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Management Commentary Practice Statement
Issues Paper

Objectives

1 The objectives of the session are to provide an update on the project and seek for members' views on a number of issues identified during the Management Commentary Consultative Group (MCCG) meetings.

Background

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.

3 To support the work on updating the current MCPS, the IASB established the MCCG which held its first two meetings in September 2018 and January 2019.

4 At their November 2018 joint meeting, EFRAG TEG and EFRAG CFSS received an update on the MCCG discussions on the application of materiality and the principles for preparing the Management Commentary (here).

5 In January 2019, the MCCG held a second meeting discussing:

(a) the overall approach to reporting performance, position and progress;

(b) the analysis of the financial statements; and

(c) matters that could affect the entity's future development.

6 Overall, members agreed that the IASB Staff had correctly identified the challenges in the area of reporting performance, position and progress that need to be addressed in revising the MCPS. However some members raised concerns about the following:

(a) the interaction (cross-references) between management commentary and other reports (slides 3–7 of the ASAF Agenda paper in 16-02);

(b) the tension between providing information 'through the eyes of management' and meeting users' needs for comparable information, and the perceived inconsistency between providing information 'through the eyes of management' and the neutrality of such information (slides 8–15);

(c) issues that arise due to the inclusion of forward-looking information within management commentary (slides 16– 19);

(d) information about tax in management commentary (slides 20–22);

(e) what was perceived as an artificial distinction between matters that could affect the entity's future performance, prospects versus key performance indicators required for the analysis of financial statements; and

(f) the seemingly narrow definition of operational performance.

7 The MCCG meeting notes for the January meeting, prepared by the IASB Staff, are available here.

8 The IASB Staff is consulting ASAF members on each of the four issues in paragraph 6(a) to (d) above; which are further discussed in the following paragraphs.

Cross-references between Management Commentary and other reports

IASB Staff proposed approach

9 The IASB Staff suggests a principles-based approach to the incorporation of information by reference between (a) management commentary and financial statements and (b) management commentary and other reports (see slide 5). In short, the following is suggested: :

(a) the management commentary should include all **relevan**t information needed to meet its objective, either directly or by cross-referencing;

(b) information provided, either directly or by cross-referencing, should **faithfully represent** the substance of the relevant matter;

(c) the management commentary can incorporate information by cross referencing to financial statements or other reports to provide a coherent discussion and avoid duplication of information in these reports; and

(d) incorporation of information by cross-referencing should not be done in a way that hinders **understandability** and **neutrality** of management commentary.

10 In addition, the IASB Staff suggests the following 'restrictions' on providing cross-references between management commentary and other reports (including financial statements):

(a) referenced documents should be available: (i) at the same (or approximately the same) time as management commentary; on the same terms and for as long as the management commentary; and

(b) the referenced document cannot be changed after the management commentary has been issued, unless the change is highlighted in an updated management commentary.

EFRAG Secretariat initial views

11 The EFRAG Secretariat takes no issue with the general principles in paragraph 9, above, but observes that the MCPS already includes a general requirement that information in the Management Commentary must possess all the qualitative characteristics set out in the Conceptual Framework. It is unclear why some of these characteristics are absent (e.g. comparability, verifiability…).

12 The EFRAG Secretariat further observes that the IASB has already considered providing guidance on the use of cross-referencing in the context of its Discussion Paper *Principles of Disclosure*. However, the IASB finally decided not to develop such guidance at its July 2018 meeting, because of potential unintended consequences that it considered could not be addressed in an efficient way and would outweigh the benefits of providing a guidance. These included:

(a) Potential conflicts with local regulations;

(b) difficulty to define the boundaries for the use of cross-references (limited to Annual Report or beyond);

(c) need to guarantee ongoing access to and availability of cross-referenced information;

(d) risk of excessive use of cross- references and resulting fragmentation of information;

(e) audit implications; and

(f) consideration of effects of technology and digital reporting.

13 Although the focus of the Principles of Disclosure proposed guidance was on cross-references between financial statements and other reports, we consider that the development of the MCPS could leverage on that work and, in particular, reconsider the reasons why the initially contemplated guidance was abandoned.

14 In its comment letter in response to the IASB's Discussion Paper *Principles of Disclosures*, EFRAG welcomed the provision of principle-based guidance on cross-referencing but considered that:

(a) the IASB should be cognisant that a broader use of cross-references could give rise to audit, legal or regulatory issues. It could also increase the likelihood of more fragmented information.

