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STAFF PAPER

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Project	**Management Commentary**
Paper topic	Sweep issues

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Purpose of this paper

1. At its October 2020 meeting, the International Accounting Standards Board (Board) gave the staff permission to begin the balloting process for an Exposure Draft of a revised IFRS Practice Statement 1 *Management Commentary* (Practice Statement).

2. In this paper, the staff ask the Board for decisions on two sweep issues that have arisen as the staff have started to prepare a draft of the Exposure Draft for balloting:

   (a) application of the Practice Statement by entities that do not apply IFRS Standards (paragraphs 4-16); and

   (b) the characteristic of 'freedom from error' (paragraphs 17–35).

3. This paper also presents for the Board's consideration staff suggestions for refinements to the wording of the disclosure objectives tentatively approved at previous Board meetings (paragraphs 36–47). These refinements are intended to clarify rather than change the objectives so the Board will be invited to comment on the staff suggestions, not asked to make any decisions.

Application of the Practice Statement by entities that do not apply IFRS Standards

Whether to restrict statements of compliance

The issue

4. At its September 2020 meeting, the Board tentatively decided that the revised Practice Statement would retain the status of the existing Practice Statement:

   (a) it would not be an IFRS Standard; and

   (b) an entity would be able to assert that its financial statements are prepared in accordance with IFRS Standards even if these financial statements are not accompanied by management commentary that complies with the Practice Statement.

5. A question has arisen as to whether the converse should also be true—should an entity be able to assert that its management commentary complies with the Practice Statement even if its financial statements are prepared in accordance with requirements other than IFRS Standards?

6. This question could arise frequently in practice, for example in jurisdictions that require some entities to apply IFRS Standards and others to apply local requirements, which may be closely aligned to IFRS Standards.

7. The existing Practice Statement does not give an explicit answer to this question:

   (a) paragraph 3 states that the Practice Statement 'should be applied by entities that present management commentary that relates to financial statements prepared in accordance with IFRSs'; but

   (b) the criteria for asserting compliance with the Practice Statement do not include a requirement for the related financial statements to be prepared in accordance with IFRS Standards. Paragraph 7 of the Practice Statement states only that 'an assertion that management commentary complies with the Practice Statement can be made only if it complies with the Statement in its entirety'.

Staff analysis

8. The Board could permit an entity to assert that its management commentary complies with the revised Practice Statement:

   (a) only if the entity has prepared its financial statements in accordance with IFRS Standards;

   (b) only if the entity has prepared its financial statements *either* in accordance with IFRS Standards *or* applying similar concepts; or

   (c) without specifying any criteria for the basis of preparation of the related financial statements.

9. The restrictions specified in the first or second of these options could be justified if meeting the overall objective of management commentary relies on the financial statements including specific information required by IFRS Standards, or on the financial statements being prepared applying concepts similar to those underpinning IFRS Standards.

10. The staff think that meeting the overall objective of management commentary does not rely on the financial statements including all the information required by IFRS Standards, or on the financial statements being prepared applying concepts identical to those underpinning IFRS Standards. The requirements the Board has developed for the Practice Statement include disclosure objectives, both for management commentary overall and for each area of content within management commentary. The information an entity would provide to meet those objectives might depend, among other things, on the basis of preparation of the related financial statements and the information disclosed in those financial statements. But because the requirements of the Practice Statement are that management commentary should meet particular objectives, not provide particular information, the end result should be the same—compliance with the requirements of the Practice Statement itself should be sufficient to meet the objective of management commentary.

11. Meeting the objective of management commentary could be difficult or even impossible in some extreme circumstances—for example, if the related financial statements are prepared on a cash basis instead of an accruals basis and disclose little further information. To address this concern, the Board could permit an entity to assert compliance with the Practice Statement only if the related financial statements are prepared applying concepts similar to those applied in IFRS Standards. The wording could, for example, follow that in paragraph 12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, which refers to 'pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards'.

12. However, such a restriction could be difficult to apply—it would require a judgement to be made about the meaning of 'similar' concepts—and could increase the barriers to adoption of the Practice Statement. Furthermore, it could be argued that the circumstances in which the restriction would be most needed are unlikely to arise in practice—an entity that prepares financial statements applying concepts very different from those underpinning IFRS Standards is unlikely to prepare management commentary that aims to comply with an IFRS Practice Statement.

Staff recommendation

13. For the reasons in paragraph 12, the staff recommend specifying no criteria for the basis of preparation of the related financial statements. In other words, the staff recommend that if an entity's management commentary complies with the Practice Statement, the entity should be able to state that fact even if its financial statements are not prepared in accordance with IFRS Standards.

Disclosure of basis of preparation of financial statements

The issue

14. A question arises about whether further disclosure should be required in management commentary if the entity's financial statements are not prepared in accordance with IFRS Standards.

Staff analysis

15. Users of an entity's management commentary might assume that if the management commentary includes a statement of compliance with an IFRS Practice Statement, the related financial statements will have been prepared in accordance with IFRS Standards. The staff think there is a risk that, if they make this assumption, they might misinterpret some of the information provided in the management commentary.

