

STAFF PAPER

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IASB® meeting

Project	Management Commentary		
Paper topic	Feedback summary—Objectives-based approach		
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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 overall objectives-based approach proposed in the Exposure Draft—whether it would provide a suitable and sufficient basis for:
 - (a) management to identify information that investors need; and
 - (b) auditors and regulators to assess an entity's compliance with the requirements of the Practice Statement (assurance and enforcement).
- 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 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 6–8);
 - (b) an overview of the key messages in the feedback (paragraphs 9–13);
 - (c) summaries of feedback on:
 - (i) the suitability and sufficiency of the approach as a basis for management to identify information that investors need (paragraphs 14–23);
 - (ii) the suitability and sufficiency of the approach as a basis for assurance and enforcement (paragraphs 24–30); and
 - (iii) steps the IASB could take to enhance the proposed objectives-based approach (paragraphs 32–33).

Exposure Draft proposals

- 6 The Exposure Draft proposed an objectives-based approach that specified an objective for management commentary (discussed in Agenda Paper 15C *Feedback summary—Objective of management commentary*), supported by:
- (a) requirements to provide information that meets specified disclosure objectives for six areas of content (discussed in Agenda Paper 15E *Feedback summary—Disclosure objectives and areas of content*);
 - (b) a requirement for management commentary to focus on key matters and provide material information (discussed in Agenda Paper 15F *Feedback summary—Key matters and material information*);
 - (c) further supporting requirements and guidance (to be discussed at a future meeting), including:

- (i) examples of possible key matters and of information, including metrics, that management commentary might need to provide to meet the disclosure objectives;
- (ii) the definition of ‘material information’ and guidance on making materiality judgements; and
- (iii) requirements for information to possess specified attributes—for example, completeness, balance and accuracy—and guidance to help management identify information that possesses those attributes.

7 Paragraphs BC69–BC71 of the Basis for Conclusions explained why the IASB proposed an objectives-based approach rather than a detailed and prescriptive list of disclosure requirements intended to meet most of the common information needs of investors in most circumstances (prescriptive approach). They explained that:

- (a) a prescriptive approach would require the IASB to identify all matters about which information is likely to be material to investors, and specify information to disclose about these matters; and
- (b) in the IASB’s view, identifying all such matters and information would not be feasible because:
 - (i) management commentary covers a broad range of matters that have affected an entity’s financial performance and financial position or could affect them in the future; and
 - (ii) the matters that might need to be discussed and the information that might be material about those matters is highly entity specific—it would depend on the industry in which the entity operates and the entity’s activities and circumstances.

8 The Invitation to Comment asked respondents if they expected that the proposed approach would be:

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

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

Key messages in feedback

- 9 Most respondents commented on the proposed objectives-based approach.
- 10 Most of these respondents—of all types, and including the investors and regulators commenting—supported the proposal that the approach should be objectives-based rather than prescriptive, and said they thought that the proposed approach would provide a suitable and sufficient basis for management to identify information that investors need.
- 11 However, some respondents said they thought management might find it difficult (at least initially) to identify the information needed to meet the disclosure objectives, due to the extent of judgement required, or that information provided solely on the basis of disclosure objectives would be less comparable than information provided to satisfy more prescriptive requirements.
- 12 A few standard-setters and investors expressed concern that, although the flexibility of an objectives-based approach would allow ‘best practice’ entities to tailor their management commentary to best meet investor needs, it could also enable other entities to avoid disclosing material (possibly unfavourable or commercially sensitive) information.
- 13 There were mixed views—among both accounting firms and other respondents—on whether the requirements of the proposed objectives-based approach would provide a suitable and sufficient basis for assurance and enforcement. Some respondents suggested the proposed approach could be strengthened by specifying some types (a ‘baseline’) of information that must always be disclosed if material—including information on topics that are of particular importance to investors.

