

IFRS Developments

IASB proposes a new framework for management commentary

What you need to know

- ▶ The IASB has proposed a number of amendments to IFRS Practice Statement 1 *Management Commentary*.
- ▶ Disclosure objectives for six areas of contents and guidance for selecting and presenting information, including metrics, are proposed.
- ▶ An entity need not comply with IFRS Practice Statements to comply with IFRS Standards.
- ▶ The comment period ends on 23 November 2021.

Highlights

On 27 May 2021, the International Accounting Standards Board (the IASB or the Board) issued IFRS Practice Statement Exposure Draft ED/2021/6 *Management Commentary*. The Exposure Draft (ED) sets out proposals for a revised IFRS Practice Statement 1 *Management Commentary* (PS1) from 2010.

Background

Management commentary is an important part of financial reporting that complements an entity's financial statements by providing a discussion and analysis, as well as forward-looking and non-financial information. Examples of jurisdiction-specific names for management commentary include "management report", "management's discussion and analysis", "operating and financial review" and "strategic report".

The Board provides several reasons for revising PS1, including innovations in other narrative reporting frameworks and shortcomings in current reporting practice, such as insufficient focus on long-term prospects and entity specific information about intangible resources and environmental, social and governance (ESG) matters.

In developing proposals for a revised practice statement (PS), the Board wants to facilitate the process of identifying and presenting information that is useful to investors and creditors. Another objective is to provide sufficient flexibility for entities to tell their "own story" and to comply with other narrative reporting requirements or guidance, such as those applicable to sustainability reporting. The Board also aims to ensure sufficient discipline to enable external assurance and enforcement of the PS.

The proposals

The proposals consist of an overarching objective of management commentary supported by more granular disclosure objectives for six content areas, and examples of information that may need to be provided to meet the objectives. The ED also contains proposals for requirements and guidance on selecting and presenting information.

In recognition of the importance of matters that could affect financial performance and position in the long term, the Board proposes a separate appendix detailing requirements and guidance in relation to information about intangible resources and relationships, as well as ESG matters.

The objective of management commentary

Building on the objective of financial reporting in the *Conceptual Framework for Financial Reporting (Conceptual Framework (2018))*, the ED proposes a twofold objective of management commentary:

- ▶ To provide information that “enhances investors and creditors’ understanding of an entity’s financial performance and financial position reported in its financial statements”
- ▶ To provide “insights into factors that could affect the entity’s ability to create value and generate cash flows across all time horizons, including the long term”

To meet the objective, management commentary must provide information that is material to investors and creditors. The Board notes that material information likely relates to “key matters”, which are matters that are fundamental to an entity’s ability to create value and generate cash flows, e.g., key features of the entity’s business model and key aspects of management’s strategy.

Another key principle of the proposals is that management commentary must provide management’s perspective. On this basis, the Board proposes that information in management commentary should derive from information used by management, including the metrics used to monitor financial performance.

Disclosure objectives for six areas of contents

The proposals require that management commentary provides material information necessary to meet a set of more granular disclosure objectives for six areas of contents. Within the objectives, there would be three components. A headline objective (1) identifies investors and creditors’ information needs for the area of content. Assessment objectives (2) identify the assessments that investors and creditors need to make in relation to the area of content. Based on these, a set of specific objectives (3) details users’ information needs. The Board proposes a bottom-up thought-process:

- ▶ Identify the information needed to meet the specific objectives (3)
- ▶ Evaluate if the information provides a sufficient basis for the identified assessment objectives (2). If not, identify additional information to be able to make those assessments
- ▶ Evaluate whether the information needed to meet the specific objectives (3) and the assessment objectives (2) is sufficient to meet the headline objective (1). If not, identify additional information to meet the headline objective

For each area of content, the ED contains examples of key matters, metrics and examples of information that may be material. The Board emphasises that the information in the examples is not always needed to meet the objectives, while other information may also be required depending on facts and circumstances.

Proposed headline objectives for the six areas of contents

The management commentary must provide information that enables investors and creditors to understand:

Business model(s)

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

Strategy

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

Resources and relationships

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

Risks

- ▶ The risks that could disrupt the business model, strategy, resources or relationships

External environment

- ▶ How the external environment has affected or could affect the business model, strategy, resources, relationships or risks to which the entity is exposed

Financial performance and financial position

- ▶ The entity's financial performance and financial position reported in the financial statements

Selecting and presenting information

Material information

The ED proposes guidance that is designed to help management identify material information, including guidance on how to identify key matters and three indicators of material information:

- ▶ Information relating to a key matter
- ▶ Information used by management
- ▶ Information in capital market communication

The Board also suggests that narrative reporting requirements or guidelines issued by, for example, industry bodies or organisations with an interest in sustainability reporting, may be helpful in identifying material information.

Attributes of useful information

The ED proposes that to meet the objective, information in management commentary must be complete, balanced, accurate and coherent. In addition, it proposes that information is more useful if it is clear and concise, comparable with information provided in previous periods and with information provided by other entities, as well as verifiable.

Application guidance is suggested in relation to each attribute. For example, to be complete, the Board proposes that material information must be included even if it has been provided in a previous period or is available in another published report. However, if certain criteria are met, such information may be included by cross-reference.

With the exception of coherence, the identified attributes correspond with the characteristics of useful financial information in the *Conceptual Framework (2018)*. Because the six areas of content are interrelated, the ED proposes to require that, if a matter discussed for one area of content has implications for other areas of content, information is provided to allow users to assess those implications. The ED also proposes that information must be presented to allow users to relate it to information in the financial statements and to provide explanations for any inconsistencies between information in the management commentary and information provided elsewhere (e.g., in investor presentations or on the website).

Metrics

Noting that material information is likely to include metrics used by management to monitor qualitative or quantitative aspects of key matters, the ED proposes to require entities to define, explain and reconcile any metric not presented in the financial statements. In addition, it proposes to require certain disclosures relating to metrics similar to, but not the same as, those used to determine management compensation and, if relevant, to metrics used to communicate forecasts and targets.

Compliance

Entities are not required to comply with a PS in order to state compliance with IFRS Standards.

In 2010, the Board decided to issue guidance on management commentary in the form of a PS to allow regulators to decide whether or not to mandate management commentary. While retaining this approach, the Board aspires for the revised PS1 to provide an effective basis to assess compliance, so that compliance with the revised PS1 can be enforced. Regardless, an entity may choose to apply the revised PS1 on a voluntary basis.

Similar to IFRS Standards, the IASB proposes that management commentary that complies with all requirements in the PS must include an explicit and unqualified statement of compliance. However, the Board proposes that entities may provide a qualified statement of compliance, setting out the reason for any departures from the requirements in the PS1, if that is the case. The Board also proposes that an entity may state compliance with the revised PS, even if its financial statements are not prepared in accordance with IFRS Standards.

Next steps

The ED is available for public comment until 23 November 2021. The Board will consider comments received before deciding on the final revisions of PS1.

How we see it

While the proposals in the ED reflect a major overhaul of the requirements and guidance on management commentary, they retain many of the basic principles in PS1. The Board's focus has been on clarifying the objective of management commentary and helping management identify and present the information needed to achieve that objective.

It is clear that the Board sees management commentary as an appropriate location for information about ESG matters that is material to investors and creditors. It is also clear that the Board envisages the revised PS to be applied in conjunction with, for example, sustainability reporting requirements and guidance. In considering the Board's proposals, a key question is whether they will provide sufficient guidance to help management navigate this complex reporting landscape and to identify and present entity-specific information that is material to investors and creditors in a single report.

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ED None

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