EFRAG

European Financial Reporting Advisory Group

Draft Comment Letter

You can submit your comments on EFRAG's draft comment letter by using the '[Express your views]' page on EFRAG's website, then open the relevant news item and click on the 'Comment publication' link at the end of the news item.

Comments should be submitted by 15 November 2021.

International Accounting Standards Board
7 Westferry Circus, Canary Wharf
London E14 4HD
United Kingdom

28 July 2021

Dear Mr Barckow,

Re: IFRS Practice Statement Exposure Draft ED/2021/6 Management Commentary

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the IFRS Practice Statement Exposure Draft ED/2021/6 Management Commentary*,* issued by the IASB on 27 May 2021 (the 'ED').

This letter is intended to contribute to the IASB's due process.

This letter has been prepared on the basis of the present mission and governance of EFRAG and it presents the views formed following EFRAG due process. It doesn't represent views of EFRAG in its possible future capacity as advisor of the EC in advising on European sustainability reporting standards nor can be read as anticipating any view from EFRAG in this possible future capacity.

Although the Management Commentary Practice Statement ('Practice Statement') is not mandated in the EU, EFRAG welcomes the IASB's consultation and sees benefit in developing guidance for jurisdictions where guidance either does not exist or could be enhanced. Initiatives such as the revised Practice Statement can also contribute to a cross-fertilisation of ideas to improve information in management commentary across jurisdictions.

EFRAG observes that the ED proposes well-structured guidance for the revised Practice Statement that includes a rich set of illustrative examples.

Objectives-based disclosures

EFRAG supports an objectives-based approach combining overall and specific disclosure objectives complemented with non-binding examples of items of information. EFRAG considers that a prescriptive rules-based approach would not be appropriate for the management commentary considering that material matters and material information about these matters are entity-specific and can change over time.

EFRAG also considers that developing specific, rule-based requirements for the management commentary is primarily the responsibility of legislators, securities regulators or national standard setters.

EFRAG supports the proposed objective for the management commentary as:

- It better emphasises the need to provide a long-term view; and the link between value creation and information reported in the entity's financial statements.

- Better distinguish the role of the management commentary from the role of the financial statements.

EFRAG also generally agrees with the proposed objectives assigned to different content element but recommend that the IASB further explain how the proposed objectives also serve the objective of stewardship of management as this is not apparent from the way the objectives are defined.

Focus on 'key' matters

EFRAG understands the term 'key matters' has been introduced to help preparers identify information that could be material in the management commentary, However, EFRAG is concerned that the ED introduces a concept of 'key' that is not used elsewhere in the IFRS literature and the new term may confuse stakeholders.

The Basis for Conclusions explains the choice of the term *key* matter instead of material matters is because *material* is a property of information and not an attribute of matters. For the same reason, the IASB proposes the term 'fundamental' rather than 'material' in the definition of key matters.

However, EFRAG found several instances in which IFRS literature (e.g., IAS 1 *Presentation of Financial Statements*[1]) applies the term material to 'transactions, events or conditions. Similarly, EFRAG encourages the IASB to consider applying the term material when referring to matters and to reconsider the effects of introducing the concepts of 'key' and 'fundamental' with the existing guidance in IFRS Standards.

The IASB should further explain how the focus on key matters interacts with the statement, made in the ED that material information may not always relate to key matters. Finally, the IASB should include guidance on key matters and making materiality judgments in the same section to enable readers better identify and understand the interaction between the interrelated concepts.

Operationality of the proposals

EFRAG notes a major difference between the proposals in the ED and those in the Disclosure Initiative project, as the ED introduces a third type of objectives referred to as 'assessment objectives' that would require preparers to assess whether the information they provide meets the information needs of users for their assessments. In the Disclosure Initiative project, the assessment that users make with the information are provided for information only and have been used in designing the overall and specific objectives.

EFRAG considers that the proposals may introduce complexity insofar as it would require preparers to assess at each closing date, whether the information they provide would be enough to form the basis for the assessment that users make.

EFRAG considers that the IASB should consider testing the above assertions in jurisdictions in which (unlike in the EU), the Practice Statement is mandated or widely used (see also our response to Question 15 on Effects Analysis).

Content elements of the Management Commentary

EFRAG considers that the six contents elements identify the important matters that need to be addressed in a management commentary and these could enhance current management commentary information as they can a) address areas that can enhance useful information for investors (business model, resources and relationships, risks); and b) incorporate progress within the content elements such that reporting can reflect a dynamic view of these elements (e.g., business model).

[1] Including in the recently issued amendments to IAS1 Disclosure of Accounting Policies in which the IASB explicitly refers in several places to 'material transactions, events or conditions'.

However, EFRAG expresses concerns on the following topics:

Governance

Governance should be addressed across the six proposed content elements in the ED. EFRAG has concerns with the statement made in paragraph B12 of the ED that the revised Practice Statement should not address governance 'because governance is typically regulated by local laws'. EFRAG considers that high-level guidance on governance should be included, as this is an essential and overarching element to achieve a well-integrated, coherent whole as intended by the IASB.

Opportunities

EFRAG notes that opportunities are not addressed as a content element and are not given the same emphasis as risks. We observe that the proposals address opportunities only as part of the discussion on strategy and considers only 'the drivers of the strategy, including the opportunities that management has chosen to pursue'. EFRAG considers that the discussion on opportunities should be given equal prominence to risks. EFRAG observes that, in practice, 'risk' could capture both positive and negative variability, thus also opportunities. EFRAG considers that combining the discussion on risks and opportunities would bring greater clarity to the proposed guidance as these two aspects are interrelated.

Intangibles-related guidance

EFRAG acknowledges that intangibles-related guidance is implicit and embedded within the guidance and illustrative examples related to the six content elements and especially within resources and relationships.

EFRAG notes that the ED states that it does not impose a specific structure for the disclosures and therefore the fact that the guidance on intangibles is embedded within the six content elements would not prevent reporting entities from grouping their disclosures about intangibles in a separate chapter.

However, to give prominence to the availability of intangibles guidance, EFRAG recommends that the IASB could consider the following:

- expand the discussion contained in paragraphs 4.16 and 4.17 to explain the specific and unique role of intangibles in value creation (synergic nature of intangibles, scalability, can create both risks and opportunities°); and /or
- cross-referencing proposed guidance to the illustrative examples contained in Appendix B.

Definition of terms used

EFRAG welcomes the inclusion of a glossary in Appendix A but notes that some important concepts used in the guidance are not explicitly defined (strategy, risks, resources and relationships). EFRAG recommends that the IASB expands the definitions contained in Appendix A to address the above items.

Resources and relationships' outputs and impacts

EFRAG notes that resources and relationships are addressed in the ED as inputs for the entities. Nevertheless, there are impacts and outputs associated with resources and relationships. Thus, it would be helpful if entities outline the feedback loop between resources and relationships and their impacts. In other words, how resources and relationships affect the business model impacts and how in turn the business model impacts affect the entity's resources and relationships.

Off-balance-sheet commitments

EFRAG suggests that the IASB considers including off-balance-sheet commitments as an additional content element.

Qualitative attributes of management commentary information

EFRAG observes that the ED is introducing alternative terminology to depict the qualitative attributes that information must possess that already exist in IFRS Conceptual Framework.

EFRAG considers that including alternative terminology in the ED that is not in use in the IFRS Literature may create confusion for preparers of financial statements that are also involved in the preparation of the Management Commentary EFRAG suggests that, instead of using alternative terms, the IASB could explain in the ED how the existing qualitative and enhancing characteristics apply in the context of the management commentary.

Interaction with Materiality Practice Statement

EFRAG considers that it is not the role of a practice statement to provide a definition of materiality (since the IFRS Conceptual Framework already provides one that is applicable for all 'financial reports' including management commentary). However, we welcome the provision of practical guidance and examples to help entities make materiality judgements in the context of the management commentary.

EFRAG recommends that the IASB further considers how its proposed application guidance on Materiality in the ED interacts with the guidance provided in the Materiality Practice Statement. This is because materiality assessments for management commentary are not done in isolation and are often combined with those made for financial statements.

Metrics

EFRAG supports the approach proposed in this ED that non-financial information is included in the entity's management commentary to explain the entity's financial performance and financial position. However, EFRAG recommends 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.

Examples of information that might be material

EFRAG generally considers the provided examples in Appendix B to be helpful in implementing the proposed guidance but believes that additional examples on Governance, Intangibles, ESG matters, business model, and risks and opportunities could be further developed (e.g., inside-out factors that are financially material because they have affected or could affect the entity's ability to create value and generate cash flows, negative intangible factors).

EFRAG has two upcoming publications that are relevant to the ED consultation, namely:

- The Discussion Paper on Better Information in Intangibles (expected end of July 2021).
- The report of the European Lab Project Task Force on Reporting on Non-Financial Risks and Opportunities and linkage to the Business Model (PTF-RNFRO) (expected September 2021). The PTF-RNFRO report will include examples of good reporting practices.

We invite the IASB and other stakeholders to consider these as additional contributions to the debate on management commentary.

Effects Analysis- Effect of Technology

EFRAG observes that the current IFRS Taxonomy allows block tagging of information in management commentary using limited and broad IFRS Taxonomy elements, such as 'nature of business' or 'management's objectives and its strategies for meeting those objectives'. The more detailed requirements in the revised Practice Statement offers an opportunity for the IASB to provide more specific IFRS Taxonomy elements for management commentary across the six content elements and their respective objectives.

EFRAG's detailed comments and responses to the questions in the ED are set out in the Appendix.

If you would like to discuss our comments further, please do not hesitate to contact Hocine Kebli, Almudena Alcala, or me.

Yours sincerely,

Jean-Paul Gauzès
President of the EFRAG Board

Appendix - EFRAG's responses to the questions raised in the ED on the revised Management Commentary Practice Statement

1. Financial statements to which management commentary relates

Notes to constituents

1 *The IASB concluded that compliance with the revised Practice Statement should not rely on the financial statements including all the information required by IFRS Standards or on them being in accordance with concepts similar to those underpinning IFRS Standards. This is because the revised Practice Statement would require management commentary to meet specified objectives, rather than to provide specified information; so, compliance with the requirements of the revised Practice Statement would rely on meeting those objectives rather than the consideration of specific accounting principles.*

2 *However, the ED proposes to require an entity to disclose in its management commentary the basis on which its financial statements are prepared if they do not comply with IFRS Standards. This is to avoid users assuming that the related financial statements were prepared in accordance with IFRS Standards if they were prepared on a different basis.*

Question 1 - The financial statements to which management commentary relates

Paragraph 2.2 of the ED proposes that management commentary identify the financial statements to which it relates. That paragraph further proposes that, if the related financial statements are not prepared in accordance with IFRS Standards, the management commentary would disclose the basis on which the financial statements are prepared.

The Exposure Draft does not propose any restrictions on the basis of preparation of the related financial statements (for example, it does not propose a requirement that financial statements be prepared applying concepts similar to those underpinning IFRS Standards).

