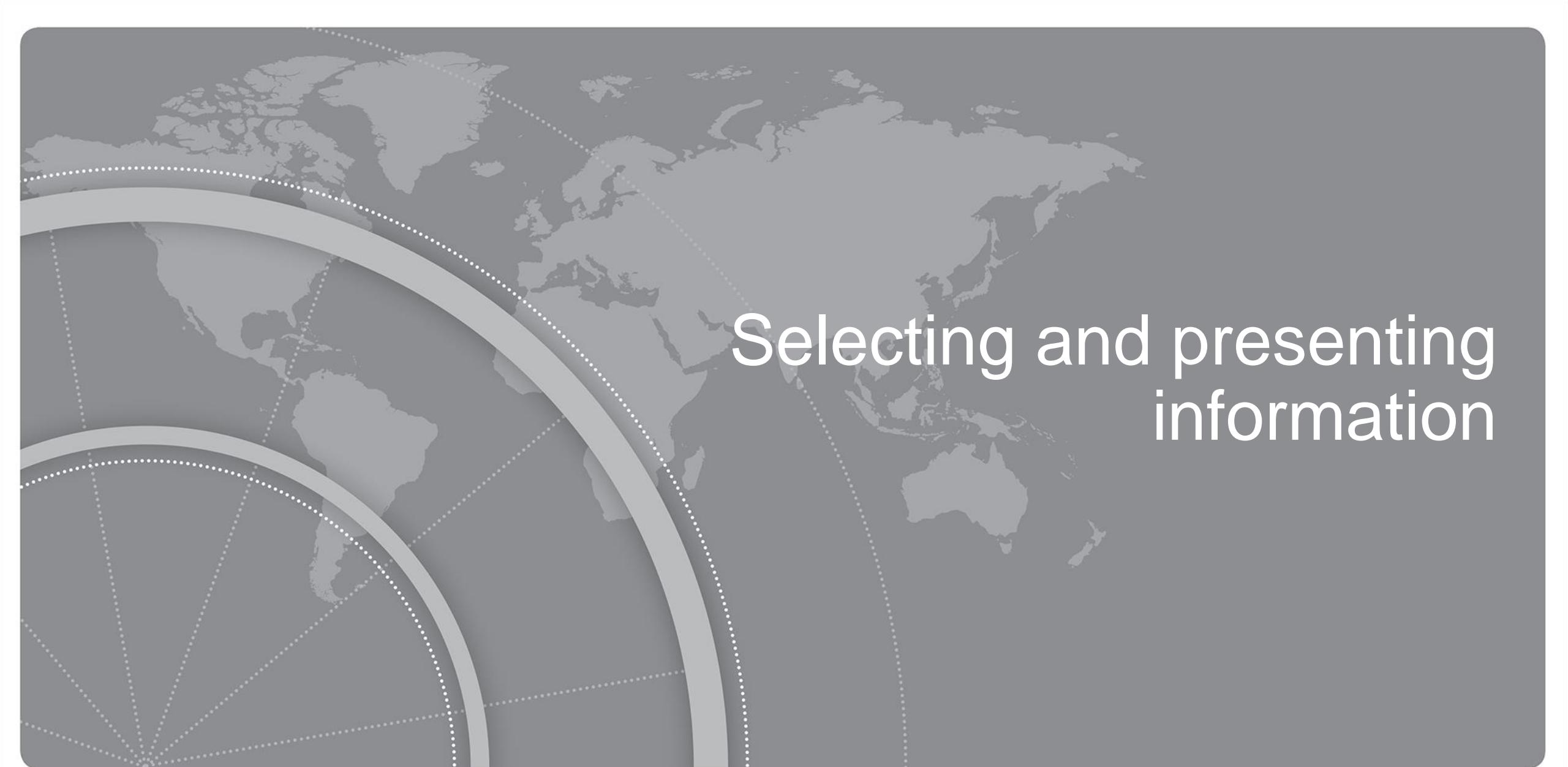
■ Risk reporting

- Unclear definition of risk: “risks which could disrupt the business model...” (only risks threatening the going concern?)
- Only downside risk → not a balanced view → require reporting on opportunities and risks
- Suggested definition: risks (opportunities) = potential future development or events that could negatively (positively) affect the achievement of corporate objectives (e.g. value creation)





Questions?