Staff recommendation

16. To avoid this risk, the staff recommend that if an entity's financial statements are not prepared in accordance with IFRS Standards, the entity should be required to state in its management commentary the basis on which its financial statements are prepared.

Questions for the Board

Questions 1 and 2—entities that do not apply IFRS Standards	
1	In paragraph 13, the staff recommend that if an entity's management commentary complies with the Practice Statement, the entity should be able to state that fact even if its financial statements are not prepared in accordance with IFRS Standards. Do you agree?
2	In paragraph 16, the staff recommend that if an entity's financial statements are not prepared in accordance with IFRS Standards, the entity should be required to state in its management commentary the basis on which its financial statements are prepared. Do you agree?

The characteristic of 'freedom from error'

The issue

17. The Board has tentatively decided that information in management commentary should possess the qualitative characteristics of useful financial information set out in the Board's *Conceptual Framework for Financial Reporting* (*Conceptual Framework*), and that the Practice Statement should describe these characteristics using terminology simpler than that than in the *Conceptual Framework*.

18. The *Conceptual Framework* identifies two fundamental qualitative characteristics that financial information must possess to be useful:

    (a) relevance—with materiality being the entity-specific aspect of relevance; and

    (b) faithful representation, which is achieved through a combination of three characteristics—completeness, neutrality and freedom from error.[1]

19. At its meetings in July 2019 and September 2019, the Board decided how to incorporate the characteristics of relance/materiality, completeness and neutrality into the Exposure Draft proposals. In the working draft of the Exposure Draft, the staff have described those characteristics as materiality, completeness and balance.

20. However, the Board did not decide how to incorporate the characteristic of freedom from error—how to label the term and how to describe it.

21. Paragraph 2.18 of the *Conceptual Framework* explains freedom from error:

> 2.18 Faithful representation does not mean accurate in all respects. Free from error means there are no errors or omissions in the description of the phenomenon, and the process used to produce the reported information has been selected and applied with no errors in the process. In this context, free from error does not mean perfectly accurate in all respects. For example, an estimate of an unobservable price or value cannot be determined to be accurate or inaccurate. However, a representation of that estimate can be faithful if the amount is described clearly and accurately as being an

[1] Paragraphs 2.4, 2.11–2.13 of the *Conceptual Framework*.

estimate, the nature and limitations of the estimating process are explained, and no errors have been made in selecting and applying an appropriate process for developing the estimate.

Views and suggestions of members of the Board and the MCCG

22. Members of both the Board and its Management Commentary Consultative Group (MCCG) have commented on how the Practice Statement should refer to freedom from error.

23. Most of those who commented think it is important to require information in management commentary to possess the characteristic explained in paragraph 2.18 of the *Conceptual Framework*. They think it is important to hold management accountable for the quality or 'trustworthiness' of management commentary.

24. However, several expressed a concern that 'free from error' may be difficult or too strong a term to apply in the context of narrative reporting. A few also expressed concern that a requirement for management commentary to be free from error could discourage management from including information based on judgement, with the result that management commentary could become less useful.

25. Some suggested ways of incorporating the concept of freedom from error in a way that would be appropriate for management commentary. One suggestion was to use a term other than freedom from error. Others were to explain that:

    (a) factual information should be accurate;

    (b) descriptions should be precise / accurate / not misleading;

    (c) assertions and estimates should be 'reasonable and supportable' (a term used in several IFRS Standards[2]), should have a reasonable basis, or should be based on reasonable assumptions; and

    (d) information should be prepared with care / adequate review and controls.

[2] IFRS 9 *Financial Instruments* / IFRS 17 *Insurance Contracts* require estimates of expected credit losses / future cash flows to reflect / incorporate 'reasonable and supportable information available without undue cost or effort'. IAS 36 *Impairment of Assets* and IAS 38 *Intangible Assets* require estimates of future cash flows / future economic benefits to be based on / use 'reasonable and supportable assumptions'.

Narrative reporting frameworks issued by other organisations

26. Because several Board members expressed concern that freedom from error could be a difficult concept to apply in the context of narrative reporting, the staff have considered whether and how narrative reporting frameworks published by other organisations include the characteristic of freedom from error among their reporting principles. We found several examples of frameworks that do include the characteristic, some of which are described further below.

27. The International Integrated Reporting <IR> Framework issued by the International Integrated Reporting Council includes reliability among its guiding principles for integrated reports. It identifies 'freedom from material error' as a component of reliability and explains that:

> Freedom from material error does not imply that the information is perfectly accurate in all respects. It does imply that:
>
> - Processes and controls have been applied to reduce to an acceptably low level the risk that the reported information contains a material misstatement
> - When information includes estimates, this is clearly communicated, and the nature and limitations of the estimation process are explained.

28. The Global Reporting Initiative includes 'accuracy' among its principles for defining report quality. Section 1.5 of its Sustainability Reporting Standard GRI 101: *Foundation* requires reported information to be 'sufficiently accurate and detailed for stakeholders to assess the reporting organization's performance'. It notes that 'the characteristics that define accuracy vary, depending on the nature of the information and who is using it'. It also lists five tests of accuracy:

(a) the report indicates the data that have been measured;

(b) the measurements for data, and bases for calculations, are adequately described, and can be replicated with similar results;

(c) the margin of error for quantitative data is not sufficient to influence substantially the ability of stakeholders to reach appropriate and informed conclusions;

(d) the report indicates which data have been estimated, and the underlying assumptions and techniques used for the estimate, or where that information can be found; and

(e) the qualitative statements in the report are consistent with other reported information and other available evidence.

