STAFF PAPER

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IASB® meeting

Project	**Management Commentary**
Paper topic	Feedback summary—Objective of management commentary

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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 (Practice Statement), as set out in the Exposure Draft *Management Commentary* (Exposure Draft).

2 This paper summarises feedback on the proposed objective of management commentary and related concepts.

3 This paper should be read in the context of Agenda Paper 15 *Feedback summary—Overview*, which discusses the sources of feedback reported in this paper, and explains some of the terminology used and how we have quantified feedback.

4 This paper does not ask the IASB for 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 6–9);

(b) an overview of the key messages in the feedback (paragraphs 10–17);

(c) summaries of the feedback on:

(i) the objective of management commentary (paragraphs 18–22);

(ii) focus on investors' information needs (paragraphs 23–27);

(iii) value creation and future cash flows (paragraphs 28–32);

(iv) the long-term time horizon (paragraphs 33–36); and

(v) management's perspective (paragraphs 37–40).

Exposure Draft proposals

6 The Exposure Draft proposed that the objective of an entity's management commentary is to provide material information that:

(a) enhances investors' 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.

7 The Exposure Draft further 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 make. Information in management commentary influences investors' decisions by influencing their assessments of:

(a) the entity's prospects for future cash flows; or

(b) management's stewardship of the entity's resources.

8 The Exposure Draft included the following supporting explanations:

(a) investors are the primary users of management commentary and while other parties—for example, the entity's employees, government agencies or members of the public—might also find management commentary useful, those other parties might have additional information needs and meeting such needs is not an objective of management commentary;

(b) the term 'ability to create value' refers to an entity's ability to create or preserve value for itself and hence for its investors (which some people refer to as 'enterprise value');

(c) an entity's activities create value if the enhance or preserve the present value of the entity's future cash flows;

(d) management commentary should include material information about the impacts of an entity's activities on other parties if those impacts could affect the entity's ability to create value for itself; and

(e) there are no prescribed timescales for periods management might choose to label as short-term, medium-term or long-term.

9 The Exposure Draft also stated that an entity's management commentary provides management's perspective of the factors that have affected the entity's financial performance and financial position, or that could affect the entity's ability to create value and generate cash flows in future:

(a) information in management commentary, including metrics, derives from information used by management;

(b) management commentary focuses on key matters identified by management; and

(c) the insights provided about the causes or implications of a matter reflect management's views.

Key messages in feedback

10 Most respondents commented on the proposed objective of management commentary. Most of these respondents supported the proposed objective, including the focus on investors' information needs and the concept of value creation set out in the Exposure Draft.

11 A few respondents broadly supported the proposed objective but recommended improvements, including explicitly referring to providing information for investors to assess management's stewardship of the entity's resources.

12 A few respondents who supported the focus on investors' information needs emphasised the need for connectivity with initiatives with a broader reporting focus, such as the EU proposals on sustainability reporting.

13 Some respondents, mainly academics and standard-setters focused on integrated or sustainability reporting, disagreed with the proposed objective of management commentary. They suggested the objective should be amended to address the information needs of a broader range of stakeholders and take a broader view of the concept of value creation. Many of these respondents advocated the approach taken in the International Integrated Reporting Council (now Value Reporting Foundation)'s International Integrated Reporting Framework (<IR> Framework).

14 A few of the respondents who agreed with the proposed objective of management commentary and the focus on investors' information needs questioned whether it is possible to draw a clear distinction between the information needs of investors and those of other stakeholders. In addition, many of those who disagreed with the proposed objective argued that addressing the needs of a broader range of stakeholders would provide better information to investors about factors that could affect the entity's ability to create value in the long term.

15 Some respondents suggested that the guidance on value creation should be more closely aligned with concepts in the <IR> Framework, in particular its discussion of how an entity creates value for itself by creating value for others.

16 Almost all respondents commenting on the proposed objective of management commentary supported the proposed reference to the ability to create value and generate cash flows ‘across all time horizons, including in the long term’.

17 Respondents commenting on management’s perspective, including almost all investors, emphasised the importance of management’s perspective in the identification of information, especially metrics, for inclusion in management commentary.

