EFRAG TEG and User Panel
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Paper 09-01
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Management Commentary Practice Statement

Issues Paper

Objective

1 The objective of the session is to obtain preliminary input from the EFRAG User Panel and EFRAG TEG on one of the six expected revised MCPS content elements, namely on ‘’*financial performance and financial position*.’

2 Preliminary input on some of the other content elements had been gotten in prior update meetings. Users’ views on this content element is considered to be of primary importance.

3 The input from this session will be considered in preparing EFRAG’s initial draft comment letter response to the forthcoming IASB ED on the revised MCPS whose publication expected in May 2021.

Project Background

4 In November 2017, the Board added to its agenda a project to update the existing Practice Statement.

5 The IASB’s research indicated that the existing Practice Statement (not revised since 2010) did not always provide investors and creditors with the information they need and that it:

(a) lacked focus on matters that are important for the entity's prospects;

(b) contained too much generic information and not enough entity-specific information; and

(c) provided insufficient discussion of matters that could affect the entity in the long term.

6 The revised MCPS is expected to propose a principles-based approach that involves providing a structured set of requirements supported by application guidance including:

(a) an objective for management commentary as a whole supported by a set of disclosure objectives for six areas of content explaining what investors and creditors need to understand and requiring entities to provide information that meets those needs.

(b) requirements for the attributes that information in management commentary should possess-including descriptions of those attributes and application guidance to help entities identify and provide information that possesses those attributes-for example, that management commentary should provide information that is material to investors and creditors and be complete and balanced.

(c) a requirement for management commentary to focus on key matters (i.e., matters that are fundamental to the entity's ability to create value and generate cash flows, including in the long term); and

(d) application guidance-provides examples of possible key matters and of information-including metrics-that management commentary might need to provide to satisfy the disclosure objectives.

7 The six areas of content in management commentary expected to be included in the revised MCPS are:

(a) *the entity's business model* that is the way the entity creates and preserves value for itself, and hence for its investors and creditors, including in the long term;

(b) *management's strategy* for sustaining and developing that business model-including the opportunities management has chosen to pursue;

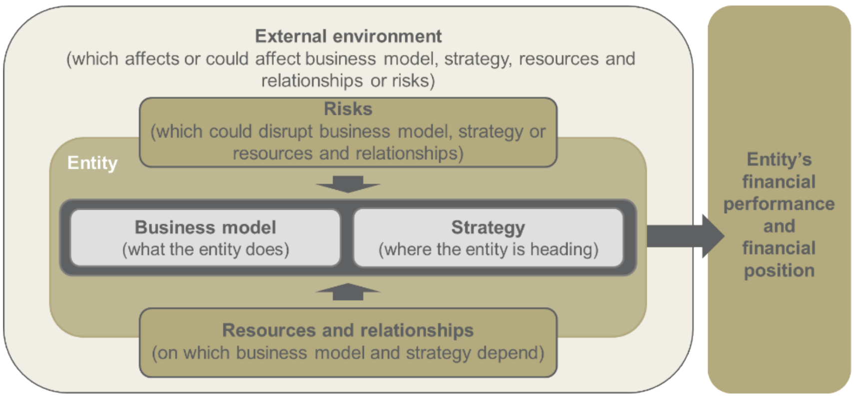
(c) *the resources and relationships* on which the business model and strategy depend-including intangible resources not recognised as assets in the entity's financial statements*;*

(d) *the risks* that could disrupt the business model, strategy, resources or relationships*;*

(e) *the factors and trends in the external environment* that could affect the business model, strategy, resources, relationships or risks; and

(f) *the entity's financial performance and financial position*-including how they have been affected, or could be affected in the future, by the matters discussed for the other areas of content.

8 Figure below illustrates the linkages between the six content elements in management commentary.



Source: IASB

9 At this meeting we would like to focus the discussion on the content elements Financial performance and financial position on which the views of users are an important element to consider.

10 Appendix 1 to this paper takes stock of the preliminary input provided by EFRAG's advisory bodies (including EFRAG's User Panel) at previous meetings and based on the tentative decisions made by the IASB).

11 Appendix2, provides, for background only a tabular summary of the objectives and key items of the other five content elements (which will not be discussed at the meeting).

Financial Performance and Position

Disclosure Objective

12 The revised MCPS is expected to state that management commentary shall provide information that enables investors and creditors to understand the entity's financial performance and financial position depicted in its financial statements. In particular, information in management commentary shall provide sufficient basis for investors and creditors to assess:

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

(b) how the entity's financial performance and financial position compare with investors' and creditors' previous expectations;

(c) the extent to which the financial performance and financial position reported in the entity's financial statements are indicative of the entity's ability to create value and generate cash flows in the future, including in the long term; and

(d) the entity's financial resilience.