29. The Climate Disclosure Standards Board includes faithful representation among its guiding principles for reporting environmental information in annual reporting packages. In describing faithful representation, its *Framework for reporting environmental & climate change information* refers to completeness, neutrality and freedom from error. In describing freedom from error, it states that:

> Disclosure of environmental information is generally made under conditions of more uncertainty than financial information and may be based on estimates and management's judgment. Therefore, in this context, faithful representation does not imply total freedom from error. However, faithful representation of information may be achieved by ensuring that sufficient evidence is available to support disclosures and that information is provided about the nature and degree of omissions, assumptions and uncertainty and by basing estimates on appropriate and neutral inputs that reflect the best available information. Therefore, in order to attain faithful representation, it may sometimes be necessary to disclose explicitly the degree of uncertainty in the reported information.

Staff analysis

30. The inclusion of the terms 'freedom from error' and 'accuracy' in other narrative reporting frameworks suggests that these terms are sufficiently familiar and explainable in narrative reporting contexts to be used in the Practice Statement without causing misunderstanding. However, the terms would need to be carefully explained—freedom from error/accuracy does not mean perfectly accurate in all respects, the characteristic manifests itself in different ways in different types of information, and the degree of precision that is needed and is attainable varies depending on the nature of the information.

31. The staff think the term 'accuracy' is better than the term 'freedom from error'—it is simpler and more positive, expressing the characteristic required, rather than a characteristic to be avoided.

32. Feedback from members of the Board and MCCG suggests that the Practice Statement should explain how the characteristic manifests itself in various types of information. It could explain, for example, that accuracy requires that:

    (a) factual information is materially accurate;

    (b) descriptions are accurate and precise;

    (c) estimates, approximations and forecasts are clearly identified as such, and are developed by correctly applying an appropriate process, and using reasonable and supportable inputs; and

    (d) assertions are based on reasonable and supportable information.

33. The concept of accuracy might be particularly difficult to understand in relation to information about the future. So the Practice Statement could include guidance illustrating how the concept would apply to such information. It could explain, for example, that:

    (a) information about management's plans is accurate if those plans are described accurately; and

    (b) information about management's judgements about the future is accurate if it describes the judgements accurately and explains accurately how those judgements have been reached.

34. The staff think the Practice Statement should not refer to a need for information to be prepared with care, or with adequate processes and controls to reduce the risk of material misstatement. The staff reached this conclusion on the basis that the role of the Practice Statement is to specify requirements for outcomes (information that satisfies specified objectives), not for controls and processes to ensure those outcomes are met.

Staff recommendations

35. The staff recommend that the Practice Statement:

(a) includes ‘accuracy’ as a required characteristic of management commentary, explaining that it does not mean perfectly accurate in all respects—the characteristic manifests itself in different ways in different types of information, and the degree of precision that is needed and is attainable varies depending on the nature of the information.

(b) gives examples of how the characteristic manifests itself in various types of information. The Practice Statement could explain, for example, that accuracy requires that:

(i) factual information is materially accurate;

(ii) descriptions are accurate and precise;

(iii) estimates, approximations and forecasts are clearly identified as such, and are developed by correctly applying an appropriate process, and using reasonable and supportable inputs;

(iv) assertions are based on reasonable and supportable information; and

(v) information about management’s judgements about the future describes the judgements accurately and explains accurately how those judgements have been reached.

Question for the Board

Question 3—freedom from error
Do you agree with the staff recommendations in paragraph 35?

Wording of proposed disclosure objectives

Background

36. The Board has tentatively decided to propose an overall objective for management commentary that is based on the objective of general purpose financial reporting set out in its *Conceptual Framework*. In setting the overall objective of management commentary, the Board sought to clarify how that objective differs from the objective of financial statements. The overall objective of management commentary tentatively approved by the Board has two components, which the staff have drafted in the working draft of the Exposure Draft as follows:

    (a) a description of information to be provided in management commentary:

    > Management commentary shall provide information that:
    >
    > (a) enhances investors' and creditors' understanding of an entity's financial performance and financial position depicted in its financial statements; and
    >
    > (b) provides insights into factors that could affect the entity's prospects for future cash flows.

    (b) a description of how that information helps investors and creditors:

    > This information, combined with information in the entity's financial statements, helps investors and creditors assess:
    >
    > (a) the entity's prospects for future cash flows; and
    >
    > (b) how efficiently and effectively management has used and protected (management's stewardship of) the entity's resources.

37. The Board has also tentatively decided to propose disclosure objectives, accompanied by supporting guidance, for the six areas of content in management commentary:

    (a) the entity's business model;

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

    (c) the entity's resources and relationships;

    (d) the risks to which the entity is exposed;

(e) trends and factors in the entity’s external environment; and

(f) the entity’s financial performance and financial position.