The objective of management commentary

Support for the proposed objective

18 Most respondents commented on the proposed objective of management commentary. Most of these respondents supported the proposed objective, including the focus on investors’ information needs and the concept of value creation set out in the Exposure Draft. These respondents commented that the proposed objective:

(a) is clear and appropriate;

(b) is consistent with:

  (i) the identification of investors as primary users of general purpose financial reports in the *Conceptual Framework for Financial Reporting*;

  (ii) the objective of management commentary set out in local laws and regulations; and

  (iii) current reporting practice;

(c) helps to distinguish the role of management commentary from the role of the financial statements;

(d) would encourage management to:

  (i) take a long-term view in discussing factors underlying the entity’s prospects;

(ii) explain a link between value created by the entity’s activities and the results reflected in the entity’s financial statements; and

(iii) provide context and management’s insights into the business to help investors make better assessments of the entity’s prospects.

> We expect the management commentary to provide us with that background information, so that we can construct a convincing story to support our future cash-flow projections for the company with confidence. *CL81 Corporate Reporting Users’ Forum*

Suggested improvements

19 A few respondents broadly supported the proposed objective of management commentary but recommended improvements, including:

(a) emphasising a particular aspect of the proposed objective:

(i) a few investors argued that management commentary should primarily focus on clarifying an entity’s financial performance and financial position reported in the related financial statements;

(ii) a few accountancy bodies and an accounting firm argued that the primary objective of management commentary should be to provide insight into factors that could affect the entity’s ability to create value and generate cash flows;

(b) capturing investors’ needs for information on matters that are not directly linked to the entity’s prospects for future cash flows but may nevertheless affect particular investment decisions (discussed further in paragraph 34 of Agenda Paper 15B *Feedback Summary—Investor feedback*);

(c) explaining the role of management commentary in integrating sustainability-related information with the information provided in the entity’s financial statements to provide a holistic view of the entity’s ability to create value; and

(d) emphasising the importance management's perspective (see paragraphs 37–40) by referring to providing investors with insight into how management manages and assesses the entity's performance, prospects and risks across different time horizons.

20 A few respondents observed that the proposed objective of management commentary did not include an explicit reference to assessing management's stewardship of the entity's resources, even though the Exposure Draft acknowledged that such an assessment could influence investors' decisions. These respondents suggested:

(a) incorporating in the objective of management commentary a requirement to provide information to help investors assess management's stewardship of the entity's resources; or

(b) explaining how the application of the proposed objective of management commentary, as well as the disclosure objectives for the areas of content, would result in providing information that is useful for assessing management's stewardship.

Disagreement with the proposed objective

21 Some stakeholders, mainly academics and standard-setters focused on integrated or sustainability reporting, disagreed with the proposed objective of management commentary. They suggested that the objective should be amended to:

(a) address the information needs of a broader range of stakeholders (see paragraph 27); and

(b) take a broader view of the concept of value creation (see paragraph 29).

22 Many of these respondents advocated the approach taken in the <IR> Framework.

Focus on investors' information needs

23 The respondents who supported the proposed objective of management commentary (see paragraph 18) also supported the focus on investors' information needs. These respondents argued that such a focus is consistent with:

(a) the role of investors as the providers of financial resources to the entity;

(b) the definition of the primary users of the general purpose financial statements that are complemented by management commentary;

(c) the intended focus of IFRS Sustainability Disclosure Standards to be developed by the International Sustainability Standards Board (ISSB); and

(d) the requirements of local securities regulations.

24 A few of the respondents who supported the focus on investors' information needs emphasised that this focus should not preclude connectivity with the EU proposals that aim at reporting on sustainability-related matters to a broader range of stakeholders and adopt the concept of 'double materiality'.

Note on terminology—double materiality

The European Commission's proposal for a Corporate Sustainability Reporting Directive describes 'double materiality' as the requirement for entities to report on both:

- how sustainability issues affect their performance, position and development (the 'outside-in' perspective); and
- the entities' impact on people and the environment (the 'inside-out' perspective).

The term 'double materiality' is also sometimes used to refer to an approach which seeks to address the information needs of a broader range of stakeholders in addition to investors.