Suitability and sufficiency as a basis for management to identify information investors need

Support

- 14 Most respondents commented on the overall objectives-based approach proposed in the Exposure Draft. Most of these respondents—of all types, and including the investors and regulators commenting—supported the proposal that the approach should be objectives-based rather than prescriptive, and said they thought that the proposed approach would provide a suitable and sufficient basis for management to identify information that investors need.
- 15 Investors supporting the proposed objectives-based approach said they thought that it could result in more useful entity-specific information than a prescriptive approach. They agreed that management is well placed to determine what matters are important for the entity’s prospects and should be discussed in the management commentary.
- 16 Other respondents supporting the proposed objectives-based approach expressed views that:
- (a) an objectives-based approach is particularly appropriate for management commentary. It supports universal application, giving entities the flexibility to reflect their industry, size, region and other unique attributes or circumstances, to tell their own unique story, and to adapt the information provided to respond to changes in circumstances. A prescriptive list of requirements is not appropriate for management commentary—it could never cover all the possible types of information an investor might need, could lead to important information being lost among more generic information, and could become out of date:

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

CL79 European Financial Reporting Advisory Group

- (b) the benefits of an objectives-based approach exceed its shortcomings and the shortcomings can be mitigated by applying existing industry-, activity- or topic-specific requirements or guidelines in conjunction with the Practice Statement requirements:

We acknowledge shortcomings to the proposed approach, namely that it undermines market calls for comparable information and can present implementation challenges, particularly in the materiality assessment and meeting the information needs of investors and creditors. ...

Notwithstanding the preceding challenges, we believe the benefits of the objectives-based approach far exceed its shortcomings, particularly as these shortcomings are readily mitigated. For example, **comparability** concerns can be resolved via existing industry, activity or topic-based standards (e.g. SASB Standards). To reduce or avoid **implementation** challenges, the Practice Statement helpfully provides illustrative guidance and examples via its *note*, *link* and *illustration* boxes. ... *CL5 Value Reporting Foundation*

- (c) developing specific rules-based requirements for management commentary is primarily the responsibility of legislators, securities regulators or national standard setters.

17 Some respondents—including investors, accounting firms, standard-setters and a regulator—highlighted particular features of the Exposure Draft proposals that they thought would help entities identify information that investors need. They referred to:

- (a) the combination of high-level and more specific disclosure objectives (discussed further in Agenda Paper 15E);
- (b) the requirements and guidance proposed to support the disclosure objectives—in particular, the examples of information that might be material proposed in Chapter 15 and in Appendix B—Long-term prospects, intangible resources and relationships and ESG matters; and
- (c) the compatibility of the proposed approach with some existing requirements and guidelines:

Members agree that the approach is capable of being generally operationalized and we did not identify material inconsistencies with IOSCO's international disclosure standards, principles and guidance.
CL25 International Organization of Securities Commissions

- 18 A standard-setter observed that the information required to apply the proposed approach should be readily available because it will be information that management uses to monitor and manage the business.

Concerns

- 19 Some respondents expressed concerns about suitability of the proposed objectives-based approach as a basis for identifying information investors need.
- 20 Some of these respondents suggested that:
- (a) management might find it difficult (at least initially) to identify the information needed to meet the disclosure objectives, due to the extent of judgement required; or
 - (b) information provided solely on the basis of disclosure objectives would be less comparable than information provided to satisfy more prescriptive requirements. An accounting firm suggested that an objectives-based approach could work better as a framework for local regulators than as requirements for preparers of management commentary—local regulators could use the framework as a tool and a starting point for developing more detailed local requirements:

We believe the proposals, such as disclosure objectives, are appropriate if they are intended as a Framework, but if ... the proposals are to have authoritative guidance, then the level of granularity of the proposals will need to be at a much higher level.

In our experience, disclosures based only on objectives tend not to be comparable between entities, even when drafted with good intentions.

CL9 EY

- 21 A few standard setters and investors suggested that, although the flexibility of an objectives-based approach would allow ‘best practice’ entities to tailor their management commentary to meet investor needs, it could also enable other entities to avoid disclosing material (possibly unfavourable or commercially sensitive¹) information. Entities might omit the information on the grounds that it is not used in managing the business or that it is not required to meet the disclosure objectives:

Despite the objectives-based approach of the current Practice Statement, the Basis for Conclusions (BC) describes a number of implementation shortcomings that have been identified in practice (BC5). However in proposing revisions that maintain the current objectives-based approach with very minimal prescription, there is a strong risk that these shortcomings will not be resolved. This is because the underlying presumption appears to be that when inadequate disclosures are being made, it is because management has a lack of understanding as to what it should be disclosing. Following this thinking then suggests that providing additional guidance should help to resolve the issue. However in practice the reasons for deficiencies in management commentaries are likely to be more varied and complex than a lack of appropriate guidance:

- There may be concerns by management that certain information is commercially sensitive or confidential and as such should not be disclosed;
- Management may not prioritise the management commentary and as such they may do the minimum necessary preparation by 'rolling over' last year's commentary and reverting to boiler-plate disclosures;
- Management may consider that the less entity-specific detail they provide the less scrutiny they will be subject to;
- Management may not feel comfortable disclosing too much forward-looking data as it is not verifiable and may open them up to criticism if they 'get it wrong';
- Management may see the management commentary as a compliance exercise which requires new content to be created, rather than seeing it as the opportunity to provide management's true perspective and views.

¹ Feedback relating to disclosure of commercially sensitive information is discussed further in Agenda Paper 15E *Feedback summary—Disclosure objectives and areas of content*.

If the shortcomings observed arise due of any of the reasons above, then they will not be resolved by providing additional objectives-based guidance. *CL10 UK Financial Reporting Council*

- 22 A few respondents said they thought the proposed objectives-based approach is too complex for preparers to understand and apply well. These respondents were concerned about specific aspects of the approach—for example, the design of the disclosure objectives, or the requirement to focus on key matters. Their concerns are discussed in more detail in Agenda Papers 15E and 15F.
- 23 A standard-setter suggested that a checklist of required information provided by local regulators would be easier for entities to implement.

Suitability and sufficiency as a basis for assurance and enforcement

- 24 Many respondents of all types commented on assurance of management commentary and enforcement of the Practice Statement requirements.

Whether the IASB should be aiming to provide a suitable and sufficient basis for assurance and enforcement

- 25 Respondents expressed differing views on whether and to what extent the IASB should be aiming for requirements that would provide a suitable and sufficient basis for assurance and enforcement:
- (a) an accountancy body questioned the need for external assurance of management commentary as a whole. It suggested that investors need (and preparers often already obtain) assurance of quantitative performance information like metrics, and that the credibility of other information in management commentary can be demonstrated by disclosing information about the processes management uses to ensure compliance with requirements, and about the governance of those processes; but

- (b) an accounting firm suggested that there is now an increasing demand for broader-scope assurance and that the IASB can play a role in facilitating it:

While some of the information included in management commentary (such as metrics not covered by statutory audit) is already often a part of stand-alone assurance engagements, we note an increasing demand from users and preparers for broadening the scope of these engagements. ...

The growing trend towards mandatory assurance in corporate reporting is evidenced by its inclusion in the European Commission's Corporate Sustainability Reporting Directive (CSRD) consultation and its reflection in the IAASB's project on extended external reporting. We recognise the Board has an important role to play in advancing the foundations for robust assurance in this area by providing requirements that are clear, and therefore enforceable. *CL68 Deloitte*

- 26 While an accountancy body suggested that it is uncertain at this stage whether regulators would seek to require compliance with the Practice Statement, the International Organisation of Securities Commissions noted that some regulators might decide to require compliance in future, so the Practice Statement should be drafted in a way that would enable them to do so.

Whether the proposed approach would provide a suitable and sufficient basis for assurance and enforcement

Support

- 27 Some respondents—including some of the accounting firms commenting—said they thought that the proposed approach would provide a suitable and sufficient basis for assurance and enforcement. A few of these respondents explained their view, suggesting that:

- (a) the structured requirements—which include areas of content, disclosure objectives, requirements to focus on key matters and extensive illustrative examples—would provide the basis auditors and regulators need:

The proposed approach should enable an assurance provider to engage with management and [those charged with governance] as to whether the information is relevant to investors and creditors and whether it is material. *CL21 KPMG*

- (b) much of the information in management commentary—for example, metrics—is verifiable. And even though some information—for example, explanations or forward-looking information—is not directly verifiable, auditors could check the underlying assumptions, and the processes for producing the information.
- (c) an entity’s internal audit function can help check the processes and controls used to identify material information and make judgements:

We believe an objective-based approach can be both operationalized and enforced. Organizations should use their internal audit activity to gain independent internal assurance on the design and effectiveness of processes, inclusive of internal controls, put in place to reasonably meet the objectives of *management commentary*. Organizations can also use their internal audit activity to assess readiness for any external audits. *CL26 The Institute of Internal Auditors*

- 28 An accounting firm observed that entities would need to develop and maintain adequate documentation of, and controls over, the processes they use to determine the information reported in their management commentary—judgement, strong governance and controls would be needed to ensure that an entity’s management commentary disclosed material information with the attributes described in Chapter 13 of the Exposure Draft.

