

This paper has been prepared by the EFRAG Secretariat for discussion at a public meeting of EFRAG TEG. The paper forms part of an early stage of the development of a potential EFRAG position. Consequently, the paper does not represent the official views of EFRAG or any individual member of the EFRAG Board or EFRAG TEG. The paper is made available to enable the public to follow the discussions in the meeting. Tentative decisions are made in public and reported in the EFRAG Update. EFRAG positions, as approved by the EFRAG Board, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances.

ED Management Commentary

Cover Note

Objective

- 1 The objective of the session is for EFRAG TEG to discuss and agree to recommend a final comment letter in response to the IASB's exposure draft *Management Commentary* (the 'ED') for consideration by the EFRAG Board.

Background

- 2 The [exposure Draft Management Commentary](#) (the ED) was published in May 2021 and was open for comment until 23 November 2021. EFRAG issued its [draft comment letter](#) (DCL) in response to the ED in July 2021 and it was open for comments until 15 November.
- 3 Agenda paper 04-03 presents a summary of the feedback received by EFRAG from its draft comment letter consultation and other outreach activities. The summary paper was presented to EFRAG TEG and EFRAG CFSS at their joint meeting on 24 November 2021. The input provided by EFRAG CFSS members at the 24 November meeting will be considered by EFRAG TEG at this meeting.
- 4 The following paragraphs present possible changes to EFRAG's comment letter, suggested by the EFRAG Secretariat after considering constituents' views and argumentation in the feedback received. Added text is presented in red and deleted text in stroke-through.
- 5 A marked-up version of the comment letter for EFRAG TEG discussion and approval reflecting the suggested changes suggested by the EFRAG Secretariat in the following paragraphs is included under agenda paper 04-02.
- 6 The comment letter paragraphs numbers referred to in the sections below are based on EFRAG's draft comment letter.

Cover letter

- 7 The cover letter has been tentatively updated to reflect the proposed changes discussed below (see agenda paper 04-02). The cover letter will be revised based on EFRAG TEG's decisions at the meeting.

Question 1. Financial statements to which management commentary relates

- 8 No necessary changes were identified.

Question 2. Statement of compliance

- 9 In its draft comment letter, EFRAG tentatively supported the ED's proposals to
- (a) Require that management commentary that complies with all the requirements include an explicit and unqualified statement of compliance
 - (b) Allow management commentary that comply with some but not all of the requirements to include a qualified statement of compliance identifying the departure from the requirements
- 10 EFRAG has received mixed feedback on its DCL position, with support from some comment-letter and outreach respondents. However, a comment letter respondent disagreed with EFRAG's position noting that:
- (a) Mandating an unqualified statement of compliance may increase costs for preparers, conflict with local regulations, interfere with the director's liabilities in different jurisdictions and may limit its uptake. It is more appropriate for local lawmakers to determine whether to mandate a statement of compliance, particularly given the evolving landscape in respect of sustainability reporting standards. the practice statement could encourage, rather than require, a statement of compliance where an entity is referring to or applying the Practice Statement in its reports.
 - (a) Allowing a statement of partial (or qualified) compliance would be difficult to operationalise and would not result in more reliable information as it could create confusion, be very difficult to assure, and increase costs in understanding which elements of the report adhere to which parts of the Practice Statement, and for what reasons other parts are not complied with.
- 11 During outreach, there was also a concern raised about the compatibility and possible challenges of partial compliance with future sustainability reporting requirements (e.g., if they have 'comply or explain' requirements).
- 12 Conversely, another comment letter respondent considered that statement of partial compliance should be mandated. This is because users of management commentary need information on whether this commentary complies with all or with some of the requirements of the Practice Statement. In doing so, preparers should use plain and clear language and avoid expressions such as 'on the basis of .'
- 13 Lastly, it was suggested to avoid using the terms 'qualified' and unqualified' to avoid any confusion with audit requirements. Instead, according to this respondent, a 'comply or explain' approach could be considered.
- 14 Based on the application challenges identified by some constituents, the EFRAG Secretariat suggests revising the drafting in the DCL to recommend that
- (b) The practice statement could encourage, rather than require, a statement of compliance where an entity is referring to or applying the Practice Statement in its reports;
 - (c) A qualified statement of compliance should not be allowed
- 15 Suggested drafting of the proposed final comment letter is included below:
- [13 EFRAG agrees with the requirement that an entity can make an unqualified statement of compliance only if its management commentary complies with all requirements in the revised Practice Statement. We observe that this requirement is carried forward from the existing Practice Statement and that EFRAG supported it at the time. However, we consider that the Practice Statement should encourage, rather than require, a statement of compliance. This is because making such a statement may increase costs for preparers, conflict with local regulations, and interfere with director's liabilities in different jurisdictions EFRAG considers that it is up to local lawmakers to determine whether to mandate a statement of compliance,*

particularly given the evolving landscape in respect of corporate reporting standards.]