13 The revised MCPS is expected to state that:

(a) Information provided in management commentary about an entity's financial performance and financial position supplements information provided in the related financial statements, and focuses on explaining the amounts presented and disclosed in those financial statements.

(b) That information will depend on the nature of the entity and its circumstances.

(c) Both financial information and non-financial information may be needed to explain the entity's financial performance and financial position.

Assessments that investors and creditors make.

14 Information about financial position and performance shall enable investors and creditors to understand:

(a) the key aspects of the entity's financial performance and financial position;

(b) the factors including matters discussed in other areas of content in management commentary that:

  (i) have affected the entity's financial performance for the reporting period;

  (ii) have affected the entity's financial position at the end of the reporting period;

  (iii) have affected the entity's financial performance or financial position since the end of the reporting period, or could affect them in the future, including in the long term;

(c) how the entity has allocated capital in the reporting period; and

(d) how the entity's financial performance and financial position compare with previously-published forecasts or targets, if any, and why variances arose.

Information to meet the disclosure objective

15 The following paragraphs describe the expected guidance for each assessment that investors and creditors make.

Key aspects of the entity's financial performance and financial position

16 Material information about key aspects of the entity's financial performance and financial position could include :

(a) an overview of the entity's financial performance and financial position; and

(b) a description of the key aspects of the entity's financial performance and financial position.

Factors that have affected the entity's financial performance for the reporting period

17 Material information about factors that have affected the entity's financial performance for the reporting period could include:

(a) metrics of the entity's financial performance for the reporting period.

(b) an explanation of changes in those metrics from previous periods, quantifying the effects of each contributing factor. The explanations could cover:

(i) the drivers of revenue—for example, identifying regions or categories of products affected by different drivers.

(ii) revenue variances—for example, how revenue is affected by price, volume and product mix factors.

(iii) the drivers of costs—for example, the split of operating costs between fixed and variable costs; or costs incurred in order to enhance key features of the entity's business model.

(iv) the drivers of cash flows—for example, how changes in customer payment terms or use of supply chain financial contributed to the entity's cash flows in the reporting period.

(c) an explanation of how matters discussed in other areas of content in management commentary have affected the entity's financial performance for the period—for example, how progress in implementing management's strategy has affected the entity's revenue, operating expenses and cash flows from operating activities.

Factors that have affected the entity's financial position at the end of the reporting period

18 These factors include:

(a) metrics of the entity's financial position at the end of the reporting period.

(b) an explanation of changes in those metrics from previous reporting periods, quantifying the effects of each contributing factor.

(c) information about the entity's ability to meet its obligations, including in the long term. The information could include:

(i) an analysis of the entity's liquidity and leverage measures and indicators, explaining variances from previous periods.

(ii) an analysis of actions management has taken to manage the entity's liquidity.

(iii) an analysis of the entity's capital structure and financing arrangements.

(iv) information about the entity's compliance (or non-compliance) with financing covenants.

(v) an analysis of how the entity's working capital requirements during the reporting period have differed from those at the end of the reporting period, or how they are expected to differ in the future.

(d) an analysis of non-controlling interests held by other parties in the entity's subsidiaries.

(e) an explanation of how key matters discussed in other areas of content in management commentary have affected the entity's financial position.

Factors that have affected the entity's financial performance or financial position since the end of the reporting period, or could affect them in the future

19 Material information about factors that have affected the entity's financial performance or financial position since the end of the reporting period, or could affect them in the future could include:

(a) information to help investors and creditors assess the extent to which the entity's financial performance in the current period is indicative of its future performance, including information about:

(i) unusual income and expenses, and how they could affect the entity's future cash flows.

(ii) changes in drivers of financial performance-or the implications of those drivers on financial performance-that could affect the entity's financial performance in the future, including in the long term.

(iii) changes in the structure of the entity that have affected performance for the current period -for example, changes resulting from the acquisition or disposal of businesses.

(b) an explanation of developments since the end of the reporting period that have affected the entity's financial performance or financial position, or could do so in the future, including, for example:

(i) an unexpected event; or

(ii) change in a leading indicator-such as an order book-used by management as an indicator of future performance.

(c) an explanation of how key matters discussed in other areas of content in management commentary could affect the entity's future financial performance or future financial position, including in the long term.

(d) an explanation of other known or reasonably expected future changes that could affect the entity's financial performance in the future, including in the long term, even if the effect has not been significant in the reporting period-for example, known or expected changes in tax rates or laws that could affect the relationship between the entity's tax charge and profit or loss.