(b) further work would be needed, together with audit authorities and regulators, to assess the audit, legal and regulatory implications of the proposed guidance across a range of different jurisdictions.

(c) any guidance on cross-references should remain principles-based (rather than refer to specific documents such as the annual report as suggested I the IASB's DP) consider the principle that cross-references to information outside the financial statements is allowed only if it is available to users of the financial statements <u>on the same terms, at the same time and continue to be available for as long</u> as the financial statements.

15 The EFRAG Secretariat observes that the 'restrictions' envisaged by the IASB Staff (Paragraph 10 above) are very similar to the broad principles enunciated in EFRAG's comment letter.

Questions for EFRAG TEG and EFRAGCFSS

16 **Question 1** - Have you encountered any issues (e.g. in relation to audit) with allowing cross-referencing from management commentary to (a) financial statements; or (b) other reports published by the entity?

17 **Question 2** - Do you agree that the principles-based approach for the interaction between management commentary and financial statements (slide 5) could help provide a coherent and understandable discussion and avoid duplication in management commentary? If not, why not, and what do you propose instead? Do you agree that a similar approach would work for the interaction between management commentary and other reports? If not, why not, and what do you propose instead?

18 **Question 3** - Do you agree that the restrictions on providing cross-references from management commentary to financial statements and to other reports described on slide 5 could help avoid fragmentation of information? If not, why not, and what do you suggest instead?

Providing information through the eyes of management

IASB Staff proposed approach

19 At the September 2018 MCCG meeting, the IASB Staff suggested retaining the principle in the existing MCPS that information in management commentary should be provided from management's view, or in other words, provided 'through the eyes of management'; Some members expressed concerns about the interaction between this principle and (a) the objective of management commentary to meet users' information needs (slides 10–11); and (b) the principle of neutrality (slides 12-14).

20 In response to these concerns, the IASB Staff has assessed that:

(a) there is no real tension between developing management commentary to reflect what management considers important and developing it to meet users' information needs as there is an overlap between information important to management in managing the business and users' information needs;

(b) in addition to considering information used in managing the business as a starting point for identifying information to be included in management commentary, the entity considers external factors and other capital markets communications, to enhance the approach of reporting 'through the eyes of management.

21 The IASB Staff also considers that there is no tension with the concept of neutrality because:

(a) neutrality is described in terms of influence on decisions made by users: what is important in achieving neutrality is that management's intention cannot be to mislead users; and

(b) the Conceptual Framework already acknowledges that perfect neutrality is seldom, if ever, achievable, so the IASB's objective is to maximise the usefulness of information, including neutrality, to the extent possible.

EFRAG Secretariat initial views

22 The EFRAG Secretariat agrees that the concepts of 'through the eyes of management' and 'neutrality' are not necessarily inconsistent.

23 We observe, in that regard, that the Conceptual Framework does not characterise 'neutral' as meaning that the information has 'no purpose or no influence on behaviour'. Relevant financial information is, by definition, information that is capable of making a difference in users' decisions. Instead, the Conceptual Framework defines neutral information as 'not slanted, weighted, emphasised, de-emphasised or otherwise manipulated to increase the probability that financial information will be received favourably or unfavourably by users'.

24 However, we consider that, because of the possible different interpretations of the word 'neutral', further discussion could be introduced in the MCPS consultative document to clarify how the concept applies to information in the management commentary. Some of the explanations contained in the Conceptual Framework could, for instance, be introduced in the MCPS.

Questions for EFRAG TEG and EFRAG CFSS

25 **Question 4** - Do you agree with the IASB Staff's analysis of why there is no tension between developing management commentary to reflect what management considers important and developing it to meet users' information needs (slide 10)?

26 **Question 5** - Would the guidance for identifying information to be included in management commentary discussed on slide 11 of ASAF Agenda paper 02 (contained in CFSS-TEG paper 16-02) be useful? Is there any other guidance that the IASB should consider including in the revised MCPS Statement?

27 **Question 6** – Slides 12-14 explain why the IASB Staff disagrees that there is a tension between providing information through the eyes of management and the concept of neutrality and why neutrality should apply to information in management commentary. Do you consider that the explanation addresses the concerns regarding the perceived tension? Do you have any additional comments on this issue?

Forward-looking information in management commentary

IASB Staff proposed approach

28 The current MCPS provides that management should:

(a) provide forward-looking information through narrative explanations or through quantified data, which may (but are not required to) include projections or forecasts, and disclose the assumptions used; and

(b) explain how and why the performance of the entity varies from forward-looking disclosures made in the prior period management commentary, as well as the implications of those variances for the entity's future performance.