*[14 EFRAG also **does not** support the proposals to allow a qualified statement of compliance to the extent that management commentary identifies the departures from the requirements of the revised Practice Statement and gives reasons for those departures.]*

*[15 This is because the proposal has the potential to lift barriers against the diffusion of the approach and concepts underpinning the management commentary further encourage the voluntary application of all or some of the guidance **would be difficult to operationalise and would not result in more reliable information. A partial statement of compliance may create confusion, pose audit challenges, increase costs in understanding which elements of the report adhere to which parts of the Practice Statement, and for what reasons other parts are not complied with.***

[16 ~~Permitting only an unqualified statement of compliance could set a high hurdle for reporting and a barrier to applying the revised Practice Statement. Some entities may want to comply with the revised Practice Statement to improve the quality and credibility of information in their management commentary but may not be able to do so because they need time to work towards full compliance]~~

[16 Finally EFRAG suggest reconsidering the use of the terms 'qualified' and 'unqualified' to avoid possible confusion with the level of audit assurance provided.

Questions for EFRAG TEG

- 16 Does EFRAG TEG agree with the above-proposed changes?

Question 3. Role of the management commentary

- 17 In its draft comment letter, EFRAG supported the proposed role of the management commentary focusing on the information needs of the primary users (investors and creditors) and relying on the concepts of value creation and enterprise value.
- 18 Most respondents supported the proposed role of the management commentary and the reference to value creation. Two respondents suggested that the IASB clarifies the reference to 'enterprise value' and the relationship with value creation as applied in the ED and other frameworks (e.g., integrated reporting framework).
- 19 However, some respondents suggested that the ED addresses the information needs of a broader set of stakeholders and considers more broadly the impacts and outcomes and the relationship between enterprise value and value created for other stakeholders. Some suggested that the ED has a narrow interpretation of 'enterprise value' in Chapter 3, which is at odds with the Integrated Reporting concept of value creation and it has ignored the inter-dependencies of value creation for other parties. They recommended that due to its importance for this project and the ISSB's work, a clear commonly-accepted definition should be developed by the ISSB in consultation with regulators and standard-setters.
- 20 The EFRAG Secretariat does not suggest changes to the current drafting of the response to Question 3 to include supporting reporting on an entity's impacts. EFRAG's responses to the ED indicates that it was prepared in the context of the current role of the management commentary while raising the IASB's attention to the need to consider ongoing developments in sustainability reporting (see the first topic in this paper).
- 21 We believe that the matter raised by some respondents would be better addressed in the context of the response to Question 9 on interconnectivity between the

activities of the IASB and of the ISSB. (See suggested changes to the response to Question 9).

- 22 However, to allow further clarity on the scope of management commentary, the EFRAG Secretariat recommends additional drafting to enhance the consistency in the guidance and further defines the different terms uses cash flow generation, value creation and enterprise value) and how they relate to each other. The proposed drafting is as follows

[To allow further clarity on the scope of the management commentary, EFRAG recommends that the guidance is expanded to better define the terms value creation, enterprise value, cash flow generation and how the guidance's definitions relate to the definitions in other frameworks. (See also our response to Question 9 on interconnectivity)]

Questions for EFRAG TEG

- 23 Does EFRAG TEG agree with the position of the EFRAG Secretariat?