How the entity has allocated capital in the reporting period

20 Material information about how the entity has allocated capital in the reporting period could include:

(a) information about capital allocation decisions during the reporting period, including:

(i) an indication of the target returns on which investment decisions were based.

(ii) information about the actual returns generated by past capital allocation decisions.

(b) an analysis of expenditure during the reporting period on:

(i) maintaining ongoing operations;

(ii) enhancing the entity's ability to create value and generate cash flows-for example, by adding customers, investing in research and development or acquiring businesses; and

(iii) other purposes-for example, repurchasing shares, repaying debt or paying dividends.

(c) an analysis of authorised and contracted future expenditure

How the entity's financial performance and financial position compare with previously-published forecasts or targets, if any

21 Material information about how the entity's financial performance and financial position compare with previously-published forecasts or targets, if any, and why variances could include:

(a) an analysis of variances between actual amounts and the forecast or target amounts.

(b) an explanation of those variances and of their implications.

Questions for the EFRAG User Panel and EFRAG TEG

22 Do members agree with the objective assigned to disclosure on financial performance and position (paragraphs 13)?

23 Do members agree with the assessments of the information needs of investors and lenders (paragraph 14)?

24 Do members have comments of the proposed information to satisfy the disclosure objective (paragraphs 15 to 23)? . If not, which alternatives would you suggest?

25 In particular do you agree with the proposed inclusion in the Management Commentary of information about how the entity's financial performance and financial position compare with any previously-published forecasts or targets?

26 Do members have other comments on the expected guidance on this content element?

Appendix 1 Summary of input received from previous discussions with EFRAG TEG and advisory Bodies

EFRAG Academic Panel – 11 February 2021

27 The focus of discussion was to obtain the Academic Panel's views on the objectives of the revised MCPS; the attributes of management commentary information; and the content elements on Business Model, Strategy, and Resources and Relationships. Members provided the following comments:

(a) It is unclear whether and how the management commentary project is related to sustainability reporting from the IASB's perspective, given the recent IFRS Foundation's consultation on the creation of a sustainability Board.

(b) As the objective of the management commentary was to provide entity-specific information on the business model, it could therefore be appropriate to have guidance on specific industries.

(c) Regarding the proposed information attributes, there were studies that showed that managers tended to be positively biased and optimistic in the management commentary.

(d) An unpublished paper about the value relevance of reporting on business model within the management report was mentioned. The authors had analysed 75 listed companies in the UK over three years and developed a taxonomy of business models consisting of 71 different business models. Members pointed to the choices, dilemmas and trade-offs made in communicating disclosures about the business model and anticipating how users would react to such communication.

(e) A previous study sponsored by EFRAG outlined that information in financial statements were needed to understand the business model of the firm. The information included in financial statements was considered more reliable than press releases and it was important to have an accounting system that did not make it difficult to understand the underlying business model.

(f) Regarding strategy, resources and relationships, some members highlighted the importance of disclosing information in the financial statements rather than in the management commentary, when appropriate and defined by IFRS Standards. They also questioned overlaps of information across the financial statements and management commentary (e.g., risk reporting).

(g) Some information about intangibles and competitive advantage could be gleaned from purchase price allocation in a business combination, but only to the extent that resources were acquired. Members regretted that these difficult issues were not addressed in a more ambitious way by the IASB.

(h) Some members questioned whether the revised MCPS sufficiently considers the proprietary costs faced by entities in providing the proposed information.

EFRAG User Panel –July 2020 and March 2018

28 EFRAG User Panel members received an update on project and discussed the approach designed by the IASB to revise the MCPS; more particularly the description of the assessments that Primary Users make about information on risks and external factors and trends'. The following comments were made:

(a) Members generally agreed with the IASB's description of Primary Users' assessment as contained in Paragraph 15 of the agenda paper and considered it to be a step in the right direction.

(b) Some members however cautioned against the risks of the guidance resulting in boilerplate disclosures on risks and stressed the need to always consider materiality.

29 Other comments, made by at least one member included the following:

(a) The need to provide dynamic information about year-on-year changes to risks and the effects mitigation actions and not just a static view at report date.

(b) Linking the information about risks in the Management Commentary and in the Financial Statement is essential.

(c) Some members considered that Environment Social and Governance (ESG) factors should be looked at both ways; i.e., including the effects the entity has on its environment; to the extent that these effects may ultimately affect the entity's ability to create value and generate cash-flows. For example, through adverse reputation risks.

(d) Quantitative information (not just descriptions) of risks and exposures and sensitivity or scenario types of analyses are helpful.

