CHAPTER 1

Management commentary: New perspective proposed by IASB

This article aims to:
Provide an overview of the new framework for management commentaries as proposed by IASB in its exposure draft.

Introduction

Management commentary, often referred to as the 'Management Discussion and Analysis' (MD&A) in India, is one of the most important means of communication by the Board of Directors of a company with its stakeholders in particular investors and creditors about the performance and various other key aspects relating to the growth of a company. Those aspects majorly cover discussions in the areas relating to an entity's financial performance, operational performance, company's expansion strategy, modernisation and diversification programmes.

In 2010, the International Accounting Standards Board (IASB) issued a practice statement - IFRS Practice Statement 1, *Management Commentary*. The aim of the statement was to assist management in presenting useful management commentary that relates to financial statements that have been prepared in accordance with the International Financial Reporting Standards (IFRS). However, IASB observed that investors were concerned about the 'information gap' between the information provided in management commentaries and the information that they need. Accordingly, the IASB as part of its project to improve the communication value of the financial statements, has proposed a major overhaul to the existing IFRS Practice Statement 1.

It issued a proposed Practice Statement on Management Commentary on 27 May 2021. The proposed statement is a new comprehensive framework that aims to bring together in one place the information that investors would need to assess a company's long-term prospects including information about sustainability matters, intangible resources and key relationships.

This article aims to provide an overview of proposals published by IASB with regard to the management commentary.

Overview of the proposed practice statement

The proposed statement advocates an objectives-based approach which will provide sufficient flexibility for a company to be able to tell its unique story, focussing on what is important for the company's long-term prospects.

Objective of management commentary

The IASB clarifies that the objective of a management commentary is to provide insights into factors that:

- *Have affected* the entity's financial performance and position reported in the financial statements and
- *Could affect* the entity's ability to create value and generate cash flows across all time horizons, including in the long term.

Accordingly, information required by the objective should meet two factors:

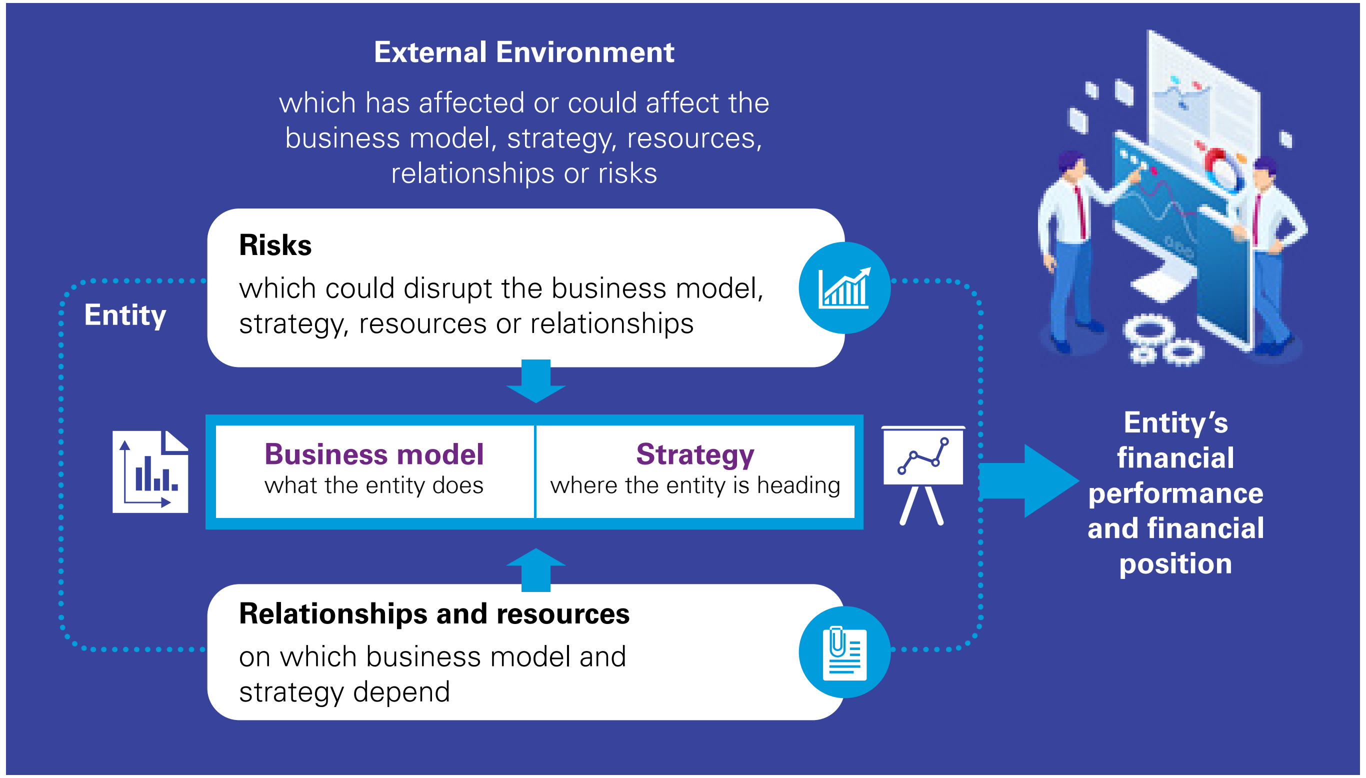
a. **Material information:** It is **material** to investors and creditors in making their decisions and