Selecting and presenting information

Materiality and focus on key matters

Proposed guidance on making materiality judgements

- disclosure objectives and examples of information that might be material
- guidance on **key matters**
- indications that **information** might be material
- guidance on **aggregation**
- guidance on uncertain future events



Fundamental to the company's ability to create value and generate cash flows, including in the long term

Investors and creditors
get material entity-specific information that focuses on key matters

Likely to be monitored and managed by management

Likely to be pervasive and relate to more than one area of content

Examples of material information

Area of content

Specific disclosure objective



Examples of information that might be material

Reflect investors and creditors' information needs

Capture changes during the period and progress
in managing key matters



Management needs to apply judgement:

- is the information material in the company's circumstances?
- is other information needed to meet the disclosure objective?

Metrics

- Material information likely to include metrics that management uses to:
 - **monitor key matters**
 - **measure progress** in managing those matters
- Depend on the company's activities and the industry in which it operates



Investors and creditors get entity-specific metrics useful for their assessments

The Exposure Draft proposes

Examples of metrics for each area of content

For business model metrics may relate to:

- the scale of the entity's operations
- the inputs involved in those operations
- environmental or social impacts of the company's activities
- effects of impacts on the company

Requirements for metrics

Relate to:

- clarity and accuracy
- comparability
- coherence

Attributes of useful information

Completeness	Balance	Accuracy
Clarity and conciseness	Comparability	Verifiability



Coherence

Based on the *Conceptual Framework*

Simplified terminology

Some additional guidance

- Within management commentary
- Across the company's reports

Selection and Presentation

MATERIALITY

- Key matters is a new concept
- Should this pervasive concept be defined in MC, what ought to be the interaction with Materiality Practice Statement? What is the interaction with other notions of materiality applied in narrative reporting?
- European Lab work shows the need for application guidance on materiality assessment.

ATTRIBUTES

- Need for distinction between coherence versus completeness
- Conceptual Framework attributes ought to be a starting point for defining attributes and add on other attributes

METRICS

- What will be the interaction with the requirements for MPMs in financial statements? Is guidance aligned with securities regulators guidance for the front-end of the report?

Selecting and presenting information (1)

■ Attributes of useful information vs. Reporting principles

- The suggested attributes seem to be rather **reporting principles** that will lead to useful information.
- How does **materiality** relate to the reporting principles/attributes?
- What about **management's view** (management approach)? Implicitly used (ED PS MC 3.18, 14.3), better list it as a reporting principle.
- **Coherence** seems to be a mixture of completeness, clarity and comparability (ED PSMC 13.27)? Redundant?
What is the difference to “connectivity” according to IIRC IR Framework?
- **Proportionality of information** as an additional reporting principle? (see GAS 20.34)

■ Materiality

- Clarify perspective (outside-in vs. inside-out)
- Wording: Material, key matter, fundamental...

Selecting and presenting information (2)