Question 4. Overall approach

- 24 In its draft comment letter, EFRAG considered that all Six content elements proposed in the ED were important and contributed to enhancing the information in the management commentary. EFRAG did not comment on the respective importance or 'hierarchy' of the content elements.
- 25 One respondent representing users considered that the Management Commentary should be centred on commenting on the financial performance and financial position and its ability to create value and generate cash-flows across all time horizons. This area of content is the most relevant and prominent and should stand out over the rest. Other content elements (such as Business model or strategy) should be commented on only to the extent that it is relevant to a better understanding of financial performance and financial position.
- 26 The EFRAG Secretariat does not agree with an amendment to the effect that management commentary should be centred on commenting on the financial performance and financial position as it was only suggested by one respondent. Furthermore, as noted below, we are proposing amending a change to the EFRAG DCL position that metrics should be limited to those that inform on the financial performance and financial position. We note that the management commentary has broader objectives than contextualising the financial statements and it is also intended to inform on the entity's enterprise value creation based on financially material factors that may not be captured in the financial statements (e.g., intangibles, ESG). EFRAG has supported the expressed overall objectives of management commentary.
- 27 However, we acknowledge that, after further outreach and assessment of the relative importance of the content areas to users, the IASB could develop a hierarchical organisation of content areas. We are seeking the views of the EFRAG TEG on this matter.

Questions for EFRAG TEG

- 28 What is the EFRAG TEG view on the proposal that the focus of management commentary should be on commenting on financial performance and financial position?

- | | |
|----|--|
| 29 | What is the EFRAG TEG view on the suggestion that the content areas should be organised in a hierarchy that gives more prominence to the financial performance and financial position content element? |
|----|--|

Governance

- 30 In its draft comment letter, EFRAG suggested that the Practice Statement should address governance matters transversally across the six content elements rather than as a separate topic.
- 31 Some comment letter respondents, while agreeing with EFRAG's suggestion that governance should be addressed, opined that it should be included as a separate element as it would also better fit with the requirements in some jurisdictions where a Governance report is required to be presented in a separate section within the Management Report. Similarly, during the outreach to targeted working groups, there was support for including governance in the Practice Statement but several respondents disagreed with the EFRAG DCL's proposed transversal inclusion of governance information. It was noted that the 'transversal inclusion' of governance information across content areas could be complex in practice and it was hard to see how it could function well without the ability to refer to a more general section on governance.
- 32 Comment letter and outreach respondents provided further arguments that underscored the importance of including governance in the Practice Statement that have been added to the proposed final comment letter. It was noted that governance is central to all areas and it would allow users to understand whether and how governing bodies oversee aspects of enterprise value creation and consider all risks and opportunities that inform strategy and performance over time. It was noted that potential future changes to the business model(s) of the entity might be triggered by changes in the governance/regulatory environment in which the entity is operating. Hence, including the description of the governance matters would provide for a better understanding of the entity's business model(s) and its operations and provide insight into future possible changes. A high-level, minimum set of governance requirements would enhance the comparability of reporting on governance across jurisdictions.
- 33 The EFRAG Secretariat suggest the following drafting for consideration by EFRAG TEG:

Governance

~~[62 EFRAG observes that governance should be addressed across the six proposed content elements in the ED. Although some aspects of governance may be addressed in the ED on a piecemeal basis (for instance as part of the discussion on strategy, progress in managing key matters and metrics used for management's incentives) the ED does not require comprehensive or detailed reporting on an entity's governance. While acknowledging that as explained in paragraph B12 of the ED, governance is typically addressed by local laws, EFRAG suggests that high level, principle-based guidance could be provided so as to enhance comparability in the reporting of governance across jurisdictions without conflicting local regulations.]~~

~~[63 The ED explains in paragraph B12 that the ED 'does not propose to require comprehensive or detailed reporting on an entity's governance because governance is typically regulated by local laws.]~~

[64 EFRAG considers that guidance on governance (including governance on ESG matters) should be transversally included across the as a separate content element. Disclosures about governance matters are central to all areas and would allow users to understand whether and how governing bodies oversee aspects of enterprise value creation and consider all risks and opportunities that inform

strategy and performance over time. Furthermore, potential future changes to the business model(s) of the entity might be triggered by changes in the governance/regulatory environment in which the entity is operating. Hence, including the description of the governance matters would provide for a better understanding of the entity's business model(s) and its operations and provide insight into future possible changes.

Users also need such information to assess management's stewardship of the entity's resources.]

Off-balance sheet commitment

- 34 In its draft comment letter, EFRAG recommended that off-balance-sheet commitment be addressed as an additional content element.
- 35 One respondent suggested that EFRAG reconsiders its recommendation insofar as disclosure about off-balance sheet commitments are already addressed by IFRS Standards. If further information is needed about commitments given or received by an entity, this could be addressed as part of the review of the relevant standards rather than by creating a requirement in the Management Commentary. One surveyed member of EFRAG's working group also expected that off-balance-sheet consideration would be addressed as part of the 'financial performance- financial position' content element. This could be clarified if necessary.
- 36 The EFRAG Secretariat agrees with the argument that there is no indication that off-balance-sheet items are not addressed or should not be within the financial performance and financial position content element and therefore suggests deleting the recommendation that these items be a separate content element.