b. **Management's perspective:** It reflects **management's perspective** and is based on information used in managing the company.

Disclosure objectives for areas of content

The proposed statement has specified six inter-related areas of content that should be discussed in an entity's management commentary with an explicit disclosure objective for each area of content. The figure below depicts the relationship between these six areas of content in management commentary.

Figure 1: Relationships between the six areas of content in management commentary



(Source: Exposure Draft on management commentary issued by IASB in May 2021)

For each of the above mentioned areas of content, the IASB has proposed disclosure objectives comprising:

Headline objectives – Overall information needs of investors and creditors for the area of content

Assessment objectives – Assessments that investors and creditors need to make in relation to the area of content

Specific objectives – Detailed information needs of investors and creditors

For a company to claim compliance with the proposed practice statement, its management commentary must meet its objectives and provide material information that meets the disclosure objectives for all areas of content.

Materiality and key matters

Information should be included in the management commentary if it is material[1] to investors and creditors. Material information would depend on the entity and its circumstances. Accordingly, management judgement would be required to identify such information.

Much of the material information will relate to key matters - **matters fundamental to an entity's ability to create value and generate cash flows**. Considering their importance, key matters are likely to be matters that management monitors and manages. Also, such matters would be pervasive and related to more than one area of content. For instance, risks to a key feature of a business model- like a competitive advantage are likely to be key risks for a company. Therefore, identifying key matters would also require management judgement.

1. Information is material if omitting or misstating or obscuring it could reasonably be expected to influence decisions that investors and creditors make on the basis of the management commentary and of the related financial statements.

Metrics

Material information is likely to include metrics[2] that management uses to monitor key matters and to measure progress in managing those matters. Those metrics are specific to an entity and typically depend on the entity's activities and the industry in which it operates. Examples of metrics that may need to be included in management commentary are described below:

Metrics for business model	• Scale of a company's operations e.g., production capacity or volumes • Environmental or social impacts of a company's activities e.g., greenhouse gas emissions
Metrics for risks	• Exposure to a risk e.g., level of reliance on a raw material • Effectiveness of management's response e.g., number of safety incidents
Metrics for strategy	• Progress towards long-term aims e.g., brand reputation scores • Progress towards milestones e.g., measures of product quality
Metrics for external environment	• Factors and trends e.g., market share statistics • Effectiveness of management's response e.g., proportion of revenue exposed to a trend
Metrics for resources and relationships	• How effectively a resource is deployed e.g., store revenue per unit of floor area • Strength of a relationship e.g. customer retention statistics
Metrics for financial performance and financial position	• Amounts presented or disclosed in the financial statements • Measures derived from the amounts presented or disclosed in the financial statements

(Source: Snapshot, Management Commentary, IASB, May 2021)

2. Metrics are measures that management uses to monitor a quantitative or qualitative aspect of a company's financial or non-financial performance or position.