■ Metrics

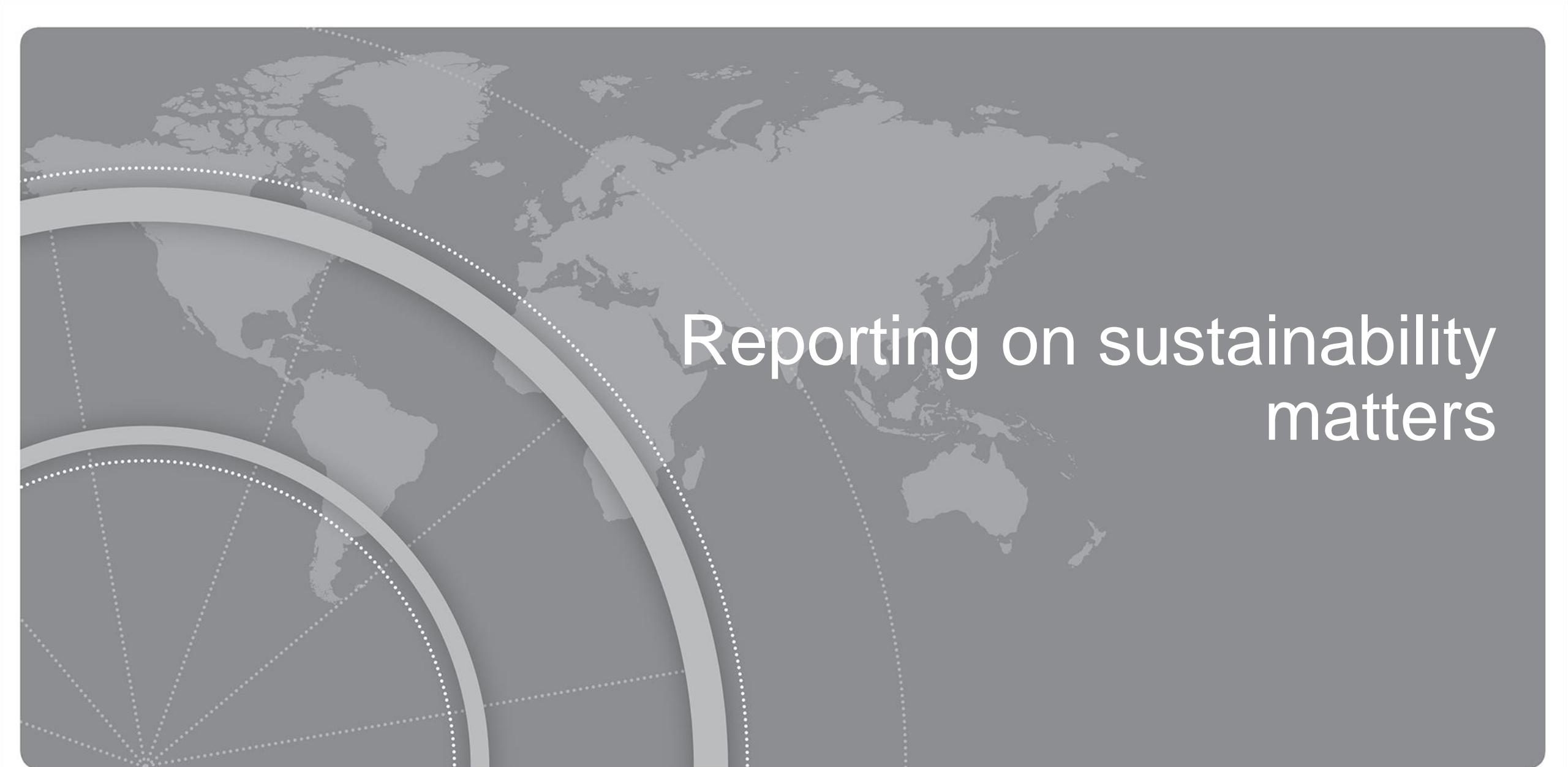
- Comprehensive requirements (“metric needs to be described clearly and precisely” (ED PS MC 14.4)),
(definition, reconciliations, comparative information)

■ Cross-references

- Consider implications for assurance of MC



Questions?



Reporting on sustainability
matters

Long-term prospects, intangibles and ESG



Dedicated appendix

- **Overview** of requirements and guidance to consider in providing material information about:
 - matters that could affect the company's long-term prospects
 - intangible resources and relationships
 - environmental and social matters
- **Examples of application** in described fact patterns



Information is reported if **material** to investors and creditors



Help **preparers** identify material company-specific information and focus on what is important to investors and creditors

Reporting on long-term prospects

Examples of applicable requirements and guidance

- The objective of management commentary
- Guidance on materiality of information about uncertain future events
- Disclosure objectives for areas of content
- Descriptions and examples of key matters for areas of content



The proposals do not require management to include forecasts or targets

- but if they are included, the proposals include requirements for providing useful information about those forecasts or targets

Reporting on intangibles

Examples of applicable requirements and guidance

- Covered by requirements and guidance on resources and relationships:
 - capture intangible resources and relationships not recognised in financial statements;
 - require focus on key intangible resources and relationships, for example, a group of specialist employees
- Matters related to key intangible resources and relationships might need to be discussed throughout management commentary, for example:
 - the scale of activities dependent on them
 - risks related to them
 - factors or trends in the external environment that could affect them.

