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Update on the Management Commentary project

Issues Paper

Objectives

- 1 The objectives of the session are to:
 - (a) provide an update on the project; and
 - (b) seek for members' views and advice on the following topics:
 - (i) applying materiality – helping preparers identify what to disclose in the Management Commentary (MC) to meet investor needs; and
 - (ii) principles for preparing the MC – how to improve the coherence, neutrality and comparability of the MC.

Project update

- 2 On 14 November 2017, the IASB added a project to its agenda to revise and update the current Management Commentary Practice Statement (MCPS) issued in 2010.

Management Commentary Consultative Group (MCCG)

- 3 To support the work on updating the current MCPS, the IASB established the MCCG which held its first meeting in September 2018.
- 4 Discussions in September 2018 included the overall approach of the project and the status of a revised MCPS, the objective; application of materiality and principles for preparing the MC, focusing on completeness, neutrality and comparability.
- 5 The MCCG generally supported the overall approach of the project and the revision of the current MCPS based on the Conceptual Framework. A member of the MCCG expressed a preference for the revised MCPS to become mandatory. Members agreed that the objective of the MC should be consistent with the objective of other forms of financial reporting.
- 6 For more information regarding project updates referred to slides 4 to 7 in agenda paper 14-02 - *ASAF 05 Management Commentary Practice Statement*.

IASB meeting on 14 November 2018

- 7 At its November meeting the IASB discussed the IASB staff recommendations on the **objective** of the MC. The IASB staff recommended that:
 - (a) the revised MCPS should include a concise statement of the objective of the MC, at about the same level of detail as the existing statements in the Conceptual Framework; and

- (b) the objective of the MC should be to give context for the financial statements by providing primary users of the MC with historical financial and operational information and some analysis that is useful in assessing the prospects for the entity's **future net cash inflows**, and **management's stewardship of the entity's economic resources**.
- 8 The IASB members generally agreed the staff's proposed approach to provide both an overarching objective for the MC and additional guidance that covers the matters and information that the MC is expected to cover. Regarding the above proposed description of the objectives, the following comment were made:
- (a) it focused too much on backward looking (i.e. historical) information and not enough on forward looking one;
 - (b) it should be made clear that the MC does not require management to forecast or otherwise predict the entity's future cash flows but rather to provide information to support user's own assessments of those cash flows;
 - (c) referring to providing a 'context' was too restricting as some information in the MC went beyond that; and
 - (d) instead some suggested that the MC 'complements and supplements' the financial statements and enhanced its usefulness.
- 9 No feedback is sought from ASAF members on the above discussions. The IASB staff plans to present recommendations on the application of materiality and the principles for preparing the MC (including the feedback sought from ASAF) at subsequent IASB meetings.

Applying materiality

- 10 The current MCPS contains no practical guidance on how materiality should be applied in the context of the MC. Some preparers have indicated that they considered this application very challenging and have called for more guidance.
- 11 The IASB staff proposes:
- (a) to emphasise that materiality is applied in the context of user assessments of cash flow prospects and stewardship (see discussion on the objective of the MC);
 - (b) to introduce a two-stage approach to identifying material information;
 - (i) first, identifying business **matters** on which information is needed; and
 - (ii) then identifying what **information** users' needs to assess those matters.
 - (c) to add guidance in the revised MCPS based on existing *Practice Statement 2 Making Materiality Judgements*.
- 12 MCCG members expressed mixed views on the proposals. Some agreed with a two-stage approach distinguishing of matters and information related to matters. Some suggested that the materiality assessment should be in accordance with the financial statements' materiality.
- 13 For more information please refer to slides 8 to 13 in agenda paper 14-02 - *ASAF 05 Management Commentary Practice Statement*.

EFRAG Secretariat preliminary views

- 14 The EFRAG Secretariat welcomes the provision of additional guidance on the application of materiality to the MC. We also take no issue with a two-stage approach although the detailed drafting of the proposal remains to be seen. We note that the two steps suggested by the IASB staff are not inconsistent with the first two steps of the 4-step approach contained in the Practice Statement 2 *Making Materiality Judgments* (see slide 11 of paper 14-02-ASAF 05 *Management Commentary Practice Statement*) applicable for information in financial statements
- 15 Considering that the objective for the MC is to ‘provide context’ and to ‘complement and supplement’ financial statements, the EFRAG Secretariat is of the view that it would be difficult to separate the assessment of materiality for these different purposes.
- 16 Therefore, EFRAG Secretariat takes the view that the materiality assessment should be combined and that it should be aligned with Practice Statement 2 *Making Materiality Judgments* and that should be the basis to include relevant information in the MC.

