ICAEW
REPRESENTATION 118/21

MANAGEMENT COMMENTARY

Issued 15 December 2021

ICAEW welcomes the opportunity to comment on Exposure Draft ED/2021/6 *Management Commentary* published by IASB in May 2021, a copy of which is available from this link.

ICAEW welcomes the IASB's Exposure Draft ED/2021/6 *Management Commentary*. Developing an international framework for non-financial reporting is central to current discussions regarding the future of corporate reporting. We believe IASB's contribution to this debate to be an important one. However, in light of recent developments, we believe this project must now be considered in relation to the new IFRS Foundation structure and the expected work plan of the International Sustainability Standards Board.

This response of December 2021 has been prepared by the ICAEW Financial Reporting Faculty. Recognised internationally as a leading authority on corporate reporting, the faculty, through its Financial Reporting Committee, is responsible for formulating ICAEW policy on financial and non-financial reporting issues and makes submissions to standard setters and other external bodies on behalf of ICAEW. The faculty provides an extensive range of services to its members including providing practical assistance with common corporate reporting problems.

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KEY POINTS

TIME TO REFLECT ON PROJECT

1. ICAEW welcomes the IASB's Exposure Draft ED/2021/6 *Management Commentary*. In our view, non-financial information (or management commentary) ranks alongside financial information in terms of its importance in improving understanding of how a company creates and maintains enterprise value. It can also provide crucial information about a company's impacts on its external environment, which is seen as essential to improving transparency and driving better corporate behaviour over time. Developing an international framework for reporting on non-financial matters is central to current discussions regarding the future of corporate reporting. We believe the IASB's contribution to this debate to be an important one, although as discussed below, it must now be considered within the context of recent developments relating to international sustainability reporting standards.
2. The establishment of the International Sustainability Standards Board (ISSB) in November 2021 is a major development and marks the first step towards the development of a global base line for sustainability reporting. We believe the draft Practice Statement 1 *Management Commentary* (Practice Statement) must now be considered in relation to the new IFRS Foundation structure and the expected work plan of the ISSB. This is not to say that the IASB should pause work on this project, but rather it is essential that the next stage is carried out in conjunction with the ISSB. Some important questions that will need to be considered include:
   - Where should the Practice Statement sit within the new IFRS Foundation's structure ie, under the IASB, the ISSB, or straddling both boards?
   - What should be the objective of the Practice Statement, taking into account the work of the IASB and expected work of the ISSB?
   - What changes need to be made to the draft Practice Statement in light of the above assessments?
3. We have set out our views on each of these questions in the following paragraphs.

DEVELOPING A FRAMEWORK FOR INTEGRATED CORPORATE REPORTING

4. We believe that there is a real and urgent need for an overarching framework for integrated corporate reporting which not only provides the conceptual underpinnings for management commentary but also the interrelation of management commentary with financial statements.
5. We are concerned that, if the Practice Statement remains under the remit of the IASB alone, there is a risk that a similar but separate framework will need to be developed under the ISSB which would lead to an unhelpful overlap and confusion. We have also observed some potential overlap between the guidance in the draft Practice Statement and what we might expect to appear in future IFRS Sustainability Disclosure Standards issued by the ISSB. In our view, management commentary forms part of the annual report and should house the information required by sustainability standards such as the IFRS Sustainability Disclosure Standards.
6. Taking into account the above, we believe the draft Practice Statement should be reconfigured such that:
   - Part of the existing Practice Statement forms an element of an overarching framework for integrated corporate reporting which helps preparers provide a narrative that sets the context for explaining company's performance in the period and describes the company's enterprise value creation. This framework would be positioned above the IASB and ISSB standards and include corporate reporting principles such as enterprise value creation, connectivity, and the capitals and resources upon which a company depends (drawing on the <IR> Framework).

- Other aspects of the Practice Statement might then be more relevant to a general standard for the presentation of sustainability-related information, taking account of the four pillars of governance, strategy, risk management and metrics and targets, together with requirements for describing the financial impact of sustainability-related matters. In doing so, consideration would need to be given to the recent publication of the *General Requirements for Disclosure of Sustainability-related Financial Information Prototype* by the IFRS Foundation's Technical Readiness Working Group (TRWG), as this will form the basis of the ISSB's own work on this area.

7. While taking such an approach will require a re-think of some aspects of the draft Practice Statement, we believe it cuts to the core issue that needs to be addressed ie, to enable a joined up corporate reporting system with clear conceptual underpinnings that is sufficiently flexible to accommodate the evolving development of the ISSB and its IFRS Sustainability Disclosure Standards.