Reporting on ESG or sustainability matters

Examples of applicable requirements and guidance

- **Environmental and social** matters are covered by requirements and guidance throughout the Practice Statement
- Information provided would cover both:
 - effects of these matters on the company
 - environmental and social impacts of the company's activities if they have affected or could affect the company's ability to create value and generate cash flows
- Management commentary provides insights into a company's **governance** but it does not replace its governance report



Other sustainability frameworks:

- can help identify information that might be material
- immaterial information specified by those frameworks can be included if it does not obscure material information

Sustainability Guidance

Observations

- Guidance on resources and relationships under six content elements encapsulates sustainability-related guidance
- Like CSRD and TCFD, MC guidance is a complementary high-level framework and standards needed to capture sustainability reporting requirements (I.e., ISSB and European Standards)
- All the examples in Appendix B are helpful
- While examples cannot be exhaustive, they should aim to illustrate all categories of intangibles and sustainability-related factors
 - Should not be biased towards climate; ensure there are sufficient social and governance examples. For instance, if these can address description of policies and outcome of policies
 - Notable omission of scenario-analysis based examples- scenario analysis is a practical disclosure to demonstrate resilience

Sustainability Guidance- EFRAG PTF-NFRS Gap Analysis (CSRD- MC)

NFRD REQUIREMENTS	FINANCIAL STATEMENTS INCL NOTES (IFRS)	(REVISED) MANAGEMENT COMMENTARY (NFI)	WHAT IS LEFT OUT / IDENTIFIED GAPS
Information to the extent necessary for an understanding of the undertaking's development, performance, position and impact of its activity, <i>(Double materiality)</i>	The outside-in perspective offers theoretical anchor points	<p>Grey area:</p> <p>Pre-financial info in the planning horizon</p> <p>Inside-out with rebound impacts on the company ('rebound effect') in the planning horizon</p>	Inside-out perspective Outside-in outside the boundaries of FI
relating to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters, including:	<p>Possible overlap on:</p> <ul style="list-style-type: none"> • employee matters with IAS 19 but only partial • IAS 37 contingent liabilities, legal claims • IAS 1 risks affecting going concern or risks and uncertainties affecting the estimates • for entities operating in high risk sectors for one of the topics, depending on judgemental materiality assessment, partial information may be found. 		Substantial part of the requirement
(a) brief description of the undertaking's business model;	None	Included in management commentary in relation with the value creation for the entity and its shareholders	Aspects other than the value creation for the entity and its shareholders

Sustainability Guidance- EFRAG PTF-NFRS Gap Analysis (CSRD- MC)

NFRD REQUIREMENTS	FINANCIAL STATEMENTS INCL NOTES (IFRS)	(REVISED) MANAGEMENT COMMENTARY (NFI)	WHAT IS LEFT OUT / IDENTIFIED GAPS
(b) a description of the policies pursued by the undertaking in relation to those matters, including due diligence processes implemented;	None	None	Entire requirement
(c) the outcome of those policies;	None	None	Entire requirement
(d) the principal risks related to those matters linked to the undertaking's operations including, where relevant and proportionate, its business relationships, products or services which are likely to cause adverse impacts in those areas, and how the undertaking manages those risks;	Possible overlap with IAS 37 disclosure in highly exposed segments.	Possible overlap with management commentary information	Substantial part of the requirement
(e) non-financial key performance indicators relevant to the particular business.	None	In progress: identification of management measures and indicators (MMI) that need to be addressed in management commentary	Entire requirement

Reporting on sustainability matters

■ Overall: MC appropriate location for ESG information

- Appendix provides a summary of requirements and guidance: enhanced emphasis
- Flexible approach to consider different concepts of sustainability reporting
- Not considered in terms of “nonfinancial performance”

■ Intangibles

- Integrated as a “resources and relationships”, no separate intellectual capital statement: sensible
- No concept (e.g. six capitals of IR), but rather individual resources



Questions?

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