38. As discussed in April 2020 Agenda Paper 15A *Introduction to disclosure objectives*, disclosure objectives for the areas of content play a critical role in supporting the overall objective of management commentary. Specifically, they are designed to help:

(a) management identify entity-specific information that needs to be included in management commentary for it to meet its overall objective; and

(b) assurers and regulators assess whether information in management commentary meets the overall objective of management commentary.

39. For each area of content, the disclosure objective includes the following components:

(a) a headline objective. A headline objective provides a high-level description of information about the area that investors and creditors need. That objective is generally consistent with the notion of catch-all disclosure objectives developed in the Targeted Standards-level Review of Disclosures project[3] as well as the high-level disclosure objectives included in recent IFRS Standards. A headline objective is intended to:

(i) narrow the overall objective of management commentary to the area of content;

(ii) provide context for applying the specific disclosure objectives and identifying what information to include in a management commentary; and

(iii) remind management to consider whether the information provided by complying with the specific disclosure objectives taken as a whole meets investors’ and creditors’ information needs for the area of content specified in the headline objective.

[3] Catch-all disclosure objectives are referred to as ‘overall disclosure objectives’ in the Targeted Standards-level Review of Disclosures project.

(b) assessments investors and creditors make. This component of the disclosure objectives sets out the main assessments investors and creditors typically make using the information provided in the area of content. Because of the connectivity between information about matters discussed in a management commentary, in some cases investors and creditors would also need to use information from other areas of content to make those assessments. Explaining why investors and creditors need information is generally consistent with the approach developed in the Targeted Standards-level Review of Disclosures project. In some cases, recent IFRS Standards also contain a description of investors' and creditors' assessments.

(c) specific objectives.[4] These objectives provide a more granular description of what investors and creditors need to understand in relation to the area of content. The Targeted Standards-level Review of Disclosures project also proposes specific disclosure objectives. Sometimes more granular disclosure objectives are also included in recent IFRS Standards.

40. The design of the proposed disclosure objectives in the context of the objectives of general purpose financial reporting and relative to the approach in the Targeted Standards-level Review of Disclosures project and IFRS Standards is summarised in Appendix A. Appendix C provides an overview of the Board's approach in its Targeted Standards-level Review of Disclosures project.

41. As also explained in April 2020 Agenda Paper 15A, the intention is that entities should comply with all components of disclosure objectives for each area of content in order to meet the overall objective of management commentary and to assert compliance with the Practice Statement.

42. To help management identify entity-specific information that needs to be included in management commentary to meet disclosure objectives for the areas of content, those disclosure objectives will be accompanied by supporting guidance, including examples of information that an entity may need to provide, linked to each of the specific

[4] April 2020 Agenda Paper 15A referred to this component of disclosure objectives as 'types of information and analysis'.

disclosure objective. Furthermore, to help management identify such information, the Practice Statement will require management to focus on key matters that are fundamental to the entity's ability to create value and generate cash flows and that are therefore likely to be monitored and managed by management. The Practice Statement will also provide descriptions and examples of key matters for each area of content.

Suggested refinements

43. In response to comments from Board members on the working draft of the Exposure Draft, the staff suggest refining aspects of the disclosure objectives as set out below:

Table 1—Suggested refinements to disclosure objectives

	Refinement suggested	Reason
(a)	Refine the wording of the overall objective of management commentary: Management commentary shall provide information that: (a) … (b) provides insights into factors that could affect the entity's ~~prospects for future cash flows~~ ability to create value and generate cash flows.	To align with the wording of the headline disclosure objectives for the areas of content and descriptions of key matters. (The Board tentatively decided to refer to both creating value and generating cash flows in those headline disclosure objectives and descriptions of key matters after it had approved the overall objective of management commentary.)
(b)	Strengthen the wording of the headline disclosure objectives for the areas of content (as set out in row B2 of Appendix B): Management commentary shall provide information ~~to help~~ that enables investors and creditors to understand…	'Help' is insufficient. An entity could meet the disclosure objective by providing information that helps even a tiny amount. 'Enables' is the term the Board has tentatively decided to propose in its Targeted Standards-level Review of Disclosures project. For more information about that project, see Appendix C. 'Enables' is also used in the disclosure objective in IFRS 15 *Revenue from Contracts with Customers* and the disclosure objectives in IFRS 17 *Insurance contracts*.

Refinement suggested	Reason
(c) Strengthen the wording of the ‘assessments’ paragraphs in the disclosure objectives for the areas of content (row B3 of Appendix B): ~~That i~~Information in management commentary shall ~~helps~~ provide sufficient basis for investors and creditors to assess: (a) …	To better reflect the intention that an entity would need to comply with all components of the disclosure objectives for areas of content in order to comply with the overall objective of management commentary. The wording ‘provides sufficient basis’ is consistent with the wording being proposed by the Board in its Rate-regulated Activities project, and is also similar to the wording used in some IFRS Standards (see Appendix A). See paragraphs 45–47 for further discussion of this change.
(d) Refine the wording of the specific disclosure objectives for the areas of content (row B4 of Appendix B): ~~The i~~ Information provided about [the area of content] shall ~~cover~~ enable investors and creditors to understand: (a) …	To better reflect the intention for these requirements to be disclosure objectives, and to align their wording with the wording of the headline disclosure objectives. As noted in row (b) of this table, this wording is also generally consistent with the wording developed in the Targeted Standards-level Review of Disclosures project, and with the wording of disclosure objectives in IFRS 15 and IFRS 17.