8. It is within this context that we have reviewed the draft Practice Statement ie, we have considered the proposed content on the assumption that it will partly form the basis of an overarching framework. For this reason, we do not comment in detail on all aspects of the consultation but rather focus on more fundamental aspects that should be considered in the next stage of this project.

ANSWERS TO SPECIFIC QUESTIONS

Question 1: The financial statements to which the management commentary relates.

Paragraph 2.2 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 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?

9. Generally speaking, we have found the draft Practice Statement to be written in such a way that suggests that management commentary is supplementary to the financial statements. However, in our view, management commentary is central to how a company explains what it does and how it generates and maintains enterprise value. The financial statements should then support and interconnect with the management commentary.

10. We believe it is helpful for the management commentary to identify the accompanying general purpose financial statements and to disclose the basis upon which those financial statements have been prepared (whether that is under IFRS or another framework). We also believe it would be helpful to require disclosure in the management commentary of the basis and/or framework(s) upon which it has been prepared, for example, this might be the IFRS Sustainability Disclosure Standards issued by the ISSB.

Question 2: Statement of compliance

Paragraph 2.5 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 explain the Board's reasoning for this proposal.

Do you agree? Why or why not?

(b) Paragraph 2.6 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 explains the Board's reasoning for this proposal.

Do you agree? Why or why not?

11. While we do not object in principle to the proposal to include a statement of compliance, we suggest that this is a matter that should be revisited as part of the next stage of this project. We note that management commentary is often adopted within the context of local mandated reporting requirements. It may, therefore, be too early to introduce compliance requirements within the Practice Statement (or its successor) as it should be for local regulators to decide on this matter, at least at this stage.

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?

12. In our view, the proposed objective of management commentary focusses too heavily on providing a supporting narrative to the financial statements. As noted in the response to question 1, however, we believe the primary objective of the management commentary is to enable assessments of how the entity has performed in the period and how it creates and maintains value ie, to enable assessments of enterprise value creation.

13. Understanding the entity's financial performance and financial position is one part of the wider objective of providing information on an entity's broader enterprise value creation. Therefore, we believe the objective of the management commentary should be revised to focus primarily on enabling assessments of an entity's enterprise value creation. In addition, we suggest that the guidance on enterprise value creation might helpfully be reviewed again. We are aware of concerns that the current guidance could be interpreted too narrowly ie, it may not be clear that a company should consider broader matters such as its purpose, strategy and wider non-financial reporting matters that are relevant to its ability to create and

maintain enterprise value. As noted elsewhere in this response, it will be important to work alongside the ISSB when reconsidering or developing guidance on this subject.

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 management 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?

14. We agree that it is helpful to set out the six areas of content for management commentary (business model, strategy, resources and relationships, risks, external environment and financial performance and financial position).

15. However, we note that the draft Practice Statement does not include a section on governance. If the Practice Statement is amended and evolves to form the basis of a framework for integrated corporate reporting then it will be important to address how reporting on governance fits with management commentary, particularly as this is likely to feature in the new IFRS Sustainability Disclosure Standards to be issued by the ISSB.

16. We would also suggest that the IASB revisits the guidance relating to a company's strategy to avoid any perception that strategy is only relevant to the extent that it maintains the company's business model. For example, it might make more explicit the reference to a company's purpose/vision and how that interrelates with its strategy and business model.

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?

17. While we understand the rationale for outlining the proposed disclosure objectives, we believe it has introduced unnecessary complexity. If the draft Practice Statement were to remain in its current format/position we would suggest that the level of disclosure objectives should be scaled back, perhaps focussing on the headline objectives. However, as outlined

above, we suggest a different direction for the Practice Statement and for this reason suggest the need for disclosure objectives is reconsidered during the next stage of this project.

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?

18. As noted in response to question 5, the need for disclosure objectives should be reconsidered once the future direction of this project has been agreed. That said, generally speaking we believe that detailed disclosure objectives are better suited at the individual standard-setting level.

19. One general observation is that there could be greater guidance to highlight linkages between different content elements of the management commentary. We suggest that this is a matter to be considered further within the next stage of this project.

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?

