STAFF PAPER

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IASB® meeting

Project	**Management Commentary**
Paper topic	Feedback summary—Disclosure objectives and areas of content

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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:

(a) the six areas of content for which disclosure objectives were proposed; and

(b) the disclosure objectives proposed for those areas of content.

3 This paper summarises the main comments received. Other comments on specific details of the proposed areas of content and disclosure objectives will be discussed at a future meeting.

4 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.

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

Structure of paper

6 This paper includes:

(a) a recap of the Exposure Draft proposals (paragraphs 7–12);

(b) an overview of the key messages in the feedback (paragraphs 13–16);

(c) summaries of the feedback on:

(i) the design of the disclosure objectives (paragraphs 17–29);

(ii) the areas of content and the disclosure objectives for those areas of content (paragraphs 30–41); and

(iii) disclosure of commercially sensitive information (paragraphs 42–51).

Exposure Draft proposals

7 The Exposure Draft proposed disclosure objectives for six areas of content:

(a) the entity's *business model*;

(b) management's *strategy* for sustaining and developing that business model, including the opportunities management has chosen to pursue;

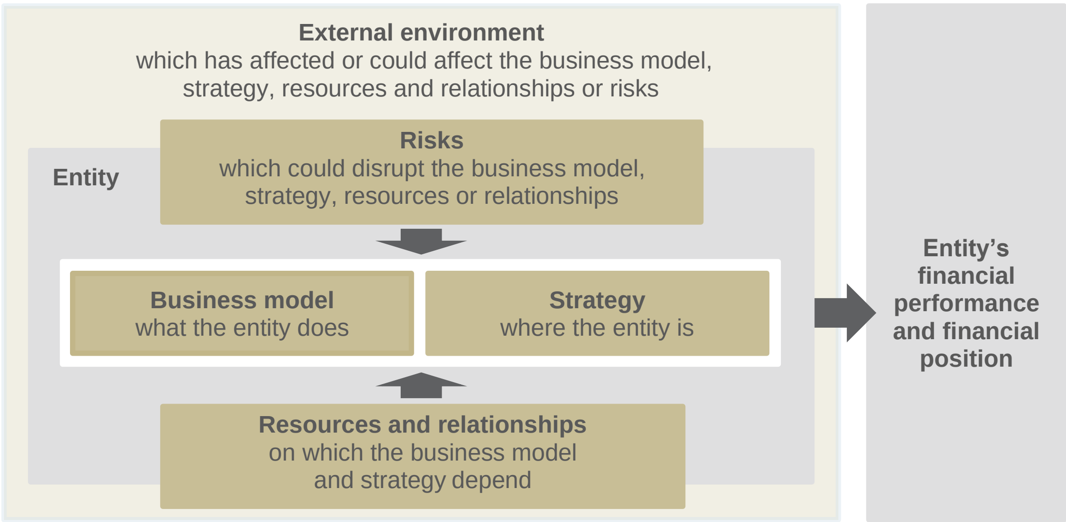
(c) the entity's *resources and relationships*, including resources not recognised as assets in the entity's financial statements;

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

(e) the entity's *external environment*; and

(f) the entity's *financial performance and financial position*—including how they have been affected or could be affected in the future by the matters discussed for the other areas of content.

Figure 1—Relationships between the six areas of content in management commentary



8 For each area of content, the disclosure objectives included three components:

(a) a headline objective—describing the overall information needs of investors for the area of content;

(b) assessment objectives—describing the assessments that rely on information provided for the area of content; and

(c) specific objectives—describing the detailed information needs of investors for the area of content.

9 The headline and specific objectives would require information that enables investors to understand a particular matter, for example how the entity's business model creates value and generates cash flows. The assessment objectives would require this information to provide a sufficient basis for investors to assess a particular matter—for example, the extent to which the entity's business model and management's strategy for sustaining and developing that model depend on particular resources and relationships.