Concerns

- 29 Some respondents—including some of the accounting firms and the few regulators commenting—expressed doubt that the proposed approach would provide a suitable and sufficient basis for assurance or enforcement. Respondents suggested that:
- (a) determining the quantity and type of information required to meet disclosure objectives, which requires significant judgement, would be very challenging and time consuming, leading to excessive costs and tensions between companies and auditors or regulators;
 - (b) it could be difficult, if not impossible, for auditors or regulators to reach consistent views on the amount and type of information needed, potentially undermining the credibility of any assurance given—the requirements might not be specific enough for consistent enforcement; or
 - (c) auditors and regulators could struggle to assess some of the subjective judgements in management commentary—they are unable to observe the processes used to make subjective judgements, and do not necessarily have access to all the sensitive information on which judgements are based.
- 30 A few respondents suggested that there are inherent limitations to the nature of external assurance that is possible for some types of information in management commentary—for example, forward-looking or highly subjective information—until entities develop the necessary systems, processes and controls, there will be inherent challenges in assessing compliance with requirements to provide such information:

We are, in principle, supportive of management commentary being subject to independent external assurance. However, there are well documented practical challenges around providing assurance over non-financial, narrative and forward-looking information. Therefore, we have concerns in relation to the auditability of management commentary until such time that reporting systems and processes reach a sufficient level of maturity. *CL37 CPA Australia and Chartered Accountants Australia and New Zealand*

- 31 A preparer expressed a view that the IASB had gone too far in attempts to make the proposed approach enforceable and that, as a result, the proposed approach gives too little flexibility to management to provide the most useful information to investors.

Steps the IASB could take to enhance the proposed objectives-based approach

- 32 Some respondents suggested steps the IASB could take to enhance the effectiveness of the proposed objectives-based approach (both in providing information that investors need and as a basis for assurance and enforcement). Suggestions included:

- (a) specifying some types (a ‘baseline’) of information that must always be disclosed if material—including information on topics, that are of particular importance to investors, for example management’s capital allocation strategy or management compensation:

We suggest that, in addition, the disclosure objectives are supported by requirements for certain information which, if it is material, must always be disclosed. This would result in the advantages of overall disclosure objectives being preserved, while at the same time bringing greater comparability among different entities. *CL57 BDO*

- (b) working with the International Auditing and Assurance Standards Board and other stakeholders to ensure the ‘assurance readiness’ of the Practice Statement—for example, to ensure that it provides criteria that would be judged as suitable for assurance:

The IASB must work in collaboration with the IAASB and other stakeholders to ensure the finalized Practice Statement is consistent with requirements (e.g., suitable criteria, appropriate subject matter, and sufficient/appropriate evidence) that support high-quality assurance of the information it addresses. *CL64 International Federation of Accountants*

- (c) strengthening the link between the information management is required to report in management commentary and the information it creates, curates, analyses and discusses in managing the business. Strengthening this link would increase the likelihood that the information is entity-specific, reduce the reporting burden on management and make the information more amenable to external assurance:²

Providing data and information that management actually uses would provide a useful insight into what management focuses on. For some entities, the management's focus will meet the expectations of investors and creditors but if it doesn't, this in itself is useful information. It would allow stakeholders to hold management to account if they feel that management's focus is not on the key matters. Furthermore, this information is much more amenable to external assurance as it can be verified from documentation circulated and recorded for management meetings. *CL10 UK Financial Reporting Council*

- (d) making a clearer distinction between requirements and non-mandatory guidance, which respondents suggested are mixed in the Exposure Draft.
- (e) adding more guidance, or publishing educational material, to assist preparers in applying the objectives-based approach. A few respondents specifically suggested adding diagrams to help preparers navigate the process of applying the various interconnected features of the approach—disclosure objectives, areas of content, key matters and materiality.

- 33 A few respondents suggested that the IASB field test the proposed approach before reaching conclusions on its operability or enforceability.

² See Agenda Paper 15C *Feedback summary—Objective of management commentary* for further discussion of feedback on the notion of management's perspective

Question for IASB members

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