Attributes of information in management commentary

To be useful to investors and creditors, information in management commentary should possess certain attributes i.e. such an information should be complete, balanced, accurate and coherent. Additionally, to be more useful, other desired attributes include clarity and conciseness, comparability and verifiability. The proposed practice statement provides following guidance for each of these attributes:

Required attributes of information

Completeness

Management commentary shall provide a complete depiction of the matters it addresses. A complete depiction of a matter requires all material information that is necessary for investors and creditors to understand the matter.

Balance

Information should be balanced- not slanted, weighted, emphasised, de-emphasised or otherwise manipulated to make it more likely that investors and creditors will receive it favourably or unfavourably.

Accuracy

Information in management commentary should be accurate. Information can be accurate without being perfectly precise. Degree of precision depends on the nature of information and nature of matters addressed.

Coherence

Information should be provided in a way that it can be related to other information published by the company, in particular in the company's financial statements, and that any apparent inconsistencies are explained.

Desired attributes of information

Clarity and conciseness

Information is more useful if it is clear and concise - plain language is used as much as possible, only material information is included, duplication and boilerplate disclosures are avoided.

Comparability

Information should be comparable with both, information provided by other companies (particularly in the same industry), and information provided by the company in the past.

Verifiability

Information is verifiable if is possible to corroborate either the information itself or the inputs used to derive the information.

(Source: Snapshot, Management Commentary, IASB, May 2021)

Prospects, intangibles and ESG matters

Investors and creditors are also interested in information about matters that could affect an entity's long-term prospects, including information about intangible resources and relationships and sustainability matters. Management determines which information is material in an entity's circumstances. For example, if one of an entity's sites has scarce water resources and is threatened with closure, investors and creditors might need information about the entity's exposure to water stress. Information about water consumption at that site might be material to investors and creditors, but information about the entity's water consumption at other sites might not be material.

The exposure draft provides guidance that the management is likely to consider in deciding what information it needs to provide about:

- Key matters that could affect an entity's long-term prospects
- Key intangible resources and relationships and
- Key environmental and social matters.

Interaction with other reporting frameworks

Generally, entities apply local laws or regulations as well as frameworks issued by other organisations, for example on sustainability, to help them identify material information for inclusion in management commentary.

Entities would also be permitted to include immaterial information required by those laws, regulations and frameworks as long as it does not obscure material information.

Next steps

Comment period of the proposed practice statement is upto 23 November 2021.

The IASB aims to keep voluntary compliance with the Revised Practice Statement. Entities may choose to prepare management commentary complying with the revised Practice Statement even if they are not required to do so. Entities would not have to apply the proposed practice statement to claim compliance with IFRS standards.

It would be for local lawmakers and regulators to decide whether to require companies to prepare management commentary that complies with the revised Practice Statement.

In India, the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 requires listed companies to include a MD&A section in the annual report either as part of the Directors' report or in addition thereto. The MD&A section includes discussion on certain matters within the limits set by the listed entity's competitive position. Those matters, *inter alia,* include:

- Industry structure and development
- Opportunities available and threats to companies
- Risks and controls
- Internal control systems and their adequacy
- Discussion on financial performance with respect to operational performance.

Additionally, in line with recent developments of the Securities and Exchange Board of India, top 1,000 listed companies (by market capitalisation[3]) will be required to submit a new report on ESG parameters, the Business Responsibility and Sustainability Report (BRSR)[4].

Companies in India should watch this space as regulators in India are likely to evaluate this Practice Statement and take a decision on its application.

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3. Based on market capitalisation calculated as on 31 March of every financial year.
4. Currently, top 1,000 listed companies are required to furnish a Business Responsibility Report (BRR). This will be replaced with the BRSR. Entities may furnish a BRSR on a voluntary basis effective FY2021-22 and are required to furnish it on a mandatory basis effective FY2022-23.