10 The Exposure Draft referred in several places to the interrelationships between the areas of content. For example, a note following paragraph 4.5 of the Exposure Draft explained that:

> The areas of content are interrelated. Information provided to help meet the disclosure objectives for one area might also help meet the disclosure objectives for other areas.

11 The Basis for Conclusions on the Exposure Draft explained that the disclosure objectives are intended to help an entity's management identify entity-specific information that needs to be included for management commentary to meet its objective, and for providers of external assurance and regulators to assess whether the information provided meets that objective.

12 The proposal for objectives-based disclosure requirements for management commentary is generally consistent with the IASB's proposal for objectives-based disclosure requirements for financial statements, as set out in the IASB's Exposure Draft *Disclosure Requirements in IFRS Standards—A Pilot Approach* (proposed Pilot Approach). However, the disclosure objectives proposed for financial statements had only two tiers—overall objectives and specific objectives—accompanied by *observations* about the matters that the disclosure objectives are intended to help investors assess. The proposed disclosure objectives for management commentary include assessment objectives set out as *requirements* to create an effective basis for assessing compliance with the Practice Statement.

Key messages in feedback

13 Most respondents commented on the design of the disclosure objectives. Many of those respondents—including almost all the investors commenting—supported the design.

14 However, many others—including most of the preparers commenting—expressed concerns about it, their main concern being that the proposed three-tier structure could be complex and burdensome for preparers of management commentary to understand and apply. Some respondents suggested simplifying the structure by eliminating the assessment objectives or merging them with the specific objectives or headline objective, noting that the resulting two-tier structure would be better aligned with

disclosure objectives proposed for financial statements in the proposed Pilot Approach.

15 There was broad support for the proposed areas of content and for the disclosure objectives proposed for those areas of content, with investors stating that these objectives correctly identify the information that investors need. However:

(a) some respondents suggested adding ‘governance’ as a distinct area of content, and some suggested incorporating explicit requirements for governance-related information throughout requirements for areas of content; and

(b) some respondents suggested broadening the ‘risks’ area of content to include both risks and opportunities.

16 Some respondents commented on disclosure of commercially sensitive information:

(a) a few investors expressed concern that the flexibility of the proposed objectives-based approach could allow management to avoid disclosing material unfavourable or entity-specific information, by claiming the information is commercially sensitive or confidential.

(b) some other respondents—mainly national standard-setters—suggested adding an exception permitting entities to omit commercially sensitive information from management commentary. They argued that disclosure of some material but commercially sensitive information could undermine an entity’s competitive position, and that the absence of an exception could discourage adoption of the Practice Statement.

Design of disclosure objectives

17 Most respondents commented on the design of the disclosure objectives.

Support

18 Many of those respondents—including almost all the investors and some standard-setters, accounting firms and accountancy bodies commenting—expressed complete or broad support for the proposed design. A few referred to specific aspects of the design that they supported: the three-tier structure, the inclusion of assessment objectives, or both.

19 As reported in paragraph 40 of Agenda Paper 15B *Feedback summary—Investor Feedback*, most of the investors commenting on the operationality of the proposed objectives-based approach expressed a view that the three-tiers disclosure objectives would provide sufficient granularity and specificity for management to identify information that investors need.

> We think the proposed design of the disclosure objectives is well structured with the proposed three components. They appear to cover successfully and sufficiently the common information needs of investors and creditors in general. By following the three disclosure objectives: headline, assessment, specific, in that order, management are likely to identify the information they should disclose in the management commentary. *CL81 Corporate Reporting Users' Forum*

Concerns

20 Although many respondents supported the proposed design of the disclosure objectives, many others—including most of the preparers, some standard-setters, some accounting firms, some accountancy bodies and a few investors commenting—expressed concerns about the design, or aspects of the design.