44. Appendix B sets out the refined disclosure objectives for all areas of content together with the descriptions of key matters (see paragraph 42).

45. Strengthening the wording of the ‘assessments’ component of the disclosure objective as discussed in paragraph 43(c) might raise questions about a difference between the requirements being developed for the Practice Statement and those being developed by the Board in its Targeted Standards-level Review of Disclosures project. As noted in paragraph 39(b), in that project, the Board tentatively decided to propose that disclosure objectives should include an explanation of how the information is expected to help users of financial statements[5]. However, these explanations would be framed as observations rather than requirements. As explained further in Appendix C to this

[5] Users of financial statements are existing and potential investors, lenders and other creditors. In the Management Commentary project, the staff refer to them as investors and creditors.

paper, the Board adopted this approach because feedback received when developing the proposals in the Targeted Standards-level Review of Disclosures project indicated that it may be impractical and unenforceable to place on preparers a compliance burden that is dependent on how users choose to perform their analyses.

46. In contrast, as noted in paragraph 41, all components of the proposed disclosure objectives for areas of content in management commentary are designed as requirements. The staff think framing the assessments paragraphs in the Practice Statement as requirements (rather than just observations) is both necessary and appropriate in that particular context. This is because:

(a) as noted in paragraph 38, the disclosure objectives in the Practice Statement are designed to help management identify entity-specific information that is material and needs to be included for management commentary to meet its objective. Furthermore, as also noted in paragraph 38, the disclosure objectives in the Practice Statement are designed to support enforceability of the Practice Statement and assurability of information in management commentary. Those disclosure objectives, including all their components set out in paragraph 39, are the only types of requirements that will be included in the Practice Statement on the areas of content. In addition, because the scope of information that might need to be included in a management commentary is very wide and that information is entity-specific, it is not feasible for the Practice Statement to provide specific disclosure requirements to support those disclosure objectives. The resulting absence of other requirements in the Practice Statement places a great deal of pressure on disclosure objectives to play a major role in determining the content of a management commentary as a whole. In contrast, the disclosure objectives in any particular IFRS Standard do not play such a major role in determining the content of the entity's financial statements as a whole and are not the only types of requirements specified in that Standard that determine the information that needs to be included in financial statements (other types of requirements in IFRS Standards determine recognition, measurement and presentation of assets, liabilities, equity, income and expenses in financial statements). Furthermore, each IFRS Standard deals with a much more narrowly circumscribed area of content than the Practice Statement, and so there is much less pressure on identifying precisely what pieces of information will be material.

(b) the assessments to be described in the Practice Statement do not relate to specific disclosure objectives, unlike the explanations in the Targeted Standards-level Review of Disclosures project of how the information is expected to help users of financial statements. Instead, each assessment (to be described in the Practice Statement) relates to the headline objective for an area of content as a whole and therefore also to each of the specific disclosure objectives for that area. The headline objective is set out at a higher level than the specific disclosure objectives in the Targeted Standards-level Review of Disclosures project. Accordingly, the Practice Statement's granular descriptions of assessments by investors and creditors need to be framed as requirements so that they would provide specificity that is necessary to support enforceability of the Practice Statement and assurability of the resulting entity-specific information.

(c) as noted in paragraph 39(b), because of the connectivity of information across areas of content in management commentary, in some cases investors and creditors would need to use information from other areas of content to make the assessments in relation to another area. In effect, that means that the assessments described for the area of content to some extent rely on the information beyond that area of content. Management would therefore be required to consider how the information identified for inclusion in one area of content in management commentary affects the information that needs to be provided in another area of content in order to provide a complete and understandable depiction of a key matter that affects the entity's ability to create value and generate cash flows (see paragraph 42). This is different from the 'assessments' described in the Targeted Standards-level Review of Disclosures project that relate to specific disclosure objectives in a particular IFRS Standard.

(d) management commentary is prepared 'through the eyes of management' and generally addresses matters that are monitored and managed by management because they are fundamental to the entity's ability to create value and generate cash flows and would therefore also affect investors' and creditors' assessments of that ability.

47. The approach to assessments in the Practice Statement is similar to the approach adopted in recent IFRS Standards where the assessments sometimes form a part of the high-level disclosure requirement (see Appendix A). However, in those Standards, not only the high-level disclosure requirement itself but also the supporting assessments are formulated at a high-level (for example, to give a basis for users of financial statements to assess the effects on the entity's financial position, financial performance and cash flows). In contrast, in the Practice Statement, the assessments are more specific, to help preparers comply with them and to help regulators and auditors assess compliance.

Question for the Board

Question 4—refinements to disclosure objectives
Do you have any comments on the refinements to the wording of the disclosure objectives discussed in Table 1?