Paragraphs BC34–BC38 to the ED explain the Board's reasoning for these proposals.

(a) Do you agree that entities should be permitted to state compliance with the revised Practice Statement even if their financial statements are not prepared in accordance with IFRS Standards? Why or why not?

(b) Do you agree that no restrictions should be set on the basis of preparation of such financial statements? Why or why not? If you disagree, what restrictions do you suggest, and why?

EFRAG's response

EFRAG agrees with not imposing restrictions or conditions on the basis of preparation of the related financial statements. However, EFRAG suggests specifying that the guidance in the revised Practice Statement is meant to apply to general purpose financial statements and not to specific purpose financial statements.

EFRAG also agrees with the proposal to require an entity to disclose in its management commentary the basis on which its financial statements are prepared if they do not comply with IFRS Standards.

3 The EU has a long tradition of requiring management commentary information. Principles for preparing management commentary are laid out in the EU Accounting Directive and are supplemented by national requirements.

4 Although the Management Commentary Practice Statement ('Practice Statement') is not mandated in the EU, EFRAG welcomes the IASB's consultation and sees benefit in developing guidance for jurisdictions where guidance either does not exist or could be enhanced.

5 Initiatives such as the Practice Statement can also contribute to the cross-fertilisation of best practices to improve information in management commentary across jurisdictions.

Identification of financial statement to which the Management Commentary refers

6 EFRAG observes that the ED does not propose any restrictions on the basis of preparation of the related financial statements. EFRAG notes this is a major change compared to the current Practice Statement which only addressed management commentaries accompanying IFRS financial statements.

7 EFRAG however agrees with not imposing restrictions or conditions on GAAPs used by entities (such as requiring that related financial statements be prepared by applying concepts similar to those underpinning IFRS Standards) as this would be very complex to implement and create an unnecessary barrier to the adoption of the revised Practice Statement. EFRAG also agrees with the proposal to require an entity to disclose in its management commentary the basis on which its financial statements are prepared if they do not comply with IFRS Standards.

8 However, EFRAG suggests specifying that the guidance in the revised Practice Statement is meant to apply to general-purpose financial statements, that is those financial statements that are issued at regular intervals by Management to a broad group of users.

9 EFRAG observes that if an entity prepares general-purpose financial statements that are not compliant with IFRS and in accordance with concepts that are substantially different from those underpinning IFRS Standards, an entity is unlikely to be able to apply the revised Practice Statement, which is based on IFRS Standards concepts and principles. For instance:

(a) The proposed definition of materiality (see paragraph 3.2 of the ED) and guidance which builds on the IFRS definition of materiality; and

(b) The qualitative 'attributes' of information defined in the ED are drawn from the IFRS Conceptual Framework (see chapter 13 of the ED and BC 102).

10 The IASB should clarify whether a statement of compliance with the revised Practice Statement is still possible when entities have a similar but not identical definition of materiality. For instance, in the EU, the existing definition of materiality in the Accounting Directive does not embed the concept of 'obscuring' which was recently introduced by the IASB in its definition. It is unclear whether this fact alone would prevent entities in the EU from stating their compliance with the revised Practice Statement.

2. Statement of compliance

Notes to constituents

11 The revised Practice Statement retains the existing 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. An entity would be able to make an unqualified statement of compliance with the revised Practice Statement only if its management commentary meets all proposed requirements, namely:

(a) *it meets the objective of Management Commentary set out in the ED;*

(b) *it provides information that meets the disclosure objectives for all areas of content;*

(c) *it provides information with the attributes specified in Chapter 13 of the draft Practice Statement; and*

(d) *all metrics in the management commentary comply with the requirements in Chapter 14 of the draft Practice Statement.*

12 The revised Practice Statement proposes to permit an entity to include a qualified statement of compliance with the Practice Statement, but only if its management commentary identifies the departures from the requirements of the revised Practice Statement and gives reasons for those departures.

Question 2 - Statement of compliance

(a) Paragraph 2.5 of the ED proposes that management commentary that complies with all of the requirements of the Practice Statement include an explicit and unqualified statement of compliance.

Paragraphs BC30–BC32 to the ED explain the Board's reasoning for this proposal. Do you agree? Why or why not?

(b) Paragraph 2.6 of the ED proposes that management commentary that complies with some, but not all, of the requirements of the Practice Statement may include a statement of compliance. However, that statement would be qualified, identifying the departures from the requirements of the Practice Statement and giving the reasons for those departures.

Paragraph BC33 to the ED explains the Board's reasoning for this proposal.

Do you agree? Why or why not?

EFRAG's response

EFRAG supports 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.

EFRAG also supports the proposal to allow a qualified statement of compliance if the management commentary identifies the departures from the requirements of the revised Practice Statement and gives reasons for those departures.

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.

14 EFRAG also supports 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.

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.

Questions to Constituents

17 To what extent is the IFRS Practice Statement 1 *Management Commentary* used (including by influencing existing local regulations) or referred to by reporting entities in your jurisdiction? Are there specific requirements with the revised Practice Statement that would limit or prevent its use in your jurisdiction?

3. Objective of management commentary

Notes to constituents

18 *The existing Practice Statement* (2010) *describes the objective of management commentary as follows:*

(a) *provide users of financial statements with integrated information that provides a context for the related financial statements. Such information explains management's view not only about what has happened, including both positive and negative circumstances, but also why it has happened and what the implications are for the entity's future.*

(b) complements and supplements the financial *statements by communicating integrated information about the entity's resources and the claims against the entity and its resources, and the transactions and other events that change them*

(c) *explain the main trends and factors that are likely to affect the entity's future performance, position and progress. Consequently, management commentary looks not only at the present, but also at the past and the future.*

19 *The revised objective (described in the question box below) aims at proposing three main clarifications to the objective,*

(a) *linking it with assessments made by investors and creditors and confirming more prominently that management commentary needs to provide information that is material to investors and creditors*

(b) *clarifying how it differs from the objective of financial statements; and*

(c) *linking it with the entity's ability to create value and generate cash flows.*

Question 3 - Objective of management commentary

Paragraph 3.1 proposes that an entity's management commentary provide information that:

(a) enhances investors and creditors' understanding of the entity's financial performance and financial position reported in its financial statements; and

(b) provides insight into factors that could affect the entity's ability to create value and generate cash flows across all time horizons, including in the long term.

Paragraph 3.2 proposes that the information required by paragraph 3.1 be provided if it is material. Paragraph 3.2 states that, in the context of management commentary, information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that investors and creditors make on the basis of that management commentary and of the related financial statements.

Paragraphs 3.5–3.19 explain aspects of the objective, including the meaning of 'ability to create value'.

Paragraphs BC42–BC61 explain the Board's reasoning for these proposals.

Do you agree with the proposed objective of management commentary? Why or why not? If you disagree, what do you suggest instead, and why?

EFRAG's response

EFRAG supports the proposed objective for the management commentary. It emphasises the need to provide a long-term view; and the link between value creation and income, expenses and cash flows resulting from the value created through the entity's operating, investing, and financing activities as reported in the entity's financial statements. However, further clarification is needed on the relationship between the notion of 'ability to create value' and 'cash flow generation'.

EFRAG considers that the proposed revised objective helps to distinguish the role of the management commentary from the role of the financial statements.

However, EFRAG notes several concerns with the proposed objective, which are further detailed below, regarding (i) explaining how the proposed objectives also serve the assessment of stewardship; (ii) inconsistency with the objective of financial reports stated in the Conceptual Framework that includes providing information on cash flows; and (iii) definition of materiality.

EFRAG recommends that the revised Practice Statement should require entities to specify what they mean by short or long-term for their business models as this can inform the evaluation of entities' long-term prospects.

20 EFRAG considers that by referring to an entity's ability to create value and generate cash flows, the proposed objective rightly emphasises:

(a) the need to provide a long-term view in discussing factors underlying the entity's prospects; and

(b) the link between value creation and income, expenses and cash flows resulting from the value created through the entity's operating, investing and financing activities and reported in the entity's financial statements.

21 However, further clarifying language is needed on the relationship between the notion of 'ability to create value' and cash flow generation. The guidance should make it clear that both 'not destroying value' and 'creation of value' are encompassed. In other words, the potential erosion of cash flows should also be considered. For instance, disclosures on whether or not an entity is adhering to the Do-no-Significant-Harm principle (i.e., an entity is not creating value for itself on the one hand, and then eroding it for local communities and the environment on the other) can inform on the entity's financial viability.

22 EFRAG considers that the objective in the current Practice Statement focuses too much on the description of the content elements (resources and claims) of the management commentary rather than on the usefulness of the information for the assessment of an entity's prospects for future cash flows and of management's stewardship of the entity's resources

23 Therefore, EFRAG welcomes the proposed objective for the management commentary.

24 EFRAG considers that the proposed objective of the revised Practice Statement helps to distinguish the role of the management commentary from the role of the financial statements. EFRAG notes the following distinction:

(a) Financial statements focus on financial information about an entity's assets, liabilities, equity, income and expenses.

(b) Management commentary supplements the information in the financial statements by explaining the factors that have affected the entity's financial performance and financial position or that could affect them in the future.

25 However, EFRAG notes several concerns with the proposed objective in the following paragraphs.

*Addressing the a*ssessment of stewardship within the proposed objective

26 EFRAG notes that Paragraph 3.3(b) of the ED states that information in management commentary helps investors and creditors to assess management's stewardship of an entity's resources how efficiently and effectively management has used and protected those resources. However, EFRAG observes that no explicit reference is made to the stewardship objective in the proposed objective for the revised Practice Statement, which seems to focus primarily on the decision-usefulness of the information for investors and creditors.

27 EFRAG considers that it is essential that the proposed guidance better explains

(a) How the different headline and specific objectives suggested for each content element address both objectives of financial reporting including management commentary as defined in the IFRS Conceptual Framework; and

(b) How it has determined that the application of the proposed objectives would result in providing information that is <u>also useful</u> for assessing management's stewardship.

*Inc*onsistency with the objective of financial reports in the Conceptual Framework

28 EFRAG observes that the proposed objective in the revised Practice Statement refers to the '*understanding of the information in the financial statements about 'financial performance and position'*. In contrast, the objective of general-purpose financial statements, as stated in Chapter 1 of the IFRS Conceptual Framework and reiterated in Paragraph 9 of IAS 1-[2] *Presentation of Financial Statements*, is to provide information about '*the financial position, financial performance,* ***and cash flows*** *(emphasis added) of an entity that is useful to a wide range of users in making economic decisions*'. In other words, unlike the objective of financial reporting, the objective of the proposed guidance does not refer to providing information on cash flows.

29 EFRAG understands that in developing the ED, the IASB has considered that information about cash flows is also captured by financial position and performance. However, for the sake of clarity and insofar as one of the objectives of the revised Practice Statement is to supplement and complement the information in the financial statements, EFRAG suggests that the objective of the revised Practice Statement should include a reference to providing information about cash flows.