21 Some respondents expressed concerns about the proposed three-tier structure, suggesting that:

(a) it could be complex and burdensome for preparers of management commentary to understand and apply. Some suggested the assessment objectives are not necessary because most of the required information will be identified by reference to the specific objectives (which are more operational), and any missing information will be identified by reference to the headline objectives (which prompt management to step back and consider whether the information as a whole meets investors' information needs for that area of content); or

(b) multiple tiers of disclosure objectives could increase the volume and complexity of information provided, with the possible result being less useful information. Respondents suggested that:

(i) when there are too many tiers, objectives can assume the appearance of a checklist, leading to less focus on important matters; or

(ii) there could be 'disclosure overload' in early years of application, while preparers of management commentary were unsure exactly what information they were required to provide to meet all the disclosure objectives.

22 A few respondents said they thought that the assessment objectives could be unworkable. They suggested management cannot be expected to judge what information various and unknown investors will need to make their assessments. Some of those respondents expressed a view that different investors need different information, and assessment practices might change over time. Some suggested that the judgement about investor needs is the responsibility of standard-setters.

23 A standard-setter suggested that the assumption that management can positively assert that it has provided sufficient information for investors to make assessments may introduce litigation risk.

24 A few respondents—including investors—noted that some preparers of management commentary may at first find it challenging to identify the information needed to 'provide a sufficient basis' for investors' assessments as required by the assessments objectives.

Comparison with the IASB's proposed Pilot Approach

25 Some respondents—mainly standard-setters—compared the disclosure objectives proposed in the Exposure Draft with those proposed for financial statements in the proposed Pilot Approach.

26 Most of the respondents highlighting the differences suggested the designs should be consistent (see paragraph 27). A few respondents noted that there could be valid reasons for differences—and that both sets of proposals are at an early stage of development—but even they urged the Board to reconsider whether disclosure objectives more like those proposed for financial statements could be sufficient to ensure the enforceability and auditability of information in management commentary.

Suggestions for alternative designs

27 Some respondents suggested simplifying the structure of the disclosure objectives by omitting the assessment objectives or merging them with the specific objectives or headline objective. In favour of such a simplification, some respondents argued that a two-tier structure:

(a) would be easier to apply;

(b) could result in more succinct management commentary; or

(c) would be better aligned with:

(i) the structure of the objectives in the proposed Pilot Approach; or

(ii) the structure of requirements in the Integrated International Reporting Council (now Value Reporting Foundation)'s International Integrated Reporting Framework (<IR> Framework).

28 A few respondents suggested a one-tier structure—an accounting firm suggested retaining only the specific objectives and an accountancy body suggested focusing on the headline objectives.

29 A few respondents—mainly preparers—suggested that some of the disclosure objectives read like a checklist of requirements, not objectives. Some of those respondents suggested that the specific objectives be recharacterised as examples of information that might be required to meet the headline objectives.

Areas of content and disclosure objectives for those areas of content

Overall support—areas of content and disclosure objectives

30 There was broad support for the proposed areas of content and for the disclosure objectives proposed for those areas of content. Most respondents commented on these aspects of the proposals, and of those commenting, most respondents of all types expressed unqualified support or suggested only limited changes.

31 Almost all investors providing views on the Exposure Draft commented on the proposed disclosure objectives and stated that these objectives correctly identify the information that investors need. Some of those investors highlighted:

(a) the close alignment of the areas of content with the key areas for which investors need information, and of the disclosure objectives with the types of information investors need.

> All six areas of content are essential for financial statement users to understand the company's ability to generate cash flows in the future and to construct their own story, or underlying assumptions, to support their forecasts of future cash flows. *CL81 Corporate Reporting Users' Forum*

(b) the emphasis given to sustainability risks, long-term risks and the long-term resilience of the business model.

(c) the greater usefulness to investors of information about all the matters covered by the six areas of content when that information is presented in one report in a coherent way.

32 In explaining their support, other types of stakeholders highlighted:

(a) the relevance of the areas of content to an evaluation of the sustainability of an entity's performance, and to an evaluation of risk.

(b) the comprehensiveness of the areas of content.