Next steps

48. The staff will continue preparing a draft of the Exposure Draft for balloting by the Board. The Board aims to publish the Exposure Draft in April 2021.

Appendix A—Design of the proposed disclosure objectives in the Practice Statement[6]

Objective of general purpose financial reporting
❖ Provide financial information about the entity that is useful to primary users[7] in making decisions relating to providing resources to the entity; ❖ To help those users assess the prospects for future net cash inflows to the entity and management's stewardship of the entity's economic resources.

Proposed objective of management commentary	**Objective of financial statements**
❖ Provide information that enhances investors' and creditors' understanding of an entity's financial performance and financial position depicted in its financial statements and provide insights into factors that could affect the entity's ability to create value and generate cash flows; ❖ To help investors and creditors assess the entity's prospects for future cash flows and how efficiently and effectively management has used and protected (management's stewardship of) the entity's resources.	❖ Provide financial information about the entity's assets, liabilities, equity, income and expenses; ❖ To help primary users assess the prospects for future net cash inflows to the entity and management's stewardship of the entity's economic resources.

Proposed disclosure objectives for areas of content in management commentary	**Proposals in Targeted Standards-level Review of Disclosures project**	**Disclosure objectives in IFRS Standards**

[6] The wording of the proposed disclosure objectives for management commentary is based on the refined wording suggested by the staff in Table 1 of this paper.
[7] Primary users are existing and potential investors, lenders and other creditors. In the Management Commentary project, the staff refer to them as investors and creditors.

Proposed disclosure objectives for areas of content in management commentary	Proposals in Targeted Standards-level Review of Disclosures project	Disclosure objectives in IFRS Standards
Headline disclosure objectives	**Catch-all disclosure objectives**[8]	**High-level disclosure objectives**
For example: Management commentary shall provide information that **enables** investors and creditors **to understand** how the entity's business model creates value and generates cash flows.	*For example:* An entity shall disclose information that **enables** users of financial statements **to**: (a) **evaluate** uncertainties associated with the entity's involvement in the defined benefit plans; and (b) **assess** the effect that defined benefit plans have on the financial performance, financial position and cash flows of the entity.	Recent IFRS Standards generally include a high-level disclosure objective. For example, paragraph 89 of IFRS 16 *Leases* states that the objective of the disclosures is for lessees to disclose information in the notes that, together with the information provided in the statement of financial position, statement of profit or loss and statement of cash flows, **gives a basis** for users of financial statements **to assess** the effect that leases have on the financial position, financial performance and cash flows of the lessee.
Assessments related to headline objectives	**Assessments related to catch-all objectives**	**Assessments related to high-level objectives**
For example: Information in management commentary shall **provide sufficient basis** for investors and creditors **to assess** how effective the entity's business model is in creating value and generating cash flows, and how scalable, resilient, adaptable and durable it is.	N/A	In some IFRS Standards, the description of the high-level objective includes a description of the assessments that users of financial statements make (see the example above).

[8] Catch-all disclosure objectives are referred to as 'overall disclosure objectives' in the Targeted Standards-level Review of Disclosures project.

Proposed disclosure objectives for areas of content in management commentary	Proposals in Targeted Standards-level Review of Disclosures project	Disclosure objectives in IFRS Standards
Specific disclosure objectives	**Specific disclosure objectives**	**Detailed disclosure objectives**
For example: Information provided about the entity's business model shall **enable** investors and creditors **to understand**: (a) the range, nature and scale of the entity's operations; (b) the inputs to the entity's operations, the outputs of its operations and the processes involved in obtaining those inputs, transforming them into outputs, delivering the outputs to customers and collecting cash; and (c) wider consequences (impacts) of the entity's operations if such impacts have affected, or could affect, the entity's ability to create value and generate cash flows, including over the long term.	*For example:* An entity shall disclose information that **enables** users of financial statements **to understand** the amounts and the components of those amounts in the statements of financial performance, financial position and cash flows arising from defined benefit plans during the reporting period.	Some recent IFRS Standards contain requirements that are structured as disclosure objectives and are consistent with the notion of specific disclosure objectives. For example, paragraph 121 of IFRS 17 *Insurance Contracts* requires an entity to disclose information that **enables** users of its financial statements **to evaluate** the nature, amount, timing and uncertainty of future cash flows that arise from contracts within the scope of IFRS 17.

Proposed disclosure objectives for areas of content in management commentary	Proposals in Targeted Standards-level Review of Disclosures project	Disclosure objectives in IFRS Standards
Assessments related to specific objectives	**Assessments related to specific objectives**	**Assessments related to detailed requirements**
N/A	*For example:* This information **is intended to help** users of financial statements **to**: (a) **navigate** subsequent detailed information about defined benefit plans and reconcile it to the primary financial statements; and (b) **identify** amounts to include or adjust for in their own analysis.	IFRS Standards generally do not set out assessments that users of financial statements make in relation to each disclosure objective.
Guidance supporting disclosure objectives	**Items of information to satisfy specific objectives**	**Disclosure requirements and guidance**
The Board proposes that the Practice Statement would include supporting guidance linked to each of the specific disclosure objectives.	The Board proposes linking specific disclosure objectives with examples of information an entity may provide to satisfy those objectives. At times, the Board may require disclosure of a particular item of information (see Appendix C, paragraphs C8–C9).	IFRS Standards contain disclosure requirements and, in some cases, guidance.

