

## STAFF PAPER

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## IASB® meeting

Project	Management Commentary		
Paper topic	Feedback summary—Making materiality judgements		
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This paper has been prepared for discussion at a public meeting of the International Accounting Standards Board (IASB). This paper does not represent the views of the IASB or any individual IASB member. Any comments in the paper do not purport to set out what would be an acceptable or unacceptable application of IFRS® Accounting Standards. The IASB's technical decisions are made in public and are reported in the IASB® *Update*.

### Purpose of paper

- 1 The papers for this meeting summarise feedback on the International Accounting Standards Board (IASB)'s proposals for a revised Practice Statement on management commentary (Management Commentary Practice Statement), as set out in the Exposure Draft *Management Commentary* (Exposure Draft).
- 2 At its March 2022 meeting, the IASB discussed feedback on the proposed requirement for management commentary to provide material information.<sup>1</sup> Following on from that discussion, this paper summarises feedback on the proposed:
  - (a) definition of material information; and
  - (b) guidance on making materiality judgements.
- 3 This paper should be read in the context of Agenda Paper 15 *Feedback summary—Cover paper*, which explains some of the terminology used and how we have quantified feedback.

<sup>1</sup> See [Agenda Paper 15F Feedback summary—Key matters and material information](#) for the March 2022 IASB meeting.

- 4 This paper does not ask the IASB to make decisions but invites IASB members' questions and comments on the feedback.

### Structure of paper

- 5 This paper includes:
- (a) a recap of the Exposure Draft proposals (paragraphs 6–10);
  - (b) an overview of the key messages in the feedback (paragraphs 11–12);
  - (c) summaries of the feedback on:
    - (i) the definition of material information (paragraphs 13–15); and
    - (ii) guidance on making materiality judgements (paragraphs 16–33).

### Exposure Draft proposals

#### *Material information*

- 6 Paragraph 3.2 of the Exposure Draft proposed to require information provided to meet the objective of management commentary to be material. That paragraph also proposed 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 the management commentary and of the related financial statements.

- 7 This investor-focused definition was based on the definition of material information in the IASB's *Conceptual Framework for Financial Reporting (Conceptual Framework)*, tailored for management commentary.

*Making materiality judgements*

- 8 Chapter 12 of the Exposure Draft proposed guidance on making materiality judgements. The aim of the guidance was to help address shortcomings in current practice—including that management commentaries sometimes:
- (a) fail to provide material information about matters important to the entity’s prospects, or obscure such information with immaterial information about less important matters;
  - (b) contain too much generic information and not enough entity-specific information; or
  - (c) focus on short-term matters and provide insufficient discussion of matters that could affect the entity’s long-term prospects—including about possible future events with uncertain outcomes.
- 9 The proposed guidance drew on guidance in the IASB’s Practice Statement 2 *Making Materiality Judgements* (Materiality Practice Statement), and emphasised the entity-specific nature of material information. The Materiality Practice Statement provides guidance for preparers of *financial statements*. However, aspects of that guidance would also apply in preparing management commentary, and the Exposure Draft drew on these aspects, focusing on those that could be particularly important in preparing management commentary.
- 10 The Exposure Draft also proposed guidance on topics not covered by the Materiality Practice Statement:
- (a) because the proposed objectives-based requirements of the Management Commentary Practice Statement do not explicitly identify the information to include in management commentary, the Exposure Draft proposed additional guidance on identifying potentially material information. Among other things, this guidance referred to:

- (i) information management uses for managing the business (paragraph 12.4);
  - (ii) types of information that management knows entities with similar activities commonly provide to investors (paragraph 12.5); and
  - (iii) narrative reporting requirements or guidelines published by other organisations, for example, an industry body or an organisation with an interest in sustainability reporting (paragraph 12.6).
- (b) because management commentary includes information about possible future events that are not reported in the entity's financial statements and have uncertain outcomes, paragraph 12.8 proposed guidance on judging the materiality of information about such events. This guidance referred to the potential effects of an event on the entity's future cash flows (including in the long term), the full range of possible outcomes, the likelihood of each outcome, and the time value of money. The Basis for Conclusions on the Exposure Draft noted the IASB's intention to consider whether to develop a proposal to add similar guidance to the Materiality Practice Statement.