30 Finally, EFRAG observes that the Basis for Conclusions (footnote 1 to paragraph BC3[3]) seems to include an alternative description of the objective for the revised Practice Statement rather than the one effectively stated in the ED. EFRAG suggests aligning the text in the Basis for Conclusions to the actual drafting of paragraph 3.1 of the ED.

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[2] .

[3] *"all reports that complement an entity's financial statements and provide management's insights into factors that have affected the entity's financial performance and financial position, and factors that could affect the entity's ability to create value and generate cash flows in the future"*

Definition of materiality

31 Paragraph 3.2 of the ED states that, in the context of management commentary, '*information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that investors and creditors make on the basis of that management commentary and of the related financial statements'*.

32 EFRAG notes that:

(a) The IFRS Conceptual Framework already includes a definition of materiality that should apply to all general-purpose financial reports which encompass management commentary.

(b) Differences in terms between the two definitions are outlined in the table below.

Proposed definition in the ED	**Definition in the Conceptual framework**
information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that <u>investors and creditors</u> make on the basis of <u>the management commentary and of the related financial statements</u>.	Information is material if omitting it or misstating or obscuring it could reasonably be expected to influence decisions that the <u>primary users of general-purpose financial reports</u> make on the basis of those reports, <u>which provide financial information about a specific reporting entity.</u>

33 EFRAG is concerned that the ED suggest a definition of materiality for the revised Practice Statement that has been derived from (but is not fully aligned with) the definition existing in the Conceptual Framework and IAS 1.

34 EFRAG, therefore, suggests that the ED refers to the existing definition rather than propose a new one or, alternatively, aligns the respective texts, to avoid diversity in practice.

Long-time horizon

35 Paragraph 3.14 of the ED notes that the revised Practice Statement does not require information that informs entities abilities to generate future cash flows to be split by time horizon nor does it prescribe timescales (i.e., short, medium and long-term).

36 EFRAG agrees that it is not appropriate to specify time horizons as the definition of the long or short term would vary depending on the business model. However, aligned with the objective of informing on long-term prospects. EFRAG recommends that the revised Practice Statement should require entities to specify what they mean by short or long-term for their business model/s as this can inform the evaluation of entities' long-term prospects.

37 When referring to time horizon there should be clearer language than 'time horizon including long term' and reference should instead be made to 'multiple time horizons' or to 'across short, medium, and long term'.

38 Furthermore, the guidance should clarify that long-term is not limited by management's forecast period. It is not necessarily clear whether long-term is intended to encompass what would be captured in the terminal value of the entity and whether there could be material impacts in the long-term that may not be reflected in the terminal value.

4. Overall approach

Note to constituents

39 The ED proposes an objectives-based approach that specifies disclosure objective as the prescriptive approach would require the IASB to identify all matters about which information is likely to be material to investors and creditors and to require specific disclosures about them and it is considered not to be feasible.

40 The current Practice Statement includes broad descriptions of what management needs to discuss for each area of content. Those broad descriptions could be viewed as broad disclosure objectives. However, the IASB considered that they are not prominent or specific enough to help management identify information needed to meet these implied objectives.

41 The ED proposes to replace those broad descriptions with explicit disclosure objectives for each area of content. The disclosure objectives are intended to provide clarity about the required contents of management commentary and to help:

(a) management identify entity-specific information that needs to be *included for management commentary to meet its objective. (Meeting the disclosure objectives is necessary if an entity wants to claim compliance with the Practice Statement.)*

(b) *providers of external assurance and regulators assess whether the information provided meets the objective of management commentary.*

42 In developing the disclosure objectives, the IASB sought to identify investor and creditors' information needs related to each area of content.

43 The ED identifies six main content elements for the revised Practice Statement which are generally consistent with the Five content elements contained in the existing Practice Statement (2010). The following differences can be noted:

(a) *'resources and relationships' which are combined with 'risks' in the current PS will now be a separate area of content from' risks'*

(b) *Factors from the external environment', currently discussed as part of the business model, would now form part of a separate area of content.*

(c) *EFRAG welcomes the two proposed changes insofar as:*

(d) *resources and relationships (including those not recognised in the entity's financial statements) play a major role in entities' ability to create value and generate cash flows. do not affect an entity in the same way as risks*

44 Factors and trends in the external environment may affect not only an entity's business model, but also its strategy, resources and relationships, or the risks the entity faces. Users increasingly request information about environmental and social factors affecting the entity's ability to create value and generate cash flows.

Question 4 - Overall approach

The Exposure Draft proposes an objectives-based approach that:

(a) specifies an objective for management commentary (see Chapter 3);

(b) specifies six areas of content for management commentary and, for each area of content, disclosure objectives that information provided in management commentary is required to meet (see Chapters 5 - 10);

(c) gives examples of information that management commentary might need to provide to meet the disclosure objectives (see Chapter 15); but

(d) does not provide a detailed and prescriptive list of information that commentary must provide.

Paragraphs BC69–BC71 explain the Board's reasoning for proposing this approach.

Do you expect that the Board's proposed approach would be:

(a) capable of being operationalised - providing a suitable and sufficient basis for management to identify information that investors and creditors need; and

(b) enforceable - providing a suitable and sufficient basis for auditors and regulators to determine whether an entity has complied with the requirements of the Practice Statement?

If not, what approach do you suggest and why?

EFRAG's response

EFRAG supports an objectives-based approach combining headline and specific disclosure objectives complemented with non-binding examples of items of information.

However, EFRAG observes that the proposals in the ED introduce additional complexity by distinguishing three types of objectives and by asking preparers to assess whether the information they provide provides a sufficient basis for users to make their assessments. It will be particularly challenging for smaller entities to have to make such an assessment.

EFRAG considers that the six content elements do identify the important matters that need to be addressed in management commentary. The guidance on the content elements could enhance current management commentary information as they address areas that can enhance useful information for investors (business model, resources and relationships, risks); and c) incorporate progress within the content elements such that reporting can reflect a dynamic view of these elements (e.g., business model).

However, EFRAG recommends that the IASB includes clarifying guidance to describe what is meant by 'resilient' and 'durable' in respect of the business model in paragraph 5.6 of the ED. EFRAG suggests the reference to outputs and impacts that are financially material to be more prominent.

EFRAG considers that the revised ED should also:

- **address governance across the six content elements;**
- **give equal emphasis to the discussion of risks and opportunities;**
- **consider combining the discussion of risks and opportunities as they are interrelated; and**
- **consider including disclosures about off-balance-sheet commitments as an additional content element.**

EFRAG notes that some of the terms used for the content elements (i.e., strategy, risks, resources and relationships) are not sufficiently or explicitly defined. EFRAG recommends that these terms should be defined in the Appendix-A (Definition) section.

The guidance on impacts could be strengthened in particular regarding the feedback loop of resources and relationships impacts that are financially material.

EFRAG also suggests that the discussion on intangible contained in paragraphs 4.16 and 4.17 is expanded (see suggestions below) and that the IASB includes cross-references between proposed guidance and the illustrative examples of intangibles contained in Appendix B.

EFRAG considers that appropriate field-testing of the objectives-based approach for disclosures is necessary to assess their applicability, enforceability, and auditability.

Overall approach

45 EFRAG supports an objectives-based approach combining overall and specific disclosure objectives complemented with non-binding examples.

46 EFRAG considers that an objectives-based approach for disclosures (also considered and tested by the IASB in the context of notes in exposure draft *('the Disclosure Initiative Pilot project'*) is particularly appropriate for information in the management commentary because:

(a) Matters that might need to be discussed (and material information about these matters) are highly entity-specific and would depend on an entity's own circumstances, activities and the industry in which an entity operates. Furthermore, key matters faced by an entity can change over time. Hence, a prescriptive approach aiming at identifying all matters about which information to disclose would not be feasible.

(b) Developing specific rule-based requirements for the management commentary is primarily the responsibility of legislators, securities regulators or national standard setters.

47 In the context of its response to the exposure-draft on the Disclosure Initiative Pilot project, EFRAG has expressed support for an approach combining:

(a) Specific objectives which are more operational; and

(b) Overall objectives that prompt entities to step back and consider whether the information as a whole meets users' information needs for that topic.

48 We consider that the above arguments also apply to the Management Commentary.

49 EFRAG suggests that the IASB considers the outcome of its ongoing consultation on the ED Disclosure Requirements in IFRS Standards—A Pilot Approach and whether the combination of overall and specific objectives is sufficient to ensure the enforceability and auditability of information and can be applied for the revised Practice Statement.

50 EFRAG also recommends that the IASB further considers and explains the relationship between the overall and specific disclosure objectives, and the concept of materiality, to clarify the proposal. EFRAG considers that it is essential to clarify the interaction between:

(a) the proposed specific principles which are supposed to reflect the 'information 'needs'' of users; and

(b) the concept of materiality which refers to information which omission, misstatement or obscuring 'could reasonably be expected to influence the decisions that the primary users of general-purpose financial statements make on the basis of those financial statements'.

51 EFRAG recommends that the IASB further consider and explain the relationship between individual disclosure objectives in IFRS Standards and the concept of materiality as this is essential to an understanding of the proposals.

52 EFRAG has, however, also expressed the view that, by nature, objective-based requirements are more prone to create applicability, enforceability and auditability which ought to be field-tested by the IASB. These issues are further discussed in the next paragraphs.

Content elements

53 EFRAG notes that the proposed six contents elements are generally consistent with the five elements that are already contained within the current practice statement.

54 EFRAG considers that the six contents elements identified the important matters that need to be addressed in a management commentary. These elements could enhance the reporting of management commentary. Some academic studies[4] have pointed to the relevance for investors of enhanced reporting of the content elements of the revised Practice Statement (i.e., business model, strategy and resources and relationships).

55 EFRAG also notes that:

(a) 'resources and relationships' which are combined with 'risks' in the current Practice Statement will be a separate area of content from' risks'

(b) Factors from the external environment', currently discussed as part of the business model, would now form part of a separate area of content.

56 EFRAG welcomes the above-proposed changes insofar as:

(a) resources and relationships (including those not recognised in the entity's financial statements) play a major role in entities' ability to create value and generate cash flows.

(b) factors and trends in the external environment may affect not only an entity's business model, but also its strategy, resources and relationships, or the risks the entity faces. Users increasingly request information about environmental and social factors affecting the entity's ability to create value and generate cash flows.

57 Finally, EFRAG also supports the fact that progress in managing key matters is discussed within the content elements (e.g., progress in managing the entity's business model, or progress in implementing the strategy...) rather than as a separate topic as is the case in the current Practice Statement. We consider that this better reflects the dynamic nature of the information about each of the content elements. For instance, this could contribute to reporting that reflects a dynamic view and sustainability of the business model rather than only presenting a static view.

58 However, EFRAG expresses a number of concerns in the following paragraphs.

Business model

59 EFRAG recommends that the IASB includes in the definition of a business model an explicit reference to value creation and time horizon. Further guidance is needed on the notion of the 'long term' in relation to the business model and strategy.