20. In our view, it is not clear how the guidance on identifying key matters outlined in the draft Practice Statement interacts with a number of its other aspects ie, the various levels of disclosure objectives, guidance on making materiality judgements, and the examples of what might be material. We are concerned that this results in confusion and might distract from the overall message that material information on the enterprise value creation should be provided in management commentary. We suggest that simplifications to the draft Practice Statement (or its successor) are needed to ensure that this key message is not lost.

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?

21. While we believe there is helpful guidance in Appendix B, in particular the examples showing how management might consider the requirements and guidance in identifying material information, we do not believe the Practice Statement is the right location for such detailed guidance. In particular, we believe that detailed guidance relating to ESG matters should now fall within the remit of the ISSB. On the other hand, should the Practice Statement evolve into a framework for integrated corporate reporting we suggest that one area it could helpfully cover relates to the boundary of information to be reported on within management commentary ie, whether there is an expectation that information should be disclosed on resources that the entity does not control but on which it depends (for example, water, land, ecosystems etc).

22. For this reason, we do not comment in detail on the detailed guidance provided in relation to long-term prospects, intangible resources and relationships and ESG matters. As previously noted, our preference is for the IASB to collaborate with the ISSB to develop an overarching framework. In doing so, we would expect much of the detail currently included in Appendix B to be located elsewhere, either within individual standards (where relevant) or as separate guidance.

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?

23. As discussed in the key points section above, we believe the establishment of the ISSB in November 2021 is a major development and marks the first step towards the development of a global base line for sustainability reporting. We believe the draft Practice Statement must now be considered in relation to the new IFRS Foundation structure and the expected work plan of the ISSB. This is not to say that the IASB should pause work on this project, but rather it is essential that the next stage is carried out in conjunction with the ISSB.

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?

24. The application of materiality to non-financial information is not always well understood and greater clarification in this matter is needed to help both preparers and users. We welcome the *General Requirements for Disclosure of Sustainability-related Financial Information Prototype* recently published by the IFRS Foundation's TRWG, which sets out a helpful clarification of materiality in relation to sustainability-related financial information. We recommend that the IASB work closely with the ISSB as it builds on the work of the TRWG when formalising any guidance on materiality for sustainability-related financial information.

Question 11: Completeness, balance, accuracy and other attributes

(a) 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?

25. Since the publication of the draft Practice Statement, the IFRS Foundation's TRWG has published a *General Requirements for Disclosure of Sustainability-related Financial Information Prototype.* Appendix D of the Protype sets out 'Qualitative characteristics of useful sustainability-related financial information'. We suggest that the IASB revisits Chapter 13 of the draft Practice Statement in light of the work of the TRWG. The IASB should work closely with the ISSB when considering what an overarching integrated framework for corporate reporting might helpfully contribute in this area and to ensure consistency across the entire corporate reporting framework.

Question 12: Metrics

Chapter 14 proposes requirements that would apply to metrics included in management commentary.

Paragraphs BC125–BC134 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?

26. We agree that the Practice Statement should focus on general requirements relating to metrics and that detailed requirements for specific metrics should be included within individual standards. Although we broadly support the guidance outlined in Chapter 14, we suggest this is an area requiring close cooperation between the IASB and ISSB at the next stage. In particular, it will be important to consider how metrics are expected to be (or have been) incorporated into the ISSB standards. Similarly, the IASB is currently considering requirements relating to Management Performance Measures as part of its project on

Primary Financial Statements, which may also be relevant when considering an overarching framework for integrated corporate reporting.

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 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?

If not, what alternative or additional examples do you suggest? Do you have any other comments on the proposed examples?

27. We believe that Chapter 15 *Examples of information that might be material* provides some useful guidance, in particular providing insights over what might be material to enterprise value creation over the longer term. However, we suggest it would make more sense for this guidance to be presented outside of the future Practice Statement (or its successor). It could, for example, be presented as separate guidance on materiality which, as noted elsewhere in our response, is an area where clarification is likely to be helpful when it comes to non-financial information.

Question 14—Effective date

Paragraph 1.6 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 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?

28. In light of our views regarding the future direction of this project we do not comment here on the proposals relating to the effective date.

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?

29. We do not comment here on any local legal or regulatory obstacles. However, we would like to take this opportunity to note that, regardless of any potential obstacles. we believe the

IASB should pursue this project in conjunction with the ISSB, albeit with a view to developing a framework for integrated corporate reporting. We believe that such a project is essential within the new IFRS Foundation to enable effective operation of both the IASB and ISSB under the new structure.

Question 16—Other comments

Do you have any other comments on the proposals set out in the Exposure Draft?

30. We have no further comments at this stage.