Appendix B—Illustrative drafting for the Exposure Draft (incorporating the refinements suggested by the staff in this paper)

	Business model	Strategy	Resources and relationships	Risks	External environment	Financial performance and financial position
B1 **Focus of management commentary**	Management commentary shall focus on key matters and provide material information about these matters. The key matters are …					
	key features of the entity's business model. These are features that underpin the entity's ability to create value and generate cash flows.	key aspects of management's strategy These are aspects that are fundamental to sustaining and developing the entity's ability to create value and generate cash flows in the future.	the entity's key resources and relationships. These are the resources and relationships that are fundamental to the entity's ability to create value and generate cash flows.	the key risks to which the entity is exposed. These are risks that could severely disrupt the entity's ability to create value and generate cash flows.	key factors and trends in the entity's external environment. These are factors and trends that have had, or could have, a fundamental effect on the entity's ability to create value and generate cash flows.	key facets of the entity's financial performance and financial position. These are facets that reflect the entity's ability to create value and generate cash flows.
	Key matters are likely to be matters that management monitors and manages, because they are fundamental to the entity's ability to create value and generate cash flows.					
B2 **Headline disclosure objectives**	Management commentary shall provide information that enables investors and creditors to understand…					
	how the entity's business model creates value and generates cash flows.	management's strategy for sustaining and developing the entity's business model.	the resources and relationships on which the entity's business model and management's strategy for sustaining and developing that model depend.	the risks that could disrupt: (a) the entity's business model; (b) management's strategy for sustaining or developing that model; or (c) the entity's resources or relationships.	how the external environment has affected or could affect: (a) the entity's business model; (b) management's strategy; (c) the entity's resources or relationships; or (d) risks to which the entity is exposed.	the entity's financial performance and financial position. .

<table>
<tr><th></th><th>Business model</th><th>Strategy</th><th>Resources and relationships</th><th>Risks</th><th>External environment</th><th>Financial performance and financial position</th></tr>
<tr><td>B3</td><td colspan="6">Information in management commentary shall provide sufficient basis for investors and creditors to assess:</td></tr>
<tr><td>Assessments investors and creditors make</td>
<td>(a) how effective the entity’s business model is—its ability to create value and generate cash flows;
(b) how scalable it is—its ability to grow to meet demand for its outputs;
(c) how resilient it is—its ability to withstand or recover quickly from shocks or difficult conditions;
(d) how adaptable it is—its ability to change in response to new circumstances; and
(e) how durable it is—its ability to remain effective in the long term.</td>
<td>(a) the potential effect of that strategy on the entity’s ability to create value and generate cash flows—whether the strategy is likely to be effective in maintaining and developing that ability; and
(b) the entity’s ability to implement the strategy—whether the strategy is achievable.</td>
<td>(a) the extent to which the business model and strategy depend on particular resources and relationships; and
(b) the entity’s ability to obtain the resources and maintain the relationships on which the business model and strategy depend.</td>
<td>(a) the extent of the entity’s exposure—that is, the likelihood of future disruption and the potential effect of that disruption on the entity’s ability to create value and generate cash flows; and
(b) how effectively management monitors and manages the exposure.</td>
<td>(a) how factors and trends in the entity’s external environment have affected and could affect the entity; and
(b) how effectively management monitors and responds to those factors and trends.</td>
<td>(a) key drivers of the entity’s financial performance and financial position;
(b) how the entity’s financial performance and financial position compare with investors’ and creditors’ previous expectations; and
(c) the extent to which the financial performance and financial position reported in the entity’s financial statements are indicative of the entity’s ability to create value and generate cash flows in the future, including over the long term.</td></tr>
</table>

	Business model	Strategy	Resources and relationships	Risks	External environment	Financial performance and financial position
B4 **Specific disclosure objectives**	The information provided about [the area of content] shall enable investors and creditors to understand:					
	(a) the range, nature and scale of the entity's operations; (b) the inputs to the entity's operations, the outputs of its operations and the processes involved in obtaining those inputs, transforming them into outputs, delivering the outputs to customers and collecting cash; and (c) wider consequences (impacts) of the entity's operations if such impacts have affected, or could affect, the entity's ability to create value and generate cash flows, including over the long term.	(a) the drivers of the strategy; (b) the long-term aims of the strategy; (c) intermediate milestones on the path towards achieving the long-term aims; (d) plans for reaching the intermediate milestones and achieving the long-term aims; (e) the entity's capital requirements, management's plans for funding the strategy and capital allocation; and (f) progress in implementing the strategy.	(a) the nature of the entity's resources and relationships; (b) how the entity accesses and deploys the resources and relationships; (c) factors that could affect the availability of the resources or the strength of the relationships; and (d) progress in managing the resources and relationships.	(a) the nature of the risks to which the entity is exposed; (b) the entity's exposure to those risks; (c) how management monitors and manages the risks and would mitigate disruption if it occurs; and (d) progress in managing risks.	(a) the nature of the factors and trends; (b) how the factors and trends have affected, or could affect, the entity; and (c) how management has responded, or plans to respond to the factors and trends.	(a) what the facets of the entity's financial performance and financial position are; (b) the factors that have affected the entity's financial performance for the reporting period; (c) the factors that have affected the entity's financial position at the end of the reporting period; (d) how the entity has allocated capital in the reporting period; (e) the factors that have affected the entity's financial performance or financial position since the end of the reporting period, or could affect them in the future, including in the long term. (f) how the entity's financial performance and financial position compare with previously-published forecasts or targets, if any, and why variances have arisen.