60 Further clarifying guidance is also needed to describe what is meant by 'resilient' and 'durable' in respect of the business model in paragraph 5.6 of the ED.

61 EFRAG also considers that except for paragraph 5.7, the current disclosure objective relating to business models in paragraph 5.7 of the ED has limited reference to outputs and impacts. The reference to outputs and impacts should be more prominent.

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

[4] Academic studies include: a) Mechelli, A., Cimini,R. and Mazzochetti,F., 2017, [The usefulness of the business model disclosure for investors' judgements in financial entities](). A European study, Spanish Accounting Review, 20-(1), 1-12; b) V.Athanasakou, 2019, [Annual Report Commentary on Value Creation Process]()-Working Paper; c) Bini, L. 2016, [Business model disclosure in the Strategic Report](), Journal of Intellectual Capital17(1):83-102.

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.

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 content elements. Users need such information to assess management's stewardship of the entity's resources. EFRAG suggests that high level, principle-based guidance could be provided so as to not create conflict with local regulations.

Resources and relationships impact

65 EFRAG notes that resources and relationships are inputs for the entities, nevertheless, there are impacts and outputs associated with resources and relationships. Thus, it would be helpful if entities outline the feedback loop between resources and relationships and their impacts. In other words, how resources and relationships affect the business model impacts and how in turn the business model impacts affect the entity's resources and relationships.

Intangibles

66 EFRAG notes that intangibles are not addressed as a separate content element. EFRAG notes that the ED states that it does not impose a specific structure for the disclosures and therefore the fact that the guidance on intangibles is embedded within the six content elements would not prevent reporting entities from grouping their disclosures about intangibles in a separate chapter.

67 Although EFRAG generally considers that the proposed guidance and examples (presented across the different content elements) and Appendix B (providing a mapping of all the instances where intangibles are addressed in the ED) are very useful. However, EFRAG considers that the proposed presentation, where the guidance is scattered across the different content elements, does not emphasise enough the specific and unique role of intangibles in the value creation:

(a) Intangibles have a synergic nature and most intangible assets do not create income on their own but only in conjunction with other assets.

(b) Intangibles can have a positive or negative effect on value creation; they can create both risks and opportunities.

(c) Unlike tangible assets, Intangibles are 'scalable' which means that can be used repeatedly and in multiple places at the same time (e.g., knowledge).

68 EFRAG suggests that the IASB could expand the discussion contained in paragraphs 4.16 and 4.17 to explain the above. We also suggest that the IASB includes cross-references between the proposed guidance and the illustrative examples of intangibles contained in Appendix B.

Off-balance-sheet commitments

69 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.

70 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 to Constituents

71 Do you agree or disagree with the guidance on Intangibles being incorporated across the six content elements? Please explain your view.

Risks

72 EFRAG recommends that the guidance relating to the risks should not only require information about the 'extent' of the entity's exposure but also require information about the cause and context of the risk exposure to help identify the mitigation of the risk.

73 EFRAG also recommends that the IASB should broaden the objective of the disclosures on the risks as follows: "The information about risks shall enable investors and creditors to understand:

(a) the nature of opportunities that have been identified in associated with, or arising from the entity's risks and their management;

(b) how management will mitigate disruption if it occurs and how the mitigation is aided by the implementation of identified opportunities; and

(c) progress in managing risks and developing opportunities."

74 Providing context behind the risk is consistent with the coherence principle as it helps to link the disclosure on risks with the factors addressed in other content elements.

Opportunities

75 EFRAG notes that opportunities are not addressed as a separate content element and are not given the same emphasis as risks. We observe that the ED addresses opportunities only as part of the discussion on strategy and considers only 'the drivers of the strategy, including the opportunities management has chosen to pursue'. Referring only to opportunities linked to the strategies an entity has already chosen to pursue is too restrictive.

76 EFRAG considers that equal emphasis should be placed on opportunities and risks as the same events, transactions or factors may create both risks and opportunities. For instance, ESG matters may generate both risks and opportunities for an entity's.

77 EFRAG observes that in practice 'risk' could capture both positive and negative variability, thus also opportunities. Therefore, EFRAG considers that combining the discussion on risks and opportunities would bring greater clarity to the proposed guidance as these two aspects are interrelated.

78 Additionally, disclosure of any trade-offs between risks and opportunities in decisions made that created value could also be material information.

Missing or Inadequate definition of the content elements

79 EFRAG notes that the ED does not explicitly define some of the content elements.

(a) Risks are described and several examples of 'risks' are provided in the ED but the term itself is not defined**.** It is therefore unclear whether, besides financial risks, it also encompasses operational, legal risks, reputation risks technology risks. Similarly, opportunities are not defined;

(b) The terms 'resource and relationships' are not clearly defined either. The resources and relationships an entity 'depend on' for value creation are not necessarily the ones the entity can control, and it is unclear where the boundaries should be set; and

(c) Strategy is not defined.

80 EFRAG encourages the IASB to include in Appendix A definitions of strategy, risks, opportunities, resources and relationships.

Operationality - Level of Judgement

81 EFRAG considers that the proposals will only achieve their full benefits if not only preparers of management commentary, but also auditors (in jurisdictions where the Management Commentary is subject to some forms of assurance) and regulators use appropriate judgement when applying those requirements.

82 In particular, EFRAG considers that the assessment objective introduced in the revised Practice Statement might introduce complexity for preparers[5] for the following reasons:

(a) There are a wide range of users with different information needs and these needs may change over time (for instance information needs in a low-inflation environment may be different than the ones in a high inflation one). It is also unclear how the proposals in the revised Practice Statement would help entities apprehend the dynamic aspect of users' needs.

(b) Materiality is a dynamic concept and what is considered material may evolve based on factors like emerging technologies, societal preferences, new knowledge (e.g., new knowledge on ESG factors), and public policy and regulations. The recent surge of interest in ESG matters is an example of that.

(c) Having the three types of objectives proposed in the ED (headline, specific and assessment objectives) (re)-assessed at each interim period might create a burden for preparers.

83 EFRAG considers that the above assertions should be further field-tested in particular in jurisdictions in which (unlike in the EU), the current Practice Statement is mandated or widely used (see also our response to Question 15 on Effects Analysis).

84 EFRAG is not considering conducting field tests as the Practice Statement is not mandated in the EU. However, EFRAG encourages the IASB to consider extensive field-testing of its proposals in the areas where the guidance has been mandated (if any) or for which evidence of widespread use exists.

Enforceability

85 EFRAG observes that, in the BC174, the IASB expects that its proposals would:

(a) make it easier for lawmakers and regulators to enforce the revised Practice Statement and for auditors to provide assurance on management commentary, or to enhance the level of assurance they provide; and

(b) encourage lawmakers and regulators to reflect the proposals in local requirements.

86 EFRAG considers that these expectations need to be confirmed by reaching out to relevant enforcers, auditors and their organisation in particular in jurisdictions where the current Practice Statement is mandated or where elements of the current Practice Statement have been incorporated into law.

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[5] See also our comment in the response to Question 6 regarding the design of the objectives.

For the same reasons as mentioned in paragraph 84 related to the status of the current Practice Statement in the EU, EFRAG is not considering extensive outreach to these stakeholders.

Question to Constituents

87 Do you have evidence of widespread use of the current Practice Statement on a voluntary basis in your jurisdiction? If so, could you indicate which types of entities?

88 Have you identified any specific issues with the enforceability and auditability of the proposals in the ED?

5. Design of disclosure objectives

Notes to constituents

89 The ED suggests a multiple-step process for Management to identify information to provide in the management commentary in which Management:

(a) *first identifies the information needed to meet the <u>specific objectives</u>.*

(b) *then evaluates whether that information provides a sufficient basis for the assessments described in the <u>assessment objectives</u>.*

(c) *then evaluates whether the information needed to meet the specific objectives and the assessment objectives is sufficient to meet the <u>headline objectives.</u>*

(d) *Finally, evaluates whether the information needed to meet the disclosure objectives for the areas of content is sufficient to meet the objective of management commentary taken as a whole*

90 At each step, if the information is insufficient, management identifies additional information needed to meet that objective.

91 The Basis for Conclusions (BC76) explain that the assessment objective was introduced '*in order to create an effective basis for assessing compliance with the Practice Statement'*.

92 The role of assessment objectives is to inform management what assessments users make in relation to an area of content to help management identify relevant information.

Question 5 - Design of disclosure objectives

The proposed disclosure objectives for the areas of content comprise three components —a headline objective, assessment objectives and specific objectives. Paragraph 4.3 explains the role of each component. Paragraphs 4.4 - 4.5 set out a process for identifying the information needed to meet the disclosure objectives for the areas of content and to meet the objective of management commentary.

Paragraphs BC72 - BC76 explain the Board's reasoning for these proposals.

(a) Do you agree with the proposed design of the disclosure objectives? Why or why not? If you disagree, what do you suggest instead, and why?

(b) Do you have general comments on the proposed disclosure objectives that are not covered in your answers to Question 6?

EFRAG's response

EFRAG considers that the proposed approach introduces greater complexity by adding to the headline and specific objective, a third category of objectives (referred to as 'assessment objectives') that would require preparers to ensure that the information they disclose would provide an adequate basis for users assessments.

EFRAG suggests that the IASB considers the outcome of its ongoing consultation on the ED Disclosure Requirements in IFRS Standards—A Pilot Approach, where only overall and specific objectives are provided and assesses whether a similar approach could be applied to the revised Management Commentary and whether the combination of overall and specific objectives is sufficient to ensure the enforceability and auditability of information.

93 EFRAG notes a major difference between the proposals in the ED and those in the Disclosure Initiative Pilot project as the ED introduces a third type of objectives referred to as 'assessment objectives') that would require, preparers to assess whether the information they provide meets the information needs of users for their assessments.

94 In the Disclosure Initiative Pilot project, the assessment that users make with the information are provided for information only and have been used in designing the overall and specific objectives. But preparers are not required to specifically step back and assess whether the information provides a sufficient basis for users to make their assessments.

95 However, EFRAG fails to understand why, as explained in BC76, separating specific objectives from assessment objectives is deemed to provide a sufficient basis for assessing compliance. EFRAG notes that in the Disclosure Initiative Pilot project, the IASB has concluded that the combination of overall and specific objectives was enough to ensure the applicability and enforcement of the proposals.

96 EFRAG suggests that the IASB considers the outcome of its ongoing consultation on the ED *Disclosure Requirements in IFRS Standards—A Pilot Project* and assesses whether a similar approach could be applied to the revised Practice statement in which an entity:

(a) First, assesses how to meet the different <u>specific disclosure objectives</u> (these specific objectives build on the information needs of users and the consideration of the assessment they make).

(b) Then considers whether, after having addressed all the specific disclosure objectives, the information as a whole for the content element meets the <u>headline objective</u>.

(c) Then consider the <u>objective of the Management Commentary as a whole</u> and assess whether the information provided across all content elements meets the overall objective of the Management Commentary as set out in the ED.