25 The respondents calling for connectivity with the EU proposals recommended that the IASB should:

(a) confirm whether the concept of double materiality is compatible with the focus on investor needs.

> It might be helpful to clarify that following this double materiality concept in the management commentary is not contradicting the IASB's investor perspective. It would underline also the IASB's openness for an idea of connectivity between the global framework for management reporting and those advanced legislative proposals for sustainability reporting discussed intensively at EU level. *CL11 German Insurance Association*

(b) position the requirements for management commentary as a baseline that could be added to by regulators and national standard-setters.

> We recognise that focusing on investors, lenders and other creditors, is within the remit of the IASB and IFRS Foundation and consistent with the approach of the ISSB…
>
> In Europe there is an ambition of reporting to a broader range of stakeholders under a double materiality perspective. We support this ambition and suggest that the Practice Statement (or any future framework and standards) is flexible enough to provide a base that can be topped up easily. *CL14 Accountancy Europe*

26 Furthermore, a few of the respondents who supported the focus on investors' information needs questioned whether it is necessary or even possible to draw a clear distinction between the information needs of investors and those of other stakeholders.

> While we generally support the view that the primary users of management commentary should be the same as those for the financial statements, (i.e., existing and potential investors, lenders and other creditors), we are concerned that drawing too clear a distinction between the information needs of investors and those of other stakeholders is unhelpful. An overly narrow interpretation of materiality could run counter to the second objective of the management commentary: providing insight over the wide range of factors that could affect an entity's ability to create value over the short, medium and long term. *CL24 Association of Certified Chartered Accountants*

> Against the background of impact-related reporting and considering a long-term time horizon, are there inside-out effects that are not relevant or material for investors, and, if yes, to what extent? *CL39 Accounting Standards Committee of Germany (DRSC)*

27 As mentioned in paragraph 21, some respondents disagreed with the proposed objective of management commentary and argued that management commentary should address the information needs of a broader range of stakeholders. These respondents provided a range of reasons, including that a broader focus in management commentary would:

(a) provide better information to investors about factors that are difficult to quantify in the short term, but could affect the entity's ability to create value in the long term;

(b) be consistent with the current practice of those entities that use their management commentary for communication with a wider audience;

(c) be more efficient for preparers than producing multiple reports aimed at the information needs of different stakeholders, including regulators and government agencies;

(d) be appropriate for a broader range of entities, including state-owned enterprises and not-for-profit entities;

(e) promote a positive change in corporate behaviour through increased transparency of the impacts of the entity's activities on people and the environment; and

(f) support addressing societal and environmental concerns overlooked by investor-focused reporting.

> Several trends are converging to suggest that social and political demands will gradually erode the primacy of shareholders: a growing awareness of the consequences of neglecting the environment; the cost of inequality within and among nations; and more corporate collapses that mirror Enron, Worldcom, Parmalat and Carillion.

> This ED provides an opportunity to better align the respective interests of shareholders, creditors and the many other stakeholders. Trends in the relative importance of many stakeholder groups suggest the need for a wider audience for the Management Commentary that is not evident in the current ED. *CL12 University of Dundee*

Value creation and future cash flows

28 Most respondents commenting on the proposed objective of management commentary agreed with the concept of value creation as set out in the Exposure Draft.

29 However, as mentioned in paragraph 21, respondents who disagreed with the proposed objective of management commentary argued for a broader view of the concept of value creation.

> Businesses recognise that value creation for the enterprise is dependent on creating value for a range of stakeholders. However, research demonstrates that without explicit encouragement there is little disclosure of matters that are: a) not quantifiable in monetary terms; and/or b) unlikely to affect enterprise value in the short term. *CL3 Prof Carol Adams*

30 Furthermore, those few respondents who agreed with the proposed objective of management commentary but questioned whether it is possible to draw a clear distinction between the information needs of investors and those of other stakeholders (see paragraph 26), also emphasised that the entity's ability to create value for itself is dependent on its ability to create value for others.