### **Key messages in feedback**

- 11 As discussed at the IASB's March 2022 meeting, some respondents commented on the proposal that the objective of management commentary, and hence the definition of material information, should focus on the information needs of investors. Most of those respondents agreed with the proposal, but some suggested that the objective should address the information needs of a broader range of stakeholders. There was little feedback on other aspects of the proposed definition of material information.
- 12 Many respondents commented on the proposed guidance on making materiality judgements. Most of those respondents expressed broad support for the guidance or questioned only specific aspects of it.

## Definition of material information

- 13    Some respondents commented on the proposal that the objective of management commentary, and hence the definition of material information, should focus on the information needs of investors. Most of those respondents agreed with the proposal, but some suggested that the objective should address the information needs of a broader range of stakeholders. Those comments were discussed at IASB’s March 2022 meeting, and are summarised in paragraphs 23–27 of [Agenda Paper 15C Feedback summary—Objective of management commentary](#) for that meeting.
- 14    There was little feedback on other aspects of the proposed definition of material information. A few respondents suggested changes to the wording of the definition. Suggestions included:
- (a)    wording the definition so it is identical to that in the *Conceptual Framework*, not tailored for management commentary; and
  - (b)    referring only to ‘management commentary’, not to ‘management commentary and the related financial statements’:
    - (i)    to clarify that management commentary should be able to stand alone; or
    - (ii)   for consistency with the definition of material information in IAS 1 *Presentation of Financial Statements*. IAS 1 defines information that is material for financial statements and refers only to financial statements.
- 15    A group representing Australian preparers suggested aligning the definition of material information with the materiality test in the Australian Corporations Act 2001. That Act requires an operating and financial review (the Australian equivalent of management commentary) to contain information that investors would ‘reasonably require to make an informed assessment’ of an entity’s operations, financial position, business strategies and prospects. The group argued that the definition proposed in the Exposure Draft is broader than the test in the Act and might require disclosure of information that is of less value to investors.

## Guidance on making materiality judgements

### *General feedback*

#### *Overall views*

- 16 Many respondents commented on the proposed guidance on making materiality judgements. Most of those respondents expressed broad support for the guidance or questioned only specific aspects of it (see paragraphs 25–33).

We view this Chapter as a helpful explanation of how materiality judgements might be made. *CL48 Australian Institute of Company Directors*

- 17 A standard-setter agreed that the guidance is important because the proposed objectives-based requirements do not explicitly identify the information to include in management commentary.
- 18 A few respondents expressing support for the guidance highlighted particular paragraphs that they supported. These paragraphs included:
- (a) paragraph 12.4(b), which notes that an indication that information might be material is that it is derived from information management uses for managing the business;
  - (b) paragraph 12.5, which refers to types of information that management knows entities with similar activities commonly provide to investors;
  - (c) paragraph 12.8, which provides guidance on judging the materiality of information about possible future events that are not reflected in the financial statements and have uncertain outcomes; and
  - (d) paragraph 12.9, which reminds preparers of management commentary that materiality judgements need to be reassessed each reporting period:

Material issues for reporting to investors are interconnected with wider sustainability impacts. Due to the increasingly complex risks faced by entities, insights into other aspects of the entity’s wider value chain and impacts have become essential in order to understand long-term resilience.

We therefore welcome the Board’s proposal that materiality judgements need to be reassessed each reporting period (paragraph 12.9), as we agree that immaterial information may become material over time and vice versa (reflecting its dynamic nature). *CL68 Deloitte*

- 19 However, a few respondents disagreed that the Management Commentary Practice Statement should include any guidance on making materiality judgements:
- (a) a standard-setter and accountancy body expressed a view that existing guidance in the Materiality Practice Statement and local regulations is well-understood and sufficient for most entities;
  - (b) the standard setter also suggested that any additional guidance viewed as necessary should be included in the Materiality Practice Statement (see paragraph 24(c) below); and
  - (c) a group representing preparers expressed a view that the additional guidance proposed in the Exposure Draft could make materiality judgements complicated.
- 20 An accountancy body suggested that consideration should also be given to materiality guidance in [SASB Standards](#) and in the Integrated International Reporting Council (now Value Reporting Foundation)’s International Integrated Reporting Framework ([<IR> Framework](#)).

*Processes and criteria applied in making materiality judgements*

- 21 A few respondents suggested also including in the Management Commentary Practice Statement guidance on the process management should follow in making materiality judgements. Respondents referred to the four-step process described in the Materiality Practice Statement and suggested the Management Commentary Practice Statement could describe a similar process, or cross-refer to Materiality Practice Statement.