> As drafted, we were unable to identify any situations that could not logically and appropriately be considered under one of those elements. CL59 *Grant Thornton*

(c) the compatibility of the areas of content with those specified by national requirements.

> From a UK perspective, at the top level, the IASB's areas of content align with those currently in the Strategic Report which would enable consistency between the UK requirements and the Practice Statement. *CL10 UK Financial Reporting Council*

(d) their view that the specific objectives are pitched at the right level. An accounting firm suggested that specific objectives more prescriptive than the objectives proposed in the Exposure Draft could lead to template-driven thinking.

(e) the benefits of including disclosure objectives relating to progress within all areas of content instead of creating a separate area of content for progress (as the current Practice Statement does). A standard-setter suggested this approach better reflects the dynamic nature of information about each of the areas of content.

33 A few respondents also commended the emphasis in the Exposure Draft on the interrelationships between the areas of content:

> We believe it is very important to emphasize the way in which the six areas of content are connected and support the other areas, since that will give coherence to management commentary. This is a key feature of the [Practice Statement] that we believe is very well articulated. *CL23 Consejo Mexicano de Normas de Información Financiera (CINIF)*

Suggestions for changes to the areas of content

34 Many respondents—including many standard-setters, accountancy bodies, accounting firms and investors—suggested adding requirements to provide governance-related information in management commentary. Some of those respondents suggested adding governance as a distinct area of content and some suggested incorporating explicit requirements for governance-related information throughout requirements for areas of content. Feedback on requirements for governance-related information will be discussed in more detail at a future meeting.

35 Some respondents of all types suggested broadening the ‘risks’ area of content to include both risks (possible future developments or events that could *negatively* affect the achievement of an entity’s aims) and opportunities (possible future developments or events that could *positively* affect the achievement of those aims). Respondents argued that:

(a) although opportunities are covered in the ‘strategy’ area of content, within that area of content the term is used with a meaning other than ‘upside potential’. It is used to mean the options, possibilities or paths that management has chosen to pursue. Referring only to opportunities linked to the strategies management has chosen to pursue is, they argued, too restrictive.

(b) if the Practice Statement gives insufficient prominence to future developments and events with upside potential, there is a possibility that an entity’s management commentary will provide an incomplete and unbalanced view of the uncertainties affecting the entity’s future prospects.

(c) it is important to acknowledge that some of the most important contemporary risks—for example, climate change—could have both downside and upside potential.

36 In contrast, a few investors expressed support for the proposals to identify risks (but not opportunities) as a separate area of content, and include disclosure objectives for information about opportunities within the strategy area of content. These investors suggested that:

(a) structuring the requirements in this way could help to counteract the tendency for management commentary to place undue emphasis on positive aspects of the entity's performance and prospects; and

(b) the opportunities that are most relevant to an assessment of an entity's future prospects are those that management has chosen to pursue.

37 A few respondents suggested that information about the entity's financial performance and financial position is of primary importance for investors, so that information should play a central role in management commentary. For that reason:

(a) an accountancy body suggested removing 'financial performance and financial position' from the areas of content and instead framing all the other areas of content in terms of their effect on the entity's financial performance and financial position; and

(b) a few investors expressed a view that information relating to the other five areas of content should be provided only to the extent necessary to assess how matters relating to these areas of content have affected the entity's financial performance and financial position, and how they will contribute to the entity's prospects for creating value and generating cash flows.

38 A few respondents suggested areas of content different from those proposed in the Exposure Draft:

(a) a group representing preparers suggested aligning the areas of content with the 'core pillars' in the recommendations of the Task Force on Climate-Related Financial Disclosures. The group noted that some countries have already mandated compliance with those recommendations, and that the Climate-Related Disclosures Prototype requirements developed for consideration by the International Sustainability Standards Board build on the recommendations. The group argued that alignment could improve the operability of the Practice Statement and facilitate uptake around the world.

(b) a few, mainly South African, respondents suggested aligning the areas of content with those in the [<IR> Framework], which includes 'governance', ‘outlook’ and ‘basis of preparation and presentation’ as separate areas of content.