97 EFRAG considers it necessary that at each step, management considers providing additional information if the objectives are not deemed to be met.

Differences in Terminology used

98 We also observe that the revised Practice Statement is using different terminology than in the ED *Disclosure Requirements in IFRS Standards* for similar concepts, namely:

(a) Headline objective (revised Practice Statement) versus Overall objectives (ED *Disclosure Requirements in IFRS Standards;*

(b) 'Could include' (revised Practice Statement) versus 'While not mandatory, the following information may enable an entity to meet [the specific disclosure objective].' (ED *Disclosure Requirements in IFRS Standards*); and

(c) Assessment objectives (revised Practice Statement) versus 'Explanation of what the information is intended to help users do (ED *Disclosure Requirements in IFRS Standards*.

99 EFRAG considers that it is unhelpful to use different terminologies across two consultations for concepts that are essentially the same. This may create confusion especially as the two consultations are conducted over the same period.

6. Disclosure objectives for the areas of content

Notes to constituents

100 The ED identifies six areas of content in the revised Practice Statement, and the IASB proposes disclosure objectives comprising:

(a) *a headline objective describing the overall information needs of investors and creditors for that area of content;*

(b) *assessment objectives describing investors and creditors' assessments that rely on information provided for the area of content; and*

(c) *specific objectives describing the detailed information needs of investors and creditors for the area of content.*

The entity's business model

101 The IASB adjusted the business model definition to refer to an entity's ability to create value and generate cash flows.

102 The ED explains that a cycle of creating value and generating cash flows within a business model involves integrated processes by which an entity obtains inputs to its operations, transforms those inputs into outputs, sells those outputs, delivers them to customers and collects cash. The proposed description of a business model highlights that 'business model' covers those processes that could create value or generate cash flows across all time horizons, including in the long term.

Management's strategy for sustaining and developing that business model

103 The ED explains that an entity's business model can evolve as management responds to internal and external factors and trends. The revised Practice Statement proposes to provide information about the entity's business model that operated during the reporting period and explains whether, how and why that model has changed since the previous reporting period.

104 The entity's resources and relationships. The ED expects the revised Practice Statement shall provide information that enables investors and creditors to understand the resources and relationships on which the entity's business model and management's strategy for sustaining and developing that model depend.

105 Managing the entity's resources and relationships includes obtaining and maintaining those resources and relationships as well as developing, enhancing and replacing them as the entity's needs evolve.

Risks to which the entity is exposed

106 The ED expects in the revised Practice Statement that entities focus on the key risks to which the entity is exposed. Key risks are risks of events or circumstances that could fundamentally disrupt the entity's ability to create value and generate cash flows, including in the long term.

The entity's external environment

107 *The ED explains that an entity can be affected by factors in its external environment (for example, the existence of a competitive threat) and by trends in these factors (for example, emerging changes in consumer preferences).*

108 *The ED expects the entity to disclose information about factors and trends in an entity's external environment which provides insights into their effects on the entity's business model, on management's strategy for sustaining and developing that model, on the entity's resources and relationships, and on the risks to which the entity is exposed.*

The entity's financial performance and financial position

109 *The ED expects the entity to disclose information about the entity's financial performance and financial position shall enable investors and creditors to understand:*

(a) *what factors have affected the entity's financial performance and financial position in the reporting period or could affect them in the future, including in the long term;*

(b) *how management has allocated financial resources in the reporting period; and*

(c) *how the entity's financial performance and financial position compare with forecasts or targets previously published by the entity, if any.*

Question 6 - Disclosure objectives for the areas of content

Chapters 5 - 10 propose disclosure objectives for six areas of content. Do you agree with the proposed disclosure objectives for information about:

(a) the entity's business model;

(b) management's strategy for sustaining and developing that business model;

(c) the entity's resources and relationships;

(d) risks to which the entity is exposed;

(e) the entity's external environment; and

(f) the entity's financial performance and financial position?

Why or why not? If you disagree, what do you suggest instead, and why?

EFRAG's response

EFRAG generally supports the headline and specific objectives proposed in the ED for the six content elements.

However, as mentioned in our response to question 3, we recommend that the IASB clarifies how the proposed headline, assessment and specific objectives also address the assessment of stewardship by management.

EFRAG also considers the guidance on opportunities should not be limited to being a subset of strategy but be given the same emphasis as the guidance on risks. Combining the discussion on risks and opportunities would bring greater clarity to the proposed guidance as these two aspects are interrelated.

Proposed objectives

110 EFRAG considers that the specific objectives as proposed are an improvement over the current guidance in the Practice Statement which only contains broad

descriptions of what management needs to discuss for each area of content that is not specific enough to help management identify information needed by users to meet these implied objectives.

111 In the response to Question 4, EFRAG notes that it considers the six content elements have identified the important matters that need to be addressed in management commentary and these elements will enhance the quality of reporting that informs investors on value creation.

112 However, as indicated in its response to Question 3, EFRAG considers that the ED does not clearly explain how the proposed specific and headline objectives also address the stewardship objective of financial reports (i.e., provide information to assess how effectively and efficiently management has discharged their responsibilities to use the entity's existing resources).

113 We observe that no explicit mention is made of the stewardship objective in the proposed objective which seems to focus only on the decision-usefulness of the information for investors and creditors. EFRAG considers that it is essential that the ED better explains how it has determined that the application of the proposed overall and specific objectives will also provide a basis for the assessment of the stewardship of management.

7. Key matters

Notes to constituents

114 Paragraphs 4.7–4.14 explain proposed requirements for management commentary to focus on key matters.

115 Matters would be identified as 'key' if they are 'fundamental to the entity's ability to create value and generate cash flows'. Understanding that ability helps investors and creditors to assess the entity's prospects for future cash flows and management's stewardship and ultimately to make investment decisions.

116 To help an entity's management identify the key matters that are specific to that entity, the ED proposes to include in the revised Practice Statement guidance supporting the definition of key matters and examples of possible key matters.

Question 7 - Key matters

Paragraphs 4.7–4.14 explain proposed requirements for management commentary to focus on key matters. Those paragraphs also propose guidance on identifying key matters. Chapters 5–10 propose examples of key matters for each area of content and examples of metrics that management might use to monitor key matters and to measure progress in managing those matters.

Paragraphs BC77–BC79 explain the Board's reasoning for these proposals.

(a) Do you agree that the Practice Statement should require management commentary to focus on key matters? Why or why not? If you disagree, what do you suggest instead, and why?

(b) Do you expect that the proposed guidance on identifying key matters, including the examples of key matters, would provide a suitable and sufficient basis for management to identify the key matters on which management commentary should focus? If not, what alternative or additional guidance do you suggest?

(c) Do you have any other comments on the proposed guidance?

EFRAG's response

EFRAG agrees that information provided in the Management Commentary should focus on matters that are 'important' to an entity's ability to create value and generate cash flows.

EFRAG acknowledges that the IASB's introduction of the notion of key matters is meant to help in the identification of material information taking into consideration that the scope of information that needs to be included in management commentary may be too broad.

However, EFRAG is concerned by the introduction of the term 'key' that is not used in the rest of the IFRS literature.

EFRAG notes that the assertion in the ED *that the term material 'is an attribute of information, not an attribute of matters' is* inconsistent with some IFRS standards which use the term material more broadly.' Furthermore, it remains unclear why, as asserted by the ED, material as a threshold of inclusion can only be a property of information but cannot be an attribute of matters.

EFRAG proposes a consolidated analysis of the notions of key matters and material information in a single section within the guidance.

EFRAG also considers that the notion 'key matters' may create confusion with the concept of 'key audit matters' as defined in the auditing standards (ISA 701).

Finally, EFRAG suggests that IASB better explains how the focus on key matters required by the ED (paragraph 4.7 of the ED) reconciles with the statement made in paragraph 3.17 that material information may also be provided if it does not relate to key matters.

117 EFRAG agrees that information provided in the management commentary should focus on matters that are 'important' to an entity's ability to create value and generate cash flows. This is because understanding that ability helps users assess the entity's prospects for future cash flows and management's stewardship and ultimately to make investment decisions.

118 EFRAG acknowledges that the IASB's introduction of the notion of key matters is meant to help in the identification of material information taking into consideration that the scope of information that needs to be included in management commentary may be too broad.

119 However, EFRAG is concerned by the introduction of new concepts of 'key' matters in the revised Practice Statement, which will be non-binding guidance. EFRAG observes that the term 'key' is not used with the proposed meaning in the existing IFRS literature including the Conceptual Framework.

120 The IASB explains in the Basis for Conclusions to the ED (BC78) that it proposes to introduce the notion of 'key' matters and avoid using the term 'material' to convey how important those matters are for the entity's ability to create value and generate cash flows because materiality as defined in the IFRS Conceptual Framework and IAS 1 '*is an attribute of information, not an attribute of matters'*. For the same reason, the IASB proposes the term 'fundamental' rather than 'material' in the definition of key matters.

121 However, EFRAG notes that the above assertion is not consistent with the recently issued amendments to IAS1 *Disclosure of Accounting Policies* in which the IASB explicitly refers in several places to 'material transactions, other events or conditions. For instance,

(a) *Paragraph 117 A of IAS 1 states :(…)' Not all accounting policy relating to material transactions, other events or conditions* (emphasis added) *is itself material;'*

(b) *Paragraph 117B (…) an entity is likely to consider accounting policy information material to its financial statements if the information relates to material transactions, other events or conditions (..)*

122 Similarly, older IFRS Standards also ascribe 'material' to notions other than information. For instance,

(a) IAS 37 refers to *'material effect on the nature and focus of the entity's operations'* (Paragraph 70 d)).

(b) IAS 36 paragraph 21 '*materially changes either the scope of the business undertaken by an entity or the manner in which the business is conducted (paragraph 46).*

123 It is unclear why in IAS 1, the IASB has considered it appropriate to refer to the materiality of 'matters' such as transactions, events or conditions and considered that a broader application of the property of materiality would not be appropriate in the revised Practice Statement.

124 Although BC78 states that '*the terms 'key' and 'fundamental' are not meant to replace materiality as a threshold for determining what information should be included in management commentary'*; we believe that there is a risk that the introduced concepts create confusion.

125 EFRAG considers that the term 'material' is well understood and used broadly. It remains unclear why, as asserted by the ED, material as a threshold of inclusion can only be a property of information but cannot be an attribute of matters. It is also unclear whether 'key matters' is a commonly applied and readily understood term by the breadth of stakeholders involved in the preparation or use of management commentary as would be the case with the term 'material matters'. Therefore, EFRAG recommends the IASB to reconsider the effects of the proposals in ED introducing the concepts of 'key' and 'fundamental' in the revised Practice Statement with the existing guidance in IFRS Standards.

126 EFRAG also considers that the notion 'key matters' may create confusion with the concept of 'key audit matters' as defined in the auditing standards (ISA 701). The latter refers to matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements.