~~*off-balance-sheet commitments*~~

~~68 EFRAG suggests that the IASB considers including off-balance-sheet commitments as an additional content element. Such commitments may have material impacts on an entity's ability to create value and generate cash flows.~~

~~69 Information in the Management Commentary would supplement the information already required by IFRS Standards (IAS 1, IFRS 7, IAS 37...) and address all material off-balance sheet transactions, arrangements, obligations (including contingent obligations), and other relationships of an entity with unconsolidated related parties, that may have a material current or future effect on its financial performance or position.]~~

Question for EFRAG TEG

- 37 Does EFRAG TEG agree with removing the recommendation regarding off-balance sheet commitment?

Question 5. Design of disclosure

- 38 No necessary changes were identified.

Question 6. Disclosure objectives for the areas of content

- 39 No necessary changes were identified.

Question 7. Key matters

- 40 No necessary changes were identified.

Question 8. Long-term prospects, intangible resources and relationships and ESG matters

Information about Intangibles

- 41 In the draft comment letter, EFRAG welcomes the proposed guidance and examples about intangibles but suggests that the IASB could expand the discussion to explain the unique role of intangibles in value creation.
- 42 One respondent while agreeing with the overall assessment, considered that reporting requirements for intangibles should not be addressed on a piecemeal basis from the sole standpoint of the Management Commentary. Instead, it should be addressed from an integrated view combining information in the management commentary, financial statements and sustainability reports.
- 43 To address the above concern, the EFRAG Secretariat suggest the changes below:

Following its agenda consultation, the IASB may soon take onboard a project on intangibles. We suggest that, in doing so, the IASB in collaboration with the ISSB considers the matter from a broader and integrated perspective combining information in the management commentary, financial statements and other reports.

In this context, the Discussion Paper¹ issued by EFRAG includes a number of analyses and proposals that could be considered.

Questions for EFRAG TEG

- 44 Does EFRAG TEG agree with the proposed changes?

Question 9. Interaction with the IFRS Foundation Trustees' project on sustainability reporting

- 45 In its draft comment letter in response to the ED, EFRAG notes that at the time of issuing the ED, the Trustees of the IFRS Foundation were still considering the Foundation's role in the development of sustainability reporting standards. EFRAG suggested that consideration should be given by the IASB to the activity of the future International Sustainability Standards Board (ISSB) when it discusses the feedback received on the ED and the possible ways forward.
- 46 Several respondents to EFRAG's consultation suggested that, due to the significant interactions between the Practice Statement and the standards that the ISSB will produce, the IASB should pause the project to revise the Practice Statement until there is sufficient clarity on the ISSB work including the location of the information to be provided under the standards. Some suggested that Management Commentary should be managed as a joint project (or in close coordination) by the IASB and ISSB going forward.
- 47 In response to the feedback received, EFRAG suggest revising the messages contained in its DCL in response to Question 9 of the ED as follows:

143 We recognise that there are significant ongoing initiatives in developing requirements for sustainability reporting that could have implications for the management commentary. When the IASB issued the ED, the ISSB was not yet established and there was a lack of clarity on the relevance of the MCPS in the context of sustainability reporting information and its role in connectivity between financial and sustainability reporting information.

144 For Europe, the report of the EFRAG European Lab Project Task Force on preparatory work for the elaboration of possible EU non-financial reporting standards⁸ (PTF-NFRS) highlights the importance of connectivity between financial

¹ [Better information on intangibles: which way to go?](#) – August 2021.

and non-financial information. As noted in earlier comments, the revised Practice Statement can potentially be a useful reference document and a source of inspiration even for jurisdictions that have robust mandatory requirements for the management report.

EFRAG suggests that the IASB reconsiders the finalisation of the MCPS project in the context of the work that the ISSB is about to start. EFRAG considers that the guidance on sustainability and connectivity in the ED could be enhanced if the project is managed jointly by the IASB and the ISSB.