30 Previously, at their March 2018 meeting some User Panel members had noted that:

(a) the MCPS was not widely used as guidance by preparers in Europe because there were national Frameworks and European Directives that were robust and extensively regulated the reporting on the topic.

(b) Some members questioned whether the project was duplicating information provided by other reporting frameworks (e.g., sustainability reporting) and considered that it was important to clearly define the objectives and boundaries of the project. Some members also considered that an overly prescriptive approach within the guidance could result in the exclusion of relevant information.

EFRAG TEG and CFSS previous discussions

31 EFRAG TEG and EFRAG CFSS received updates on the MCPS project at their November 2018, March 2019, July 2019 and July 2020 joint meetings. EFRAG TEG also received updates at its April and December 2019 and January 2021 meetings. EFRAG TEG has not made any decisions on this project at this stage.

32 EFRAG TEG and EFRAG CFSS members made the following comments: that will be considered in assessing the forthcoming ED:

(a) Some EFRAG TEG members noted that reporting obligations in the Management Commentary already existed in the EU through the relevant Directives and their national transpositions. These could be used as a basis to assess the operationality of the forthcoming Exposure Draft ('the ED').

(b) Some members invited the EFRAG Secretariat to further investigate how widely the MCPS is used in the EU. One member questioned the objective of the EFRAG response to the ED in the EU context where the guidance is not endorsed and how the project would interact with other ongoing initiatives. Another member noted the importance of the revision of the MCPS in the context of conveying the interaction between financial and non-financial information.

(c) To be useful, the Management Commentary should be kept as clear and concise as possible and avoid technical / conceptual language. Members encouraged the IASB to use clearer, more concise and actionable language. In doing so, the IASB should clearly identify which is the expected audience for Management Commentary Practice Statement and ensure that the proposed content and the communication is fit for them.

(d) Mixed views were expressed on the expected requirement to provide information on actual versus forecast results and targets. Some members supported the requirement while others expressed reservations. It was noted that the revised MCPS would not require the publication of forecasts or targets but additional information if and when such forecasts or targets have been made publicly available.

(e) Members generally considered that there was a lot of useful information in the expected proposals (in particular, reporting on progress across different topics). Some requirements needed to be clarified, in particular the reference to comparability and the requirement for preparers to disclose and explain differences with information provided by peers.

(f) Regarding ESG matters, members generally agreed that the MCPS should remain in its originally stated scope to address financial and non-financial information that assists and provides context in the interpretation of a complete set of financial statements and improves users' ability to make better economic decisions (e.g. focus on outside-in matters that affect the entity's prospects for future cash flows and consider inside-out matters only to the extent that they are pre-financial in nature and can crystallise into financial effects for the entity).

(g) Members however, also encouraged the IASB to consider the interactions of MCPS with other frameworks, including on non-financial information, and strive to offer a platform that facilitates the interoperability and integration of information required by other frameworks.

(h) Regarding the application of materiality and the other general principles for preparing the Management Commentary:

   (i) Most members considered that more clarity on the objective and content areas of the MC was needed before discussing the application of materiality or the principles to apply in its preparation and guidance on the application of materiality is welcomed.

   (ii) Some members mentioned that the linkage (or coherence) principle is important but it should not be considered to encompass completeness which should be recognised as a principle in its own right for the purpose of the MC.

   (iii) Some members supported the provision of principle-based guidance on the use of cross-references between the MC and other reports but suggested that the IASB reconsiders the issues that were identified when similar guidance was considered as part of the Principles of Disclosure project.

   (iv) Some members suggested to consider referring to terms such as 'balanced' or 'unbiased' (as either alternatives or accompanying guidance to the concept of neutrality).

Appendix 2 –Disclosure objectives and descriptions of key items for the other Five content elements

	Business Model	Strategy	Resources and relationships	Risks	External environment	Financial performance and financial position
Focus of management commentary	**Management commentary shall focus on key matters and provide material information about these matters. The key matters are …**					
	key features of the entity's business model. These are features that underpin the entity's ***ability to create value and generate cash flows***.	key aspects of management's strategy These are aspects that are fundamental to sustaining and developing the entity's ***ability to create value and generate cash flows.***	the entity's key resources and relationships. These are the resources and relationships that are fundamental to the entity's ***ability to create value and generate cash flows***.	the key risks to which the entity is exposed. These are risks that could severely disrupt the entity's ***ability to create value and generate cash flows***	key factors and trends in the entity's external environment. These are factors and trends that have had, or could have, a fundamental effect on the entity's ***ability to create value and generate cash flows***	key facets of the entity's financial performance and financial position. These are facets that reflect the entity's ***ability to create value and generate cash flows***
	Key matters are likely to be matters that management monitors and manages, because they are fundamental to the entity's ability to create value and generate cash flows.					