- 22 A few standard-setters suggested requiring management commentary to disclose the process and criteria management has applied in making materiality judgements.

Our integrated reporting experience is that the process of determining materiality is a critical disclosure as it shares insight on the completeness of the entity's process, and hence is significant information for investors and other users.

*CL17 Integrated Reporting Committee of South Africa*

- 23 Suggestions included:

- (a) requiring entities to name (industry- or topic-specific) frameworks or guidelines used in that process and explain methods used to quantify or evaluate matters and information about them;
- (b) basing requirements on those in the [<IR> Framework](#); and
- (c) requiring disclosure in the 'basis of preparation' section of the management commentary.

*Interaction with the Materiality Practice Statement*

- 24 Some respondents commented on the interaction between the Management Commentary Practice Statement and the Materiality Practice Statement. Respondents suggested that the IASB:

- (a) clarify the relationship between the guidance in the Management Commentary Practice Statement and the guidance in the Materiality Practice Statement—specifically how the two sets of guidance align, whether and how they differ and what additional considerations are needed for management commentary. Respondents who requested this clarification suggested it was needed because materiality judgements for management commentary will not be made in isolation—they will often be combined with those made for the financial statements.
- (b) add to the proposed guidance on making materiality judgements in the Management Commentary Practice Statement a cross reference to the

Materiality Practice Statement (and eventually to materiality guidance in future IFRS Sustainability Disclosure Standards)—on the grounds that much of that guidance would apply to information in management commentary.

- (c) locate guidance on making materiality judgements for management commentary in the Materiality Practice Statement instead of in the Management Commentary Practice Statement—on the grounds that materiality guidance would more accessible and easily understood if it were all located in one document.
- (d) include in the Management Commentary Practice Statement the guidance proposed in paragraph 12.8 of the Exposure Draft *without* also amending the Materiality Practice Statement (as described in paragraph 10(b))—because materiality in the context of information provided in financial statements is different from materiality in the context of information provided in management commentary.

***Feedback on specific aspects of the guidance***

- 25 Some respondents commented on specific aspects of the proposed guidance—mainly guidance on topics not covered by the Materiality Practice Statement.

*Information commonly provided by entities with similar activities*

- 26 A few respondents commented on the proposal in paragraph 12.5 that, to identify potentially material information, management would consider types of information that it holds and ‘knows entities with similar activities commonly provide to investors’:
  - (a) as noted in paragraph 18(b), a few respondents explicitly welcomed this guidance; but
  - (b) a few other respondents suggested omitting it on the grounds that:

- (i) it is inconsistent with the notion of materiality as an entity-specific attribute—management should be required to consider only matters that are key for the entity; or
- (ii) the guidance could be difficult to interpret (leading to enforcement challenges) and burdensome to apply. It raises a question about whether benchmarking is required.

Although we concede this kind of peer-comparison is quite common in practice and helpful for preparers, we have concerns on the wording of this paragraph. ... the tone of the paragraph suggests a requirement for an entity's management to perform a peer review with regard to information provided in the peers' management commentary. We oppose such a requirement as it puts an undue burden on the entities in jurisdictions that have adopted the PS 1.

*CL39 Accounting Standards Committee of Germany*

*Use of industry- or topic-specific requirements or guidelines*

27 A few respondents commented on the proposal in paragraph 12.6 that industry- or topic-specific requirements or guidelines could help management identify potentially material information:

- (a) a group representing preparers suggested that the need to decide which requirements or guidelines to follow, and then to apply them, would place additional burdens on management; and
- (b) the International Organization of Securities Commissions suggested that the Management Commentary Practice Statement should refer explicitly to IFRS Sustainability Disclosure Standards.

*Information about possible future events with uncertain outcomes*

- 28 A few respondents commented on the proposed guidance in paragraph 12.8 on judging the materiality of information about possible future events that are not reflected in the financial statements and have uncertain outcomes:
- (a) as noted in paragraph 18(c), a few respondents—including a regulator—expressed explicit support for that guidance;
  - (b) an accountancy body suggested the guidance was too vague—further detail and illustrations would be helpful;
  - (c) a group representing preparers suggested adding the explanations and illustrations of nested and dynamic materiality described in paragraph 31 below; and
  - (d) a standard-setter suggested that providing information about possible future events with uncertain outcomes would involve a level of forecasting that would be a significant extension of conventional financial reporting, which it said reinforced its view that the proposals should be field tested.