127 EFRAG considers that entities may find it difficult to determine whether and how the proposed notion of key matters interrelates with the key audit matters discussed with their auditors.

128 EFRAG also recommends that the IASB better explains the interactions between the following statements:

(a) Paragraph 4.7 requiring disclosure in the management commentary to focus on 'key matters'; and

(b) Paragraph 3.17, which states 'material information does not necessarily relate to a key matter. Material information is included in management commentary even if it does not relate to a key matter.

129 Finally, EFRAG observes that the guidance on the interaction between key matters versus material information is fragmented within the ED (paragraphs 3.17, 4.7, and 12.3 to 12.9). This may make it difficult for stakeholders to understand the intended two-step approach for identifying material information for management commentary. Therefore, EFRAG proposes a consolidated analysis of the notion of key matters and material information in a single section within the guidance.

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

Notes to constituents

130 *As noted in the Basis for Conclusions (BC12), one reason for starting the project was to help management identify what information to provide on interrelated matters of particular interest to investors and creditors—on matters that could affect an entity's long-term prospects, on intangible resources and relationships and on ESG matters.*

131 *Paragraphs 4.16 and 4.17 state that Investors and creditors are particularly interested in information about matters that could affect an entity's long-term prospects. Such matters could include matters relating to the entity's intangible resources and relationships (including resources not recognised as assets in the entity's financial statements) and environmental, social and governance (ESG) matters.*

132 *Management commentary provides material, entity-specific information about such matters to meet its overall objective set out in Chapter 3 and the specific disclosure objectives set out in Chapters 5–10.*

133 *Appendix B to the draft Practice Statement provides an overview of requirements and guidance throughout the Practice Statement that management is likely to need to consider in deciding what information it needs to provide about these matters.*

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

Requirements and guidance proposed in this Exposure Draft would apply to reporting on matters that could affect the entity's long-term prospects, on intangible resources and relationships, and on environmental and social matters. Appendix B provides an overview of requirements and guidance that management is likely to need to consider in deciding what information it needs to provide about such matters. Appendix B also provides examples showing how management might consider the requirements and guidance in identifying which matters are key and which information is material in the fact patterns described.

Paragraphs BC82–BC84 explain the Board's reasoning for this approach.

(a) Do you expect that the requirements and guidance proposed in the Exposure Draft would provide a suitable and sufficient basis for management to identify material information that investors and creditors need about:

(i) matters that could affect the entity's long-term prospects;

(ii) intangible resources and relationships; and

(iii) environmental and social matters?

Why or why not? If you expect that the proposed requirements and guidance would not provide a suitable or sufficient basis for management to identify that information, what alternative or additional requirements or guidance do you suggest?

(b) Do you have any other comments on the proposed requirements and guidance that would apply to such matters?

EFRAG's response

EFRAG welcomes the provision of additional guidance to help entities provide information on matters that affects their long-term perspective and in particular on intangibles and ESG matters.

EFRAG considers that the proposed guidance and examples on Intangibles are useful, but the presentation of the guidance scattered across the six content elements does not emphasise enough the role of intangibles in value creation.

As noted in an earlier response (Question 4 on content elements), EFRAG suggests that the discussion on intangibles in paragraphs 4.16 and 4.17 is expanded to explain the unique features of intangibles in value creation and that cross-references are made to the illustrative examples contained in Appendix B.

EFRAG welcomes the proposed guidance on Environment and Social Matters but recommends that the IASB also consider addressing governance.

Lastly, EFRAG notes that the illustrative examples in Appendix B of the ED could be given more prominence by including cross-references in the ED.

134 EFRAG welcomes the provision of additional guidance to help entities provide information on matters that affects their long-term perspective and in particular on intangibles and ESG matters. We observe that these aspects are not addressed in the existing practice statement.

135 As noted by the EC in its proposals for a Corporate Sustainability Reporting Directive, these matters are often under-reported, although they increasingly affect an entity's ability to create value and generate cash flows and are matters of increasing interest to users.

Intangibles

136 As mentioned in our response to Question 4, EFRAG considers that the proposed guidance on intangible is useful. However, we consider that the guidance is not given enough emphasis by being scattered across the different content elements. We suggest that intangibles are addressed more comprehensively in paragraphs 4.16 and 4.17.

We also suggest cross-referencing proposed guidance to examples in Appendix B within the main guidance on ESG matters

137 EFRAG welcomes the requirements in the ED

(a) to provide information about factors and trends in an entity's external environment that fundamentally affect the entity, including social and environmental factors; and

(b) to explain how those factors and trends have affected or could affect the entity's business model, management's strategy for sustaining and developing that model, the entity's resources and relationships and the risks to which the entity is exposed.

138 EFRAG generally agrees with the core principle set in the ED (paragraph B2) that 'to comply with the Practice Statement, management commentary provides information about ESG matters '*if that information is 'material' to users'; that is when omitting, misstating or obscuring ESG information could influence the decisions of said users'* (i.e., focus on financial materiality).

139 However, as mentioned in our response to Question 6, EFRAG considers that the revised Practice Statement should also address Governance across the six content elements. Disclosures on governance are essential to understand the other content

elements (in particular, strategy and risks). If Governance is left out of the requirements in the revised Practice Statement, this may defeat the objective to have coherent and comparable information for users. High-level objectives and principles can be defined, and examples provided to illustrate them as for the other content elements.

Illustrative examples

140 EFRAG notes that there are 40 useful illustrative examples in Appendix B of the ED on long-term prospects (20 examples), intangibles (8) and ESG matters (12 examples). These examples should be given more prominence within the guidance in the main document. This could be done by cross-referencing proposed guidance to examples in Appendix B within the main guidance. This will also give prominence to the extent to which the guidance addressed long-term prospects, intangible resources and ESG matters.

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

Notes to constituents

141 The Basis for Conclusion (BC84,) explains that the IASB envisages that an entity could apply the revised Practice Statement in conjunction with narrative reporting requirements or guidelines issued by other bodies or organisations and addressing specific topics such as environmental, social, or other sustainability matters. Management commentary could be an appropriate location for information about environmental and social matters that an entity's management has identified by applying other requirements or guidelines, and that is material to investors and creditors in the context of management commentary.

142 It is also noted in BC14 that the Trustees of the IFRS Foundation are considering the Foundation's role in the development of sustainability reporting standards. The IASB will consider developments in the Trustees' work when it discusses the feedback received on this Exposure Draft.

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

Paragraphs BC13–BC14 explain that the Trustees of the IFRS Foundation have published proposals to amend the Foundation's constitution to enable the Foundation to establish a new board for setting sustainability reporting standards. In the future, entities might be able to apply standards issued by that new board to help them identify some information about environmental and social matters that is needed to comply with the Practice Statement.

Are there any matters relating to the Trustees' plans that you think the Board should consider in finalising the Practice Statement?

EFRAG's response

EFRAG observes that there are significant ongoing initiatives in developing requirements for sustainability reporting that could have implications for the management commentary. Connectivity between financial and non-financial information is essential as emphasised in the report of the EFRAG European Lab Project Task Force on preparatory work for the elaboration of possible EU non-financial reporting standards.

EFRAG notes that the project to revise the Practice Statement was started before the consultation and decision of the IFRS Foundation to create a sustainability board. We suggest that the future International Sustainability Standards Board considers how the sustainability reporting objectives interact with the objectives and contents of this guidance.

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.

143 We recognise that there are significant ongoing initiatives in developing requirements for sustainability reporting that could have implications for the management commentary.

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 standards[6] (PTF-NFRS) highlights the importance of connectivity between financial 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.

145 EFRAG notes that the project to revise the Practice Statement was started before the consultation and decision of the IFRS Foundation to create a sustainability board. We suggest that the future **International Sustainability Standards Board** considers how the sustainability reporting objectives interact with the objectives and contents of this guidance.

10. Making materiality judgements

Notes to constituents

146 The ED proposes guidance to help management identify material information:

(a) guidance on identifying key matters and material information (Paragraphs 4-7 to 4-14)

(b) examples of key matters for each area of content (Chapters 5 to 10);

(c) examples of metrics that management might use to monitor key matters and to measure progress in managing those matters for each area of content (Chapter 14); and

(d) examples of material information linked to specific disclosure objectives (Chapter 15)

147 *The ED provides a description of indications that information might be material—for example, if it relates to a key matter, it is derived from information management uses*

[6] EFRAG, PTF-NFRS, *Proposals for a Relevant and Dynamic EU Standard-Setting* (February 2021).

for managing the business, or it has been included in the entity's capital market communications.

Question 10 - Making materiality judgements

Chapter 12 proposes guidance to help management identify material information. Paragraphs BC103–BC113 explain the Board's reasoning in developing that proposed guidance.

Do you have any comments on the proposed guidance?

EFRAG's response

EFRAG welcomes the provisions of application guidance to help an entity apply materiality judgement and identify information that is material in the context of the management commentary.

EFRAG recommends that the IASB further considers how its application guidance on materiality could be related to the IFRS Practice Statement Practice Statement 2 - *Making Materiality Judgements.*

148 As mentioned in its response to Questions 3 and 9, EFRAG considers that it is not the role of the revised Practice Statement to provide a definition of materiality.

149 EFRAG welcomes the provisions of application guidance to help an entity apply materiality judgement and identify information that is material in the context of the management commentary.

150 EFRAG acknowledges that placing the compliance requirement on disclosure objectives and not on items of information would require an entity to apply materiality judgements to a universe of possible disclosures to meet a set objective. That might be challenging and burdensome for preparers. The proposed approach would require preparers to determine the information that would meet the needs of users of financial statements, whose perspectives may differ from their own. Preparers would need to determine and also justify that they have met the stated objectives.

Interactions with the Materiality Practice statement

151 EFRAG first observes that the existing IFRS Practice Statement Practice Statement 2 - *Making Materiality Judgements* only addresses materiality judgements when preparing general purpose financial statements in accordance with IFRS Standards.

152 EFRAG recommends that the IASB further considers how its proposed application guidance on Materiality in the ED interact with the guidance provided in the Materiality Practice Statement. This is because materiality assessments for management commentary are not done in isolation and are often combined with those made for financial statements.

153 The Materiality practice statement suggests a four-step approach for information in financial statements in which an entity:

(a) First, identify information that has the potential to be material (Step 1).

(b) Then, assess whether the information identified in Step 1 is, in fact, material (Step 2).

(c) Organise the information within the draft financial statements in a way that communicates the information clearly and concisely to primary users (Step 3).

(d) Review the draft financial statements to determine whether all material information has been identified (Step 4).

154 We understand that the Management Commentary requires an extra step to first identify 'key matters' on which to report on, as unlike for financial statements, key matters to report on are not defined by standards. However, once key matters have been identified, the assessment of material information about these matters could follow the multiple-step approach suggested in the Materiality Practice Statement.

11. Completeness, balance, accuracy and other attributes

Notes to constituents

155 The IASB proposes to provide guidance on the three components of faithful representation completeness, balance and accuracy. But the ED does not directly refer to the overarching characteristic of faithful representation. According to BC100, the IASB's' research suggests that preparers of management commentary may not widely use or understand the term 'faithful representation'.