29 The IASB Staff suggests to maintain the existing guidance of not requiring forecasts but suggests adding a requirement to:

(a) include any forecasts or targets in the management commentary if these have already been published elsewhere; as well as

(b) subsequent comparison of those forecasts and targets with the entity's actual results.

EFRAG Secretariat initial views

30 The EFRAG Secretariat considers that it should be made clear that the MCPS does not require management to provide forecasts or predictions of the entity's future cash flows but rather to provide information to support user's own assessments of those future cash flows. In that context, the management commentary could provide context information when such forecasts are provided (assumptions, reconciliation actual/forecasts etc).

31 The EFRAG Secretariat considers that this is consistent with the stated objective of the management commentary to '*give context for the financial statements by providing primary users of the management commentary with the historical financial and operational information and 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 resource*s' (Slide 29).

32 Regarding the proposal to include in the management commentary any forecasts or targets published elsewhere, the EFRAG Secretariat considers that it is necessary to be aware of the potential legal and audit implications in some jurisdictions of including forecasts information in the management commentary (as opposed to only

a general discussion about the future or prospects of the entity under trend information). This is because:

(a) in some jurisdictions, information in the management commentary is subject to some form of review or assurance by auditors; and

(b) local regulators may impose specific conditions on forecast information In the management commentary.

33 Lastly, the EFRAG Secretariat is not persuaded that including any forecasts or target published during the year (and subsequent comparison to actual results) would always result in useful information. For instance if an entity publishes quarterly sales and earnings forecasts during the year, including all these forecasts can result in clutter and outdated information by the time the management commentary is drawn up.

Questions for EFRAG TEG and EFRAG CFSS

34 **Question 7 -** Do you agree with the IASB Staff's proposals to add a requirement of: (a) inclusion of forecasts and targets in management commentary if they have already been published elsewhere; and (b) subsequent comparison of those forecasts and targets with the entity's actual results? If not, why? What do you propose instead?

35 **Question 8** - Have you encountered or do you foresee any issues in your jurisdiction related to providing forecasts and targets in management commentary?

Information about tax in management commentary

IASB Staff proposed approach

36 The IASB Staff considers there are some factors that may affect an entity's tax expense in the future that may not be captured by IAS 12 *Income Tax* disclosures and would be necessary to o assess whether an entity's effective tax rate is sustainable. The IASB Staff suggests that the management commentary should discuss factors such as:

(a) known or expected future changes in applicable tax rates or in tax law; and

(b) known or expected factors that could reasonably be expected to result in the relationship between tax expense and accounting profit for future periods differing from the relationship for the current year (for example, if a tax break or incentive is expected to expire).

EFRAG Secretariat initial views

37 The EFRAG Secretariat observes that the existing MCPS does not require any specific disclosures related to tax.

38 In 2011 EFRAG and UK FRC 2011 issued a Discussion Paper *Improving the Financial Reporting of Income Tax* (link). Although the DP was primarily focused on information in financial statements, outreach conducted by EFRAG provided evidence that users were interested in identifying future cash flows associated with tax and information about the sustainability of effective tax rates as inputs for modelling as well as information about risks associated with tax position (including uncertain ones). This seems to confirm the information needs identified by the IASB Staff.

39 Therefore, the EFRAG Secretariat supports the proposal to include a discussion of factors known or expected to change the tax expense in the future. The EFRAG Secretariat, however, considers that due to the sensitive nature of the information

about tax prospects, the IASB Staff should be cautious about any attempt to provide separate information about factors known or expected to change the tax expense in the future as such a requirement could lead to boilerplate disclosure rather than entity-specific information.

40 The EFRAG Secretariat also considers that prior to making any decisions, a broader analysis of the information needs of the users of financial statement should be conducted . Interactions of any proposed guidance in the MCPS with existing IFRS Standards should be considered to avoid duplications or inconsistencies especially with information on tax provisions provided in the notes to in relation to commitments and contingent liabilities as required by IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and IAS 1 *Presentation of Financial Statements*).

Question for EFRAG TEG and EFRAGCFSS

41 **Question 9** - Do you think the revised MCPS should include guidance on providing information about tax? If yes, do you agree with the proposal that management commentary should include a discussion of factors known or expected to change the tax expense in the future? If not, why and what would you propose instead?

Agenda Papers

42 In addition to this cover note, agenda paper 16-02 - *ASAF Paper 02 Management Commentary Practice Statement* – has been provided for the session.