31 Some respondents suggested that the discussion of the concept of value creation in the Exposure Draft would benefit from closer alignment with the concepts articulated in the <IR> Framework, in particular:

(a) explaining how an entity's ability to creates value for itself is linked to the value the entity creates for others;

(b) referring to 'value creation, preservation or erosion' to encourage a more balanced discussion of the entity's activities; and

(c) linking the concept of value creation, preservation or erosion to increases and decreases over time in the six forms of capital described in the [<IR> Framework] (namely financial, manufactured, intellectual, human, social and relationship and natural capitals) and not simply to the present value of future cash flows.

32 Furthermore, respondents had various suggestions on improving the terminology used to refer to an entity's ability to create value for itself, including:

(a) using a term such as 'enterprise value' throughout the document to distinguish creating value for the entity itself from the broader notion of creating value for other parties;

(b) clearly defining the term 'enterprise value' or else avoiding this term;

(c) collaborating with the ISSB on a consistent definition of terms such as 'value creation' and 'enterprise value'; and

(d) considering whether it is redundant to refer to an entity's ability to 'create value' *and* 'generate cash flows' if value creation is defined in terms of the present value of future cash flows.

Long-term time horizon

33 Almost all respondents commenting on the proposed objective of management commentary supported the proposed reference to the ability to create value and generate cash flows 'across all time horizons, including in the long term'. In particular, a few investors emphasised the need to understand factors that could affect the long-term prospects of the entity, including for periods beyond management's planning horizon.

34 However, a few other respondents, notably a standard-setter and an accountancy body, disagreed with the emphasis on factors that could affect the entity's ability to create

value and generate cash flows in the long term. These respondents argued that information about such factors can be misleading to investors as the entity's business environment and strategy are constantly changing and adjusting. Furthermore, a few Australian respondents highlighted the potential personal liability risk faced by directors in their jurisdiction from making forward-looking statements.

35 Almost all respondents commenting on the approach of not prescribing timescales for periods management might choose to label as short-term, medium-term or long-term supported this approach. However, a few respondents suggested the IASB should provide guidance on the notion of 'long term', in particular whether management commentary should discuss factors that could affect the entity beyond management's planning horizon.

> …if there is no guidance or prescription as to what 'long-term' means, we remain concerned that the excessive focus on short-term analysis at the expense of true long-term analysis will continue. *CL10 UK Financial Reporting Council*

36 Furthermore, a few respondents suggested that management should be required to specify in the management commentary how they define short term, medium term and long term.

Management's perspective

37 The Exposure Draft did not specifically ask respondents to comment on the notion of management's perspective. However, some respondents, including almost all investors, emphasised the importance of management's perspective in the identification of information, especially metrics, for inclusion in management commentary.

> …we believe there are missed opportunities to reinforce the importance of linking disclosures in management commentary to the actual data that management creates, curates, analyses and discusses as part of its

management of the business. There are several benefits to strengthening this link:

- It increases the likelihood that the data is entity-specific;
- It provides investors and creditors with an insight into management's perspectives and an understanding of what management spends its time focussed on;
- It reduces the reporting burden as management commentary should simply reflect data that management already has to hand…

We also believe that this additional focus will facilitate external assurance by linking management commentary more closely to what management actually focuses on in the performance of its role. *CL10 UK Financial Reporting Council*

38 Suggestions for enhancing the guidance on management's perspective include:

(a) as mentioned in paragraph 19(d), emphasising the importance of management's perspective in the objective of management commentary by referring to providing investors with insight into how management manages and assesses the entity's performance, prospects and risks across different time horizons; and

(b) articulating 'management's perspective' as a reporting principle, as was done in the 2010 version of the Practice Statement, or an attribute of useful information, instead of discussing it as an explanation supporting the objective of management commentary.

39 Furthermore, a few respondents, including many investors, highlighted the particular importance of management's perspective with regards to the requirements relating to metrics. Suggested enhancements to the proposals included:

(a) requiring management to report metrics that they regularly use; and

(b) explaining that an entity is not required to calculate and disclose metrics that are not used internally, apart from aggregating internally used metrics.

40 However, one investor argued that metrics established by industry bodies may also be useful to investors irrespective of whether management uses these metrics as they may be too aggregated for management's purposes.

Question for IASB members

Question for IASB members
Do you have any questions about or comments on the feedback reported in this paper?