(a) *the three components of faithful representation described in the conceptual framework (i.e., complete, neutral and free from error) have been 'translated' into 'complete', 'balance' and 'accurate', respectively.*

(b) *Similarly, the four enhancing characteristics (understandability, comparability, verifiability and timeliness) have become three only (clarity and conciseness, comparability and verifiability,*

156 The IASB decided to not list timeliness as an attribute of useful information in management commentary because:

157 (a) the timing of publication of management commentary is a local jurisdictional and regulatory matter.

158 (b) management commentary can still have confirmatory value, and therefore be useful, even if it is published after the financial statements.

Question 11 - Completeness, balance, accuracy and other attributes

Chapter 13 proposes to require information in management commentary to be complete, balanced and accurate and discusses other attributes that can make that information more useful. Chapter 13 also proposes guidance to help management ensure that information in management commentary possesses the required attributes.

Paragraphs BC97–BC102 and BC114–BC116 explain the Board's reasoning for these proposals.

Do you agree with these proposals? Why or why not? If not, what do you suggest instead and why?

(b) Paragraphs 13.19–13.21 discuss inclusion of information in management commentary by cross-reference to information in other reports published by the entity.

Paragraphs BC117–BC124 explain the Board's reasoning for these proposals.

Do you agree with these proposals? Why or why not? If not, what do you suggest instead and why?

EFRAG's response

EFRAG generally agrees that qualitative attributes of information are useful but we suggest that, rather than using alternative terms, the ED explains how the existing fundamental and enhancing characteristics in the Conceptual Framework apply in the context of the management commentary.

EFRAG supports the requirement for information in management commentary to be presented 'as a well-integrated, coherent whole' and that this coherence principle applies both within the sections of the management commentary but also with the information presented in the financial statements.

EFRAG is 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.

159 EFRAG agrees that the identification of qualitative characteristics or attributes for the information in the management commentary is useful.

160 However, EFRAG observes that the IFRS Conceptual Framework defines qualitative characteristics[7] of useful financial information contained in 'financial reports' considered in general which encompass the management commentary as well.

161 The ED proposes alternative terminology to the concept of faithful representation as the IASB has considered, based on its research that '*preparers of management commentary may not widely use or understand the term 'faithful representation'.*

162 EFRAG observes that:

(a) the three components of faithful representation described in the conceptual framework (i.e., complete, neutral and free from error) have been 'translated' into 'complete', 'balance' and 'accurate', respectively.

(b) Similarly, the four enhancing characteristics (understandability, comparability, verifiability and timeliness) have become three only (clarity and conciseness, comparability and verifiability, whereas timeliness is not considered in the ED)

163 EFRAG can understand the IASB's aim to use simpler language as an entity's management commentary is often prepared by a larger group of individuals than those involved in preparing its financial statements, and that some of these individuals may be unfamiliar with the terminology in IFRS Standards and the Conceptual Framework.

164 However, EFRAG considers that introducing alternative terminology in the ED that is not in use in the IFRS Literature can be confusing for preparers of financial statements that are also involved in the preparation of the Management Commentary insofar as the latter's objective is to supplement and provide context for the information contained in the financial statements.

[7] The IFRS Conceptual Framework defines two fundamental characteristics (Relevance and Faithful Representation) and four enhancing characteristics (Comparability, Verifiability, Timeliness and Understandability).

165 EFRAG suggests that, instead of using alternative terms, the IASB could explain in the ED how the existing qualitative and enhancing characteristics apply in the context of the management commentary.

166 EFRAG also notes that no mention is made to the concept of relevance. EFRAG understands that this may be because the ED requires to provide information that is material (and materiality) is the entity-specific aspect of relevance. However, this could be better explained in the ED.

167 If the IASB decided to proceed with its proposals we suggest that, as a minimum, the IASB better explains how the 'attributes' proposed in the ED relate to the definitions of the qualitative characteristics in the conceptual framework and explain the differences.

Coherence

168 EFRAG supports the proposal contained in Chapter 13 of the draft revised Practice Statement to require information in management commentary to be presented as a well-integrated, coherent whole.

169 EFRAG notes that the ED rightly clarifies coherence principle applies both across the different sections of the management commentary but also with the information presented in the financial statements. Because management commentary is intended to enhance users' understanding of an entity's financial statements, it is essential that management commentary provides information in a way that allows users to relate that information to information in the entity's financial statements.

170 EFRAG suggests that in addition to the proposed guidance and examples, the IASB could consider the suggestions within the PTF-NFRS report on coherence between financial statements and other reports such as the Management Commentary.

171 The PTF-NFRS report suggests that coherence (or 'linkage' as referred to in the report) can be achieved through the identification of 'anchor points. An 'anchor point' is defined as data and/ or information (quantitative or qualitative) that offers a connection opportunity (e.g., area of overlap) between financial reporting and non-financial /sustainability reporting. Examples of anchor points may include but are not limited to:

- (a) Information about recognised and unrecognised intangibles;
- (b) Forward-looking information required by some standards;
- (c) Information on risks; and
- (d) Sustainability disclosure derived from accounting data.

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')

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

174 EFRAG considers that the requirement 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.

12. Metrics

Notes to constituents

175 The ED does not propose to specify a list of metrics because information about metrics that are specific to an entity and reflect the industry in which it operates.

176 Instead, the revised Practice Statement provides guidance for management to identify entity-specific material information, including metrics, related to matters discussed in management commentary.

177 The ED states that material information is likely to include metrics an entity's management uses to monitor key matters and to measure progress in managing key matters. For each area of content, the Board proposes to provide examples of metrics sometimes used to monitor key matters and progress in managing them.

178 The proposals also permit management to use detailed topic-specific or industry-specific requirements or guidelines issued by other bodies to identify metrics that might be material to investors and creditors.

Question 12 - Metrics
Chapter 14 proposes requirements that would apply to metrics included in management commentary.

Paragraphs BC125–BC134 to the ED explain the Board's reasoning for these proposals. Do you agree with these proposals? Why or why not? If not, what do you suggest instead and why?

EFRAG's response

EFRAG welcomes the requirements and guidance on the use of metrics but has concerns about the broad scope of the notion 'metrics' and the lack of guidance on metrics related to non-financial information.

EFRAG supports the approach proposed in this ED that non-financial information is included in the entity's management commentary to explain the entity's financial performance and financial position. However, EFRAG recommends 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.

EFRAG considers that in the absence of explicit standards or related regulation, there may be limitations in the effective practical application of the principles related to non-financial information metrics (clarity and accuracy, coherence, comparability).

179 EFRAG agrees that the Management Commentary should not specify a list of metrics that an entity would be required to provide because information about metrics is specific to an entity and reflect the industry in which it operates, and its other circumstances).

180 EFRAG observes that the ED defines the notion of 'metrics' very broadly as 'any measure that management uses to monitor a quantitative or qualitative aspect of a company's financial or non-financial performance or position'. It encompasses:

(a) Both financial and non-financial measures; and

(b) Both performance and financial position measures.

181 EFRAG observes that this definition is broader than:

(a) The notion of Management Performance Measures used in the Exposure Draft ED/2019/7 General Presentation and Disclosures);

(b) The disclosure requirements under IFRS 8 Segment Reporting;

(c) The notion of Alternative Performance Measures (used in ESMA's 2015 guidelines);

(d) The requirement in the EU Accounting Directive to present 'key performance indicators'.

Metrics of financial performance or financial position

182 EFRAG supports the proposed further requirements, in paragraph 14.6 of the ED for metrics of financial performance or financial position that are 'derived by adjusting measures presented or disclosed in the financial statements'.

183 EFRAG notes that the requirement to explain, reconcile, label consistently and not present such metrics more prominently are generally consistent with the proposals on Management Performance Measures (MPMs) in the General Presentation and Disclosures. EFRAG suggests that the IASB should clarify or explicitly state the interaction between the guidance for management commentary metrics and the proposed requirements for MPMs in the General Presentation and Disclosures project.

Metrics other than financial performance or position

184 EFRAG has no major objections to the proposed principles relating to the metrics (clarity and accuracy, coherence, comparability). However, EFRAG considers that there may be limitations in the effective practical application of such principles to non-financial information (e.g., customer satisfaction scores, operational metrics) in the absence of explicit standards or regulations governing such information. For instance, the notions of 'accuracy', consistency or 'comparability' are not absolute concepts, and implies that there is a common framework to depict and 'measure' the related metrics against.

185 EFRAG recommends 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.

13. Examples of information that might be material

Notes to constituents

186 The ED *proposes to include in the revised Practice Statement examples of information that might be material to help management identify entity-specific information that needs to be included in management commentary to meet the disclosure objectives for each area of content. The examples are each linked to a specific disclosure objective.*

187 The IASB does not propose to specify in Chapter 15 items of information that should always be required, and proposes an objectives-based rather than a prescriptive approach to disclosure.

Question 13 - Examples of information that might be material
Material information needed to meet the disclosure objectives set out in Chapters 5–10 will depend on the entity and its circumstances. Chapter 15 proposes examples of information that might be material.

Paragraphs BC80–BC81 explain the Board's reasoning for these proposals. Do you expect that the proposed examples would help management to identify material information that management commentary might need to provide to meet disclosures objectives for information about: (a) the entity's business model; (b) management's strategy for sustaining and developing that business model; (c) the entity's resources and relationships; (d) risks to which the entity is exposed; (e) the entity's external environment; and (f) the entity's financial performance and financial position? If not, what alternative or additional examples do you suggest? Do you have any other comments on the proposed examples?

EFRAG's response

EFRAG considers that the illustrative examples in Appendix B will help entities to exercise judgement to disclose management commentary information that meets the disclosure objectives. **EFRAG suggests additional examples related to Governance, Intangibles, ESG matters, business model, and risks and opportunities for consideration by the IASB as further detailed below. Finally, EFRAG recommends that the IASB further consider and explain the relationship between individual disclosure objectives in the revised Practice Statement and the concept of materiality as this is essential to an understanding of the proposals**.

188 EFRAG generally considers the provided examples to be helpful in implementing the proposed guidance but believes that additional examples on Governance, Intangibles, ESG matters, business model, and risks and opportunities could be further developed. This is further detailed below.

189 However, EFRAG has concerns with the expression 'Examples of information that might be material'. We suggest instead to refer to information that might be considered in meeting the objectives. We believe that introducing a 'presumption of materiality' may create confusion.

190 EFRAG observes that the ED does not explain the relationship between individual disclosure objectives in IFRS Standards and the concept of materiality. Although we understand that materiality is an overarching principle and need not be repeated in each IFRS Standard, we consider that it is essential to clarify the interaction between:

(a) the proposed specific principles which are supposed to reflect the 'information 'needs'' of users; and

(b) the concept of materiality which refers to information which omission, misstatement or obscuring 'could reasonably be expected to influence the decisions that the primary users of general-purpose financial statements make on the basis of those financial statements'.