Questions for EFRAG TEG/CFSS

- 17 Does EFRAG TEG-CFSS agree that the revised MCPS discussed the proposed distinction between matters that need to be addressed in the MC and material information about those matters?
- 18 Does EFRAG TEG-CFSS identify any other considerations for materiality assessment that should be in the revised MCPS?

Principles for preparing management commentary

- 19 The current MCPS provides that the MC should include information that possesses the qualitative characteristics of useful financial information as described in the Conceptual Framework. However, the current MCPS does not elaborate on how to achieve those characteristics in the MC.
- 20 The IASB staff is proposing to focus on a limited number of principles:
 - (a) ‘coherence’ (in relation to completeness) and ‘neutrality’ due to their necessity to achieve faithful presentation; and
 - (b) comparability since this enhancing qualitative characteristic featured regularly in discussion on the MC.

Coherence

- 21 The IASB staff suggests that the revised MCPS states a requirement for ‘coherent’ narrative (principle referred to as ‘linkage’ in the slide deck).
- 22 For that purpose of coherent narrative, the linkage approach would require an entity to build the content of the MC in a methodical manner that supported the characteristic of completeness. This linkage should be built around management’s view of what was important to the future of the business.
- 23 Applying the linkage approach across the content elements in the MC should include the follow thought process:
 - (a) what’s important to the future of the business?;
 - (b) what’s the strategy for managing it?;
 - (c) what progress is being made?; and
 - (d) are the potential implications clear to the report user?.

- 24 For further guidance to support a narrative coherence in the MC the entity should consider; internal information, external factors and capital markets communications, which would enhance the approach of reporting ‘through the eyes of management’.
- 25 The MCCG generally supported the concept of coherent narrative. However; some mentioned that there were different views on what “coherence” means. Some also expressed concerns about using internal metrics and decisions as guidelines for completeness.

Neutrality

- 26 The IASB staff proposed that the revised MCPS would describe how management could apply the following aspects of neutrality that could alter the users’ assessments based on entities considerations such as:
- (a) overall tone and content which provides a balanced view to support the entity’s prospects for future net cash inflows and management’s stewardship of its economic resources;
 - (b) prominence, obscurity, or omission of matters which could affect the users’ interpretation of information in the MC;
 - (c) selection and presentation of information which could cause the users to take an unjustified decision;
 - (d) range of potential outcomes discussed which could influence the users’ decision; and
 - (e) consistency in the basis of presentation or calculation of information might unduly influence the users’ decisions.

Some MCCG members mentioned difficulties relating to neutral information suggesting that reporting such information may not always be useful because reporting on negative matters could result in self-fulfilling prophecies.

Comparability

- 27 The IASB staff did not propose to prescribe specific disclosures. However, the revised MCPS could include principles-based guidance aligned with the Conceptual Framework that could support better comparability of information in relation to:
- (a) other information published by the entity (whether within or outside the MC and financial statements);
 - (b) estimates, forecasts and targets previously provided by the entity; and
 - (c) measures and methodologies common to the industry.
- 28 The IASB consultative groups (MCCG; Capital Markets Advisory Committee and Global Preparers Forum) expressed concerns on sensitive information and comparability with other entities and remarked difficulties in relation to comparability with industry metrics as verifiability would only be possible for current year results and historical information.
- 29 For more information regarding applying materiality referred to slides 15 to 24 in agenda paper 14-02 - *ASAF 05 Management Commentary Practice Statement*.

EFRAG Secretariat preliminary views

- 30 The EFRAG Secretariat first note that the current MCPS already contains a general requirement that information must possess **all** the qualitative characteristics of useful financial information. It is unclear why certain of the qualitative characteristics have not been considered for further guidance, in particular verifiability, understandability and freedom for errors.

- 31 The IASB staff suggest introducing a new principle (i.e. not previously identified as such in the Conceptual Framework) of linkage (or coherence) which it links to completeness. We observe that the current MCPS refers to a similar notion when it requires that the MC provides '**integrated information** (emphasis added) providing a context for the related financial statements...'; without further discussing the concept.
- 32 The EFRAG Secretariat therefore supports discussing the principle in the revised MCPS as this has the potential to enhance the connection between financial statements and wider corporate reporting.

Questions for EFRAG TEG/CFSS

- 33 Does EFRAG TEG-CFSS agree with the proposed approach for the principles of coherence, neutrality and comparability?
- 34 Does EFRAG TEG-CFSS have any other comments on the proposed approach of the current MCPS?

Agenda Papers

- 35 In addition to this cover note, agenda paper 14-02 - *ASAF 05 Management Commentary Practice Statement* – has been provided for the session.