	Business Model	**Strategy**	**Resources and relationships**	**Risks**	**External environment**	**Financial performance and financial position**
Headline disclosure objective ***(WHAT)***	**Management commentary shall provide information and analysis to help investors and creditors understand…**					
	how an entity's business model ***creates value and generate cash flows***.	management's strategy for sustaining and developing the entity's ***business model.***	the resources and relationships on which the entity's ***business model*** and management's ***strategy*** for sustaining and developing that model depend.	the risks that could disrupt: (a) the entity's ***business model***; (b) management's ***strategy*** for sustaining or developing that model; or (c) the entity's ***resources or relationships***.	how the external environment has affected or could affect: (a) the entity's ***business model;*** (b) management's ***strategy***; (c) the entity's ***resources or relationships***; or (d) ***risks*** to which the entity is exposed.	the entity's ***financial performance and financial position***

	Business Model	Strategy	Resources and relationships	Risks	External environment	Financial performance and financial position
Assessments investors & creditors make. ***(WHY)***	**Information in management commentary shall provide sufficient basis for investors and creditors to assess:**					
	(a) how effective the entity's business model is - its ability to create value and generate cash flows; how scalable it is - its ability to grow to meet demand for its outputs; (c) how resilient it is - its ability to withstand or recover quickly from shocks or difficult conditions; (d) how adaptable it is - its ability to change in response to new circumstances; and (e) how durable it is - its ability to remain effective in the long term.	(a) the potential effect of that strategy on the entity's ability to create value and generate cash flows - whether the strategy is likely to be effective in maintaining and developing that ability; and (b) the entity's ability to implement the strategy - whether the strategy is achievable.	(a) the extent to which the business model and strategy depend on particular resources and relationships; and (b) the entity's ability to obtain the resources and maintain the relationships on which the business model and strategy depend.	(a) the extent of the entity's exposure -that is, the likelihood of future disruption and the potential effect of that disruption on the entity's ability to create value and generate cash flows; and (b) how effectively management monitors and manages the exposure.	(a) how factors and trends in the entity's external environment have affected and could affect the entity; and (b) how effectively management monitors and responds to those factors and trends	(a) key drivers of the entity's financial performance and financial position; (b) how the entity's financial performance and financial position compare with investors' and creditors' previous expectations; and (c) the extent to which the financial performance and financial position reported in the entity's financial statements are indicative of the entity's ability to create value and generate cash flows in the future, including over the long term.

	Business Model	**Strategy**	**Resources and relationships**	**Risks**	**External environment**	**Financial performance and financial position**
Specific disclosure objectives *(HOW)*	**The information provided about [the area of content] shall enable investors and creditors to understand:**					
	(a) the range, nature and scale of the entity's operations; (b) the inputs to the entity's operations, the outputs of its operations and the processes involved in obtaining those inputs, transforming them into outputs, delivering the outputs to customers and collecting cash; and (c) wider consequences (impacts) of the entity's operations if such impacts have affected, or could affect, the entity's ability to create value and generate cash flows, including	(a) the drivers of the strategy; (b) the long-term aims of the strategy; (c) intermediate milestones on the path towards achieving the long-term aims; (d) plans for reaching the intermediate milestones and achieving the long-term aims; (e) the entity's capital requirements, management's plans for funding the strategy and capital allocation; and (f) progress in implementing the strategy.	(a) the nature of the entity's resources and relationships; (b) how the entity accesses and deploys the resources and relationships; (c) factors that could affect the availability of the resources or the strength of the relationships; and (d) progress in managing the resources and relationships.	(a) the nature of the risks to which the entity is exposed; (b) the entity's exposure to those risks; (c) how management monitors and manages the risks and would mitigate disruption if it occurs; and (d) progress in managing risks.	(a) the nature of the factors and trends; (b) how the factors and trends have affected, or could affect, the entity; and (c) how management has responded or plans to respond to the factors and trends.	(a) what the facets of the entity's financial performance and financial position are; (b) the factors that have affected the entity's financial performance for the reporting period; (c) the factors that have affected the entity's financial position at the end of the reporting period; (d) how the entity has allocated capital in the reporting period; (e) the factors that have affected the entity's financial performance or financial position since the end of the reporting period, or could affect them in the future, including in the long term. (f) how the entity's financial performance and financial position compare with previously published forecasts or targets, if any, and why variances have arisen.