Appendix C—The Board's approach in its Targeted Standards-level Review of Disclosures project

C1 In its Targeted Standards-level Review of Disclosures project, the Board is proposing a new approach to developing and drafting disclosure requirements in IFRS Standards. The Board's objective is to develop disclosure requirements in a way that will help stakeholders apply more effective judgement and improve the usefulness of disclosures for the primary users of financial statements.

C2 From May 2018 to September 2018, the Board developed draft guidance to use when developing and drafting disclosure sections of IFRS Standards in future. Subsequently, the Board tested that draft guidance by applying it to the disclosure sections of IFRS 13 *Fair Value Measurement* and IAS 19 *Employee Benefits*. In light of lessons learned from that testing, the Board made some amendments to the draft guidance in February 2020.

Disclosure objectives

C3 A key aspect of the draft guidance addresses how the Board could use disclosure objectives more effectively. Specifically, the draft guidance proposes:

(a) requiring entities to comply with overall disclosure objectives that explain the overall or 'big picture' information needs of primary users of financial statements and prompt entities to consider whether the information as a whole provided by complying with the specific disclosure objectives in a Standard meets those overall user information needs;

(b) requiring entities to comply with specific disclosure objectives based on the detailed information needs of primary users of financial statements;

(c) supplementing those specific disclosure objectives with explanations of what those users are expected to do with the information provided; and

(d) linking specific disclosure objectives with examples of information an entity may provide to satisfy the objectives (see paragraphs C8–C9).

C4 Board members and staff consulted users and preparers of financial statements, and others, while testing the draft guidance on IFRS 13 and IAS 19. One of the lessons learned from that consultation was the importance of articulating disclosure objectives in a way that places a reasonable and enforceable compliance burden on preparers. Specifically, the Board learned that it cannot write disclosure objectives in a way that requires a preparer to do a user's analysis for them.

C5 Consider, for example, one of the Board's tentative specific disclosure objectives for IAS 19. That disclosure objective would:

(a) require an entity to disclose information that enables users of financial statements to understand amounts in the primary financial statements arising from defined benefit plans during the reporting period; and

(b) go on to explain that this information is intended to help users of financial statements to (i) navigate subsequent detailed pension disclosure information and reconcile it to the primary financial statements and, (ii) identify amounts to adjust for in their own analysis.

C6 In this example, a preparer can reasonably be required to provide, and clearly communicate, information sufficient to enable the understanding required in paragraph C5(a). The compliance burden for a preparer is to *enable* that understanding—it does not require that a user actually does understand, nor does achieving compliance depend on the analysis that a user chooses to perform.

C7 Conversely, a preparer cannot reasonably be held to account for the user analysis described in paragraph C5(b). This is because placing a compliance burden on preparers that is dependent on how a user chooses to perform their own analysis is impractical and unenforceable. Instead, this explanatory paragraph is intended to help preparers to fully understand the objective in paragraph C5(a) and apply judgement about how best to satisfy it—without introducing an unrealistic compliance burden.

Information to satisfy specific disclosure objectives

C8 The draft guidance proposes linking specific disclosure objectives with examples of information an entity may provide to satisfy those objectives. This is intended to help entities understand what the Board had in mind when developing the specific disclosure objectives and apply effective judgement about what to disclose.

C9 Applying the draft guidance, the Board would typically use less prescriptive language when referring to items of information that may be needed to meet the specific disclosure objectives (‘while not mandatory, the following information may enable an entity to meet the disclosure objective’). This language would be intended to focus an entity’s compliance requirement on applying judgement and satisfying disclosure objectives rather than on disclosing a ‘checklist’ of information. The draft guidance also notes that, at times, the Board may identify information which, when material to an entity, would always be needed by users of financial statements and that, in these cases, the Board may use prescriptive language to require disclosure of a particular item of information.

Forthcoming consultation

C10 The Board completed its decision making on the Targeted Standards-level Review of Disclosures project in March 2020 and expects to publish an Exposure Draft in March 2021[9]. The Exposure Draft forms part of the Board’s testing of its proposed new approach and seeks to obtain stakeholder feedback on whether the proposals—including those related to the drafting of disclosure objectives—would be effective in helping stakeholders to apply judgement and improve the usefulness of disclosures in financial statements.

[9] At the April 2020 Board Meeting, the Board considered how it can assist stakeholders during the covid-19 pandemic and decided to delay the publication dates of some forthcoming major consultations. As part of that discussion, the Board decided to delay the publication of the Exposure Draft to March 2021.