In the EU the Corporate Sustainability Reporting Directive of April 2021, if implemented as proposed by the European Commission, will result in the Management Report being the location of sustainability reporting information, and this will be included from a double-materiality perspective. So, Management Report will be the location for a broader perspective on the entity's developments and performance, including governance matters and sustainability matters (the latter with a double-materiality perspective).

EFRAG considers that it is important that the practice statement on Management Commentary allows enough flexibility as to the placement of information to accommodate different jurisdictional requirements.

Question 10. Making materiality judgements

48 No necessary changes were identified.

Question 11. Completeness, balance, accuracy and other attributes

49 In its draft comment letter, EFRAG was concerned by the requirements in the ED that management commentary shall be provided 'in a way that enhances comparability' and that management should consider 'information they know entities with similar activities commonly provide to users. EFRAG considers that the requirement should be clarified that it is not expected that preparers actively monitor the disclosures made by their peer companies as that would place an unnecessary burden on them.

50 Respondents generally agreed with the view expressed. However, one respondent specifically asked EFRAG to use stronger language to recommend to the IASB to reconsider the guidance in paragraphs 12.5, 12.6 and 14.10 of the ED that could unintentionally create an expectation from an audit and enforcement standpoint that reporting entities are obliged to identify and verify whether other reporting entities with similar activities are providing specific types information or if guidelines for such types of [material] information are published by an organisation with interest in sustainability reporting (paragraphs 12.5, 12.6, Question 10). This requirement would not be operational and place an unnecessary burden on companies.

51 The EFRAG Secretariat suggest targeted changes to the current drafting which already reflect enough the concerns about the proposals in the ED:

Comparability

[172 EFRAG is concerned about the following provisions:

(a) the provision in paragraph 13.23 stating that 'information in management commentary shall be provided in a way that enhances comparability without omitting material information;' and

(b) the provision in paragraph 12.5 ('If management has a type of information, it knows entities with similar activities commonly provide to investors and creditors, it considers whether that information would be material in the context of the entity's management commentary')

c) the provision in paragraph 12.6 ('Narrative reporting requirements or guidelines published by, for example, an industry body (...) could help management identify information that might be material

d) the provision in paragraph 14.10 ('management is aware of differences between the method the entity uses to calculate the metric, or the name management uses to label the metric and a method or name commonly used by other entities with similar activities or operating in the same industry, management commentary shall describe those differences.)

[173 It is unclear what 'in a way that enhances comparability' means and what it implies from preparers.]

[174 EFRAG considers that the requirement listed above should be clarified that it is not expected that preparers actively monitor the disclosures made by their peer companies. If that were the case, it would place an unnecessary burden on preparers to have to monitor peers in pursuit of comparability. Achieving comparability across entities ought to be solely attained through preparers adhering to sufficiently specified guidance by the standard setter.]

Questions for EFRAG TEG

52 Does EFRAG TEG agree with the proposed changes?

Question 12. Metrics

- 53 In its draft comment letter, EFRAG tentatively supported
- 54 the approach proposed in the ED that non-financial information is included in the entity's management commentary to explain the entity's financial performance and financial position;
- 55 however, EFRAG recommended that the IASB should focus the scope of non-financial information and non-financial metrics presented in management commentary to those that are needed to explain the entity's financial performance and financial position.
- 56 EFRAG has received feedback from some respondents that non-financial, information and metrics in the management commentary should not be limited 'to those that are needed to explain the entity's financial performance and financial position' as this would not fully satisfy all objectives if the management commentary and in particular the objective to provide insight into factors that could affect the entity's ability to create value and generate cash flows across all time horizons (second objective).
- 57 In response to the above, the EFRAG Secretariat suggests deleting paragraph 185:
[185:
: EFRAG recommends that the IASB should further clarify that the scope of non-financial information and non-financial metrics presented in management commentary is limited to those that are needed to explain the entity's financial performance and financial position.]

Questions for EFRAG TEG

58 Does EFRAG TEG agree with the proposed changes to EFRAG's comment letter?

Question 14. Effective date

59 No necessary changes were identified.

Question 15. Effects analysis

60 No necessary changes were identified.

Question 16. Other comments

61 No necessary changes were identified.

Questions for EFRAG TEG

62 Does EFRAG TEG have any other proposals for drafting changes to consider?

63 Subject to any agreed changes, does EFRAG TEG agree to recommend the final comment letter for consideration by the EFRAG Board (through written procedures)?