191 EFRAG notes the need for a distinction between information that is a "nice-to-have" for users versus information which if omitted would influence their decisions.

192 EFRAG recommends that the IASB further consider and explain the relationship between individual disclosure objectives in the revised Practice Statement and the concept of materiality as this is essential to an understanding of the proposals.

Disclosure about Governance

193 If the IASB follows EFRAG's suggestion to address governance across the proposed six content elements in the ED, it could consider providing examples of information that could be material in relation to the following:

(a) The remuneration policy (the ED already partly address the matter in the section on Metrics)

(b) The governance on environment and social matters.

***Disclosures abou*t Intangibles**

(c) Examples illustrating the synergic nature of intangibles (contribute to the creation of value in combination with other intangibles and other assets).

(d) Example of 'negative intangible that are not resources but may create liabilities, such as environmental spills, poor corporate reputation can negatively impact the market value of a company.

***Disclosure about* ESG matters**

(e) Disclosure about due diligence processes implemented to assess Environment or Social matters.

(f) Example illustrating how an entity defines its time horizons (short, medium, long term) for ESG matters.

(g) An example of scenario analysis disclosure to evaluate climate-related risks and opportunities that can affect the entities value creation and future cash-flows. Scenario analysis disclosure shows the resilience of entities' business models and the effectiveness of their strategy and risk management.

(h) An example of material impacts on the environment and society (i.e., inside-out) that may be also financially material.

(i) An example that addresses both environment and social factors.

(j) Current environmental examples are mainly focused on compliance with regulatory requirements. There is a need for examples focused on opportunities and durability around sustainability themes with a focus of disclosures on the following:

  (i) Economic benefits of investing in the circular economy;

  (ii) Benefits of climate change adaptation;

  (iii) Human capital and human rights; and

  (iv) Other environmental factors (e.g., biodiversity).

Business Model

(k) Example of an entity with several business models.

(l) Example of interactions between the business model, resource allocation (inputs), and outputs.

Risks and Opportunities

(m) Example of disclosure of factors that create both risks and opportunities to illustrate the interrelationships and the 'management's perspective' on such factors.

14. Effective date

Notes to constituents

194 The IASB proposes that the revised Practice Statement supersede the 2010 Practice Statement for annual reporting periods beginning on or after the date of its issue. The IASB proposes to permit early application of the revised Practice Statement.

195 The basis for Conclusions (136-137) notes that entities would need time to review the contents of the revised Practice Statement and create or adjust their internal systems and control procedures to ensure that they provide material information in management commentary and present it in a way that helps investors and creditors. The time needed would depend on an entity's current narrative reporting system, as well as on an entity's facts and circumstances, such as its size and the local requirements or regulations that apply to its narrative reporting

196 The proposed effective date would give entities at least one year before their management commentary would be required to comply with the revised Practice Statements.

Question 14 - Effective date

Paragraph 1.6 of the ED proposes that the Practice Statement would supersede IFRS Practice Statement 1 Management Commentary (issued in 2010) for annual reporting periods beginning on or after the date of its issue. This means that the Practice Statement would be effective for annual reporting periods ending at least one year after the date of its issue.

Paragraphs BC135–BC137 to the ED explain the Board's reasoning for this proposal.

Do you agree with the proposed effective date? Why or why not? If not, what effective date do you suggest and why?

EFRAG's response

EFRAG considers that the proposal to set the effective date of the revised Practice Statement for annual periods on or after its date of issue (with early application allowed) is appropriate.

However, EFRAG considers that transitional provisions would be helpful to clarify the need to provide comparative information upon the period of transition.

197 Considering the non-mandatory nature of the guidance, EFRAG has no objections to the proposal that the revised Practice Statement should apply for annual periods on or after its date of issue (with early application allowed).

198 EFRAG observes that the ED does not propose any specific transitional provisions, based on the assumption that '*information in management commentary is expected to be derived from information already used by management in managing the business, so an entity would not need to produce information specifically for management commentary (BC 138)*'.

199 EFRAG considers that the above assertion may not always be true for all entities and for all the content elements. The availability of such information may depend on an entity's own circumstances, current organisation and size. Furthermore, some entities may need to create or adjust their internal systems and control procedures to ensure that they provide material information in management commentary and present it in a way that helps investors and creditors.

200 EFRAG observes the provision in paragraph 14.8 of the ED stating that the management commentary shall (a) provide comparative amounts, if obtainable without undue cost or effort for the previous reporting period; and for earlier reporting periods if necessary to show the emergence of trends or if the financial statements include information for those earlier periods.

201 EFRAG considers that transitional provisions would be helpful to clarify the need to provide comparative information upon the period of transition.

15. Effects analysis

Notes to constituents

202 In its Basis for Conclusions, (BC 139 and following) the IASB acknowledges that Comparing the effects of proposals in the ED with the effects of applying the current requirements in practice would be difficult, because 'the IASB has little evidence of entities applying the current Practice Statement'.

203 The effects analysis is mainly qualitative, rather than quantitative.

(a) *Initial and subsequent costs and benefits are likely to vary among stakeholders. Quantifying costs and, particularly, benefits is subjective and difficult.*

(b) *No sufficiently established and reliable techniques quantify either costs or benefits in this type of analysis.*

204 In summary, the IASB's assessed that the 'likely effects of its proposals are as follows proposals are expected to result in:

(a) *An improved focus on key matters and provision of entity-specific information in management commentary;*

(b) *Provision of material information of particular interest to investors and creditors, including information on matters that could affect an entity's long-term prospects, on intangible resources and relationships and on ESG matters;*

(c) *Information that is more coherent within management commentary and with the entity's financial statements and other publicly available reports;*

(d) *Other improvements to the quality of information in management commentary, including information that is more balanced, complete, comparable and verifiable; and*

(e) *More detailed tagging of information in management commentaries, which could lead to easier access to management commentary in electronic form.*

205 The IASB's proposals could also:

(a) *Make it easier for lawmakers and regulators to enforce the revised Practice Statement and for auditors to provide assurance on management commentary, or to enhance the level of assurance they provide; and*

(b) *Encourage lawmakers and regulators to reflect the proposals in local requirements.*

206 In the IASB's view, the likely benefits of implementing and adopting the revised Practice Statement would significantly outweigh the likely costs of implementing the proposals and of ongoing application.

Question 15 - Effects analysis

(a) Paragraphs BC139–BC177 of the Basis for Conclusions accompanying the Exposure Draft analyse the expected effects of the proposals in this Exposure Draft.

Do you have any comments on that analysis?

(b) Paragraphs BC18–BC22 discuss the status of the Practice Statement. They note that it would be for local lawmakers and regulators to decide whether to require entities within their jurisdiction to comply with the Practice Statement.

Are you aware of any local legal or regulatory obstacles that would make it difficult for entities to comply with the Practice Statement?

EFRAG's response

EFRAG considers that the effects of the proposals in the ED are difficult to assess on an 'ex-ante' basis as such impacts would depend on the extent to which local lawmakers, regulators and standard setters incorporate the revised Practice Statements into their local requirements.

EFRAG encourages the IASB to further research the extent to which the revised Practice Statement is used or referred to across the different jurisdictions. Without assessing the effects of the current Practice Statement which has been in place for 10 years, it is difficult to assess the impact of the revised Practice Statement.

In jurisdictions where the current Practice Statement is mandated or widely used on a voluntary basis, EFRAG encourages field-testing to further understand the expected impact of the proposals in the ED, their applicability, enforceability and auditability.

Lastly, EFRAG encourages the IASB to integrate electronic reporting into the ED's proposals for reporting management commentary information and further consider how the current IFRS taxonomy could be enhanced to address the changes introduced by the proposals in the ED as highlighted in the Basis for Conclusions.

Overall assessment

207 EFRAG observes that since the IASB proposes to retain the status of the Practice Statement as voluntary guidance, it would be up to local lawmakers and regulators to determine whether entities within their jurisdiction should comply with the requirements (in part or in full) and whether the information would be subject to any form of external assurance.

208 Therefore, the possible effects of the proposals in the ED are difficult to assess on an 'ex-ante' basis as such effects would depend on the extent to which local lawmakers, regulators and standard setters incorporate the revised Practice Statements into their local requirements.

209 However, EFRAG sees benefits in the proposed requirements that better reflect users' needs, even in jurisdictions where the current Practice Statement is not mandated as this can encourage jurisdictions to incorporate some of the concepts in the revised Practice Statement in local requirements.

210 Without assessing the effects of the current Practice Statement which has been in place for 10 years, it is difficult to assess the impact of the revised Practice Statement. Therefore, EFRAG encourages the IASB to further research the extent to which the current Practice Statement is used or referred to across the different jurisdictions.

211 The impact of the proposals may vary based on local regulations and laws. It is therefore essential that the field test activities:

(a) involve representatives of enforcers (lawmakers, regulators, standard-setters) and auditors;

(b) consider the diversity of the nature of reporting entities and does not focus only on the advanced or best-resourced entities; and

(c) includes an assessment by users of management commentary on the benefits of the approach and the usefulness of the information resulting from the application of the revised Practice Statement.

212 In jurisdictions where the current Practice Statement is mandated or widely used on a voluntary basis, EFRAG encourages field-testing to further understand the expected impact of the proposals in the ED, their applicability, enforceability, and auditability.

213 In addition, the effects of the proposals may vary based on the size and sophistication of entities. Less resourced or less-sophisticated entities when confronted with the need for judgement, may be tempted to use the examples in the revised Practice Statement as a checklist.

Effect of Technology

214 EFRAG observes the IASB discusses the effect of technology in -Basis for Conclusions (BC159 – 161) but not in the ED itself.

215 The current IFRS Taxonomy allows block tagging of information in management commentary using limited and broad IFRS Taxonomy elements, such as 'nature of business' or 'management's objectives and its strategies for meeting those objectives'.

216 The more detailed requirements in the revised Practice Statement offers an opportunity for the IASB to provide more specific IFRS Taxonomy elements for management commentary across the six content elements and their respective objectives. The incorporation of text block tagging may facilitate textual analysis of management commentary information and make it easier for users to identify and analyse similarities and differences between entities and across different periods.

217 In that regard, we observe that in a 2016 report[8], the CFA institute suggested that electronic tagging beyond the financial statements would be 'extremely valuable to investors' and that this could be extended further through the incorporation of text block tagging to facilitate textual analysis of management commentary information.

218 We, therefore, encourage the IASB to integrate electronic reporting could be integrated into the ED's proposals for reporting management commentary information and further consider how the current IFRS taxonomy could be enhanced to address the changes introduced by the proposals in the ED as highlighted in the Basis for Conclusions.

16. Other comments

Question 16 – Other comments
Do you have any other comments on the proposals set out in the Exposure Draft?

EFRAG's response

EFRAG has no other comments on the proposals set out in the ED.

[8] CFA Institute, Data and Technology: Transforming the financial information landscape (2016)