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## Update on the Management Commentary project

### Issues Paper

#### Objective

- 1 The objective of the session is to provide an update on the IASB revisions to the Management Commentary Practice Statement Project (revised MCPS) focusing on the tentative decisions made by the IASB since the project was last discussed by EFRAG TEG and EFRAG CFSS. The session will also outline the topics that will be addressed at the fourth and final meeting of the Management Commentary Consultative Group (MCCG) that will occur on December 13.

#### Background

- 2 In November 2017 the Board added to its agenda a project to update the Management Commentary Practice Statement (MCPS). The IASB expects to publish an Exposure Draft on the revised MCPS in the second half of 2020.
- 3 The table below provides a summary of the tentative decisions made so far by the IASB and related EFRAG TEG and EFRAG CFSS discussion sessions.

| Topic  | Tentative decisions made       | Discussion by EFRAG   |
|--|--------------------------------|---|
| Objective of management commentary (IASB November 2018)      | See paragraph 4, below         | <a href="#">EFRAG TEG-CFSS – December 2018</a>                        |
| Making relevance and materiality judgements (IASB July 2019) | See paragraphs 5 to 7, below   | <a href="#">EFRAG TEG-CFSS – November 2018</a>                        |
| Faithful representation (IASB September 2019)                | See paragraph 8 to 11 below    | Discussed at the present meeting                                      |
| Enhancing qualitative characteristics (IASB October 2019)    | See paragraphs 12 to 14        | <a href="#">EFRAG TEG-CFSS – July 2019</a> and at the present meeting |
| Business Model (IASB Nov 2019)                               | See paragraphs 15 to 16, below | <a href="#">EFRAG TEG – April 2019</a> and at the present meeting     |

#### Objective of Management Commentary

- 4 Although at its November 2018 meeting, the IASB did not take a formal vote, they agreed with the IASB Staff recommendation to describe the objective of the MC as follows:
  - (a) to give context for the financial statements by providing primary users with historical financial and operational information and analysis that is useful in

assessing the prospects for the entity's future net cash inflows, and its management's stewardship of the entity's economic resources; and

- (b) to provide further clarity on the roles that historical information and forward-looking information play in management commentary and the difference between the objective of management commentary and the objective of financial statements.

### **Making materiality and relevance judgements**

- 5 At its July 2019 meeting, the IASB tentatively decided to introduce in the revised MCPS guidance on making materiality judgements in preparing management commentary that would:
  - (a) incorporate key elements of the guidance from Making Materiality Judgements Practice Statement 2 (Materiality Practice Statement) supported, where necessary, by cross-references to further guidance in the Materiality Practice Statement;
  - (b) provide additional guidance where it is necessary because the nature of management commentary differs from the nature of financial statements; and
  - (c) focus on explaining the materiality process, in particular on identifying material information.
- 6 The IASB tentatively decided that the revised MCPS would
  - (a) recognise the guidance in the MCPS on elements of MC as a general source of identifying such information;
  - (b) provide guidance in identifying material information to make an explicit link between identification of material information and the objective of management commentary and describe practical sources that could help management identify matters that may need to be discussed in management commentary; and
  - (c) explain how management would consider what information to provide about such matters in each content element to deliver a coherent narrative.
- 7 The IASB decided to include in the revised MCPS guidance on the other steps of the materiality assessment process that would prompt management to:
  - (a) consider the likelihood of a matter occurring, not just the size of the impact, in assessing the quantitative factors when making materiality judgements;
  - (b) consider the appropriate level of aggregation when assessing what information an entity needs to provide in management commentary; and
  - (c) highlight the links between different pieces of information when organising the information within management commentary.

### **Faithful representation**

- 8 At its September 2019 meeting, the IASB tentatively decided that the revised MCPS would:
  - (a) include guidance on the qualities that make up faithful representation - completeness, neutrality and freedom from error; and
  - (b) explain that these qualities should be maximised to the extent possible
- 9 The IASB tentatively decided that the revised MCPS would include a description of completeness based on paragraph 2.14 of the *Conceptual Framework*. In particular, a complete depiction of a matter should include material information and a depiction of a matter is determined by reference to primary users' information needs.

- 10 The IASB tentatively decided that the revised MCPS would require that the management commentary be **neutral**, include a description of neutrality based on paragraph 2.15 of the *Conceptual Framework* and require explanatory information to understand the likelihood of outcomes within a range when the range of possible outcomes is given.
- 11 The IASB also discussed what guidance on freedom from error should be included in the revised Practice Statement but did not make a decision on this topic and also highlighted the importance of using plain language in describing the qualitative characteristics of useful financial information in the revised MCPS.

#### **Enhancing qualitative characteristics**

- 12 At its October 2019 meeting, the IASB tentatively decided that the revised MCPS would:
  - (a) include a description of comparability reflecting paragraphs 2.24, 2.26 and 2.28 of the *Conceptual Framework*;
  - (b) explain that although comparability with other entities is desirable, it should not override the requirement to provide relevant entity-specific information;
  - (c) state that in preparing MC, an entity's management should consider the fact that users need to make comparisons with information provided by other entities, with information reported in management commentary in previous periods and with other information published by the entity; and
  - (d) require an entity's management to explain the assumptions made and methods, any changes since the previous year in those assumptions and methods, reference where new information is provided, provide comparative information for each performance measure and consider whether information presented in MC is consistent with information reported in the entity's financial statement.
- 13 The IASB also tentatively decided that the revised MCPS would:
  - (a) include in its discussion of understandability the current guidance in the MCPS on presentation;
  - (b) explain that making MC concise is an important part of making it understandable;
  - (c) permit the incorporation of information in management commentary by cross-reference, to help management apply the overarching principle the revised MCPS should include guidance:
    - (i) on enhancing the understandability of management commentary when information is incorporated by cross-reference; and
    - (ii) on conditions that must be met by a report when management commentary incorporates information by cross-reference to that report.
- 14 The IASB also tentatively decided that the revised MCPS would:
  - (a) include a description of verifiability based on paragraphs 2.30 and 2.32 of the *Conceptual Framework*;
  - (b) require management to distinguish information based on judgement from factual information and explain the process and sources used to produce the information, describe the assumptions and methods used to calculate it, and state the information's limitations; and
  - (c) retain the statement that it does not mandate the level of assurance to which management commentary should be subjected.