*Aggregation*

- 29 A few respondents commented on proposed guidance in paragraphs 12.10–12.11 on factors to consider in judging how much to aggregate information:
- (a) a few respondents suggested aligning the guidance with that in IAS 1 or that proposed in the IASB’s [Exposure Draft \*General Presentation and Disclosures\*](#);
  - (b) a few respondents suggested adding more guidance or examples to illustrate the guidance, because adequate disaggregation is important when providing information about operations facing different economic conditions or with different business cycles, and judgement is required; and
  - (c) an accounting firm queried the suggestion that management commentary might need to disaggregate information provided in the financial statements:

We believe there should be consistency between paragraphs 12.10 and 12.11 and the aggregation/disaggregation guidance in IAS 1.29 through IAS 1.31. More specifically, we interpret paragraph 12.11(b) to suggest that a greater level of disaggregation is applied in communication to investors than in the financial statements and, therefore, more disaggregated information must be presented in the management commentary. This seems to raise a rather complex issue in terms of whether the financial statements are aligned with the requirements on aggregation in IFRS in the applicable fact pattern. We, therefore, encourage the Board to reconsider the consistency between the requirements in paragraph 12.11(b) and aggregation requirements in IFRS. *CL9 EY*

*Guidance applied in judging the materiality of sustainability-related information*

- 30 An accounting firm suggested highlighting guidance that could be particularly important for judging the materiality of sustainability-related information. The firm referred to paragraph 12 of the [General Requirements for Disclosure of Sustainability-related Financial Information Prototype<sup>2</sup>](#), which:
- (a) clarifies the need to apply a filter when identifying material information about an entity’s impacts on society and the natural environment. Information would be material if the impacts could reasonably be expected to affect the entity’s future cash flows.<sup>3</sup>
  - (b) observes that material information could include information about events that have a low likelihood of occurring but a high potential impact on the entity’s future cash flows.<sup>4</sup>

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<sup>2</sup> Developed by the Technical Readiness Working Group, chaired by the IFRS Foundation, and published in November 2021 to provide recommendations to the International Sustainability Standards Board for consideration by that Board.

<sup>3</sup> Paragraph 5.7(c) of the Exposure Draft proposes that management commentary should provide information that enables investors to understand the environmental and social impacts of the entity’s activities *if those impacts have affected or could affect the entity’s ability to create value and generate cash flows*, including in the long term. (Emphasis added)

<sup>4</sup> Covered in note (a) following paragraph 12.8 in the Exposure Draft.

- 31 A group representing preparers suggested supplementing the proposed guidance on judging the materiality of information about possible future events with uncertain outcomes (paragraph 12.8 of the Exposure Draft) with the explanations and illustrations of nested and dynamic materiality from the paper [Reporting on enterprise value: Illustrated with a prototype climate-related financial disclosure standard](#).<sup>5</sup>

**Note on terminology—nested and dynamic materiality**

The paper *Reporting on enterprise value: Illustrated with a climate-related financial disclosure standard* refers to three ‘nested’ lenses of reporting on sustainability-related matters:

- matters reflected in the entity’s financial statements;
- matters likely to influence enterprise value; and
- a broader range of matters relating to the impact of the entity’s activities.

The paper uses the concept of ‘dynamic materiality’ to refer to the movement of sustainability-related matters between those lenses over time.

**Other comments**

- 32 A standard-setter questioned the statement in the Basis for Conclusions that materiality is an attribute of information, not an attribute of matters. The standard-setter noted that recently-issued amendments to IAS 1 *Presentation of Financial Statements* refer to ‘material transactions, other events or conditions’.
- 33 A few preparers suggested adding more guidance on the quantitative aspects of materiality assessments—for example, on judging when a metric is material. One preparer noted that the absence of quantitative thresholds means that management has to exercise judgement, which leads to diversity in practice.

<sup>5</sup> Co-authored by the Carbon Disclosure Project (CDP), the Climate Disclosure Standards Board (CDSB), the Global Reporting Initiative (GRI), the International Integrated Reporting Council (IIRC) and the Sustainability Accounting Standards Board (SASB), and published in December 2020.

## Question for IASB members

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Do you have any questions or comments on the feedback reported in this paper?