39 Other suggestions included:

(a) adding ‘prospects’ as a separate area of content, on the grounds that management’s view of the entity’s future development is a core element of management commentary, and information on that topic would be more understandable if presented in one place, and separately from other information. The group of academics suggested that information specified for a ‘prospects’ area of content could be non-mandatory, to accommodate the needs of entities in jurisdictions where providing some forward-looking information might be a problematic.

(b) requiring an entity’s management commentary to discuss the entity’s overall purpose and the ongoing relevance of its purpose—such information would provide an anchor for information relating to the other areas of content.

(c) consolidating the six areas of content into four—business model, strategy, risk and financial performance

Suggestions for changes to the disclosure objectives

40 As reported in paragraph 46 of AP15B, some investors suggested giving greater prominence to specific information that is of particular importance to investors—for example, information about management’s funding and capital allocation strategies and metrics that play a role in determining management compensation.

41 Some respondents made more specific suggestions for additional disclosure objectives or refinements to some of the proposed disclosure objectives. Their suggestions will be discussed at a future meeting.

Disclosure of commercially sensitive information

Exposure Draft proposals

42 The Exposure Draft proposed no exception for commercially sensitive information. Paragraph BC113 of the Basis for Conclusions explained that:

> The Board's Management Commentary Consultative Group discussed whether there should be an exception permitting an entity not to disclose information that is material but commercially sensitive. Members of the Consultative Group expressed mixed views. Furthermore, the disclosure requirements of IFRS Standards do not generally include exceptions for commercially sensitive information: there is an exception in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, which applies only to 'extremely rare' cases in which disclosure of information could prejudice seriously the entity's position in a dispute with other parties.

Feedback

Views of investors and regulators

43 As reported further in paragraphs 39–40 of Agenda Paper 15B, a few investors, while expressing overall support for the proposed objectives-based approach, expressed concern that even without an explicit exception for commercially sensitive information, the flexibility of that approach could allow management to avoid disclosing material unfavourable or entity-specific information by claiming the information is commercially sensitive or confidential.

44 In particular, some of those investors were concerned that entities may be reluctant to provide material information about key aspects of management's strategy to sustain and develop the entity's business model, about specific management targets, or about the entity's key resources and relationships—for example, about who the entity's major suppliers are, how dependent the entity is on those suppliers and how the entity manages its relationships to minimise the risk of over-dependence.

> For example, when discussing matters of strategy, it seems highly likely that some companies will choose to omit significant amounts of information that would be useful to investors by claiming that it is 'confidential' and / or 'commercially sensitive'. We note that already a number of FTSE 100 companies refuse to disclose management performance metrics for the coming year in their annual report on the basis that the information is commercially sensitive. This is important information for shareholders and the refusal to disclose the information until the end of the year when the pay award has already been made makes a complete nonsense of the concept of performance-related pay. CL28 *UK Shareholders' Association and ShareSoc*

45 A regulator and a few standard-setters expressed a similar concern:

> However, we do expect some resistance from preparers to provide some of the proposed information due to strategic reasons. We understand this will require a deep cultural change in some jurisdictions. *CL30 Securities and Exchange Commission of Brazil*

Disclosure that commercially sensitive information has been omitted

46 A few respondents noted that, if the requirements do not include an exception for commercially sensitive information, entities that omit material information on grounds of commercial sensitivity would not be able to make an unqualified statement of compliance with the requirements of the Practice Statement. A standard-setter suggested that, as a consequence, qualified statements could be commonplace.

47 An accounting firm suggested requiring entities that depart from the requirements of the Practice Statement on commercial sensitivity grounds to disclose in the 'basis of preparation' section that they have done so, and explain why. The firm said it expected such departures to be a rare occurrence because IFRS Standards do not offer relief from disclosing information on commercial sensitivity grounds.

Requests for exception

48 Some respondents—mainly national standard-setters