#### **What is an entity's business model?**

- 15 At its November 2019 meeting, the IASB tentatively decided to recommend that the revised MCPS explains the meaning of an entity's business model by reference to:
- (a) value the entity creates for itself. The MCPS should also make clear that the notion of value created for an entity is related to the entity's ability to generate cash flows;
  - (b) the link between an entity's business model and the entity's stated purpose;
  - (c) the elements of the business model - that is, its inputs, processes and outputs;
  - (d) a business model being a matter of fact and observable through an entity's actions.
- 16 In addition, the IASB has tentatively decided that the revised MCPS requires management to discuss the impacts of the operation of the entity's business model if those impacts could affect the entity's ability to generate cash flows in the future.

**EFRAG TEG and CFSS previous discussions**

- 17 EFRAG TEG and EFRAG CFSS received updates on the MCPS project at their November 2018, March 2019 and July 2019 meetings. EFRAG TEG also received an update at its April meeting. EFRAG TEG has not made any decisions on this project at this stage. The following views were expressed at the previous meetings:
- 18 Regarding the overall proposals to revise the MCPS:
- (a) Members were generally supportive of the initiative but some expressed concerns about overlaps with other projects (such as the Primary Financial Statements project) and the lack of clarity, at this stage, of the objectives and boundary of the project; and
  - (b) Some members also questioned the use of technical language and references in IFRS Standards as a basis for developing guidance for the MCCPS. These members suggested that the IASB considers clarity and conciseness of the Practice Statement. However, TEG has not made any formal decision to date.
- 19 Regarding the concept of **business model** and strategy to provide a focus for building the report, one member mentioned that splitting the business model and strategy created more difficulty than seeing the business model and strategy as a whole.
- 20 Regarding the application of **materiality** and the **principles for preparing the MC**:
- (a) Most members agreed on more clarity on the objective and content areas of the MC is needed before discussing the application of materiality or the principles to apply in its preparation and guidance on the application of materiality is welcomed; and
  - (b) 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.
- 21 Regarding the use of cross-reference and the concept of neutrality (and its interaction with the principle of 'through the eyes of management'):
- (a) 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; and
  - (b) Some members suggested to consider referring to terms such as 'balanced' or 'unbiased' (as either alternatives or accompanying guidance to the concept of neutrality).
- 22 Regarding narrative coherence and entity's long-term success:

- (a) Some members considered that the emphasis on narrative coherence as a principle guiding the content of the MC was confusing. Other members considered that narrative coherence was more about consistency between and across reports, including MC and financial statements: and
  - (b) Some members noted that a reference to the concept of 'value creation' rather than net future cash inflows, would provide a better anchor for the content of the management commentary. Lastly, they encouraged to use clearer, more concise and actionable language to take account of the broader audience for the management commentary information.
- 23 At its 26 September 2019 meeting EFRAG TEG discussed the possible interaction of MCPS consultation and the EFRAG research project on intangibles, it was noted that the IASB had clarified that the MCPS would remain a principle-based document that would not provide detailed reporting requirements or suggest KPIs. Instead it is expected that the MCPS would set as a principle, that when management identifies 'resources and relationships that the entity depends on for its long-term success', it would need to provide qualitative and quantitative information necessary for primary users' understanding of the nature and importance of those resources and relationships (and their continued availability) to the future operation of the business. For more information see the [agenda paper](#).
- 24 EFRAG Secretariat will continue to monitor those interactions and consider how to use the insights from the research to address the issues in forthcoming MCPS consultation.

*Meeting of the Management Commentary Consultative Group (13 December 2019)*

- 25 At this date, EFRAG Secretariat has not received the agenda paper of the final MCCG meeting on 13 December 2019 (these papers are expected by 29 November). However, the following topics are expected to be covered:
- (a) whether the current proposals taken as a whole are sufficient for preparing MCPS that meet users' information needs and if not, what further guidance is needed;
  - (b) how to consider the previous feedback from the MCCG, and whether the MCCG is supportive of the revised proposals (for example, on disclosure objectives for each of the content elements);
  - (c) Consider support for some aspects of the revised MCPS: for example, interaction of the revised MCPS with other reporting frameworks, responsibility for preparing management commentaries, including a statement of compliance, and whether the current proposals would provide an enforceable basis for preparing Management Commentary;
  - (d) Topics previously not discussed with the MCCG or where further input is needed.
- 26 The EFRAG Secretariat will upload the paper as soon as it will be made available.

**Questions for EFRAG TEG**

- 27 Do EFRAG TEG members have comments on the IASB tentative decisions?
- 28 Do EFRAG TEG members have specific recommendations to make to the EFRAG Secretariat in view of the forthcoming participation in the last MCCG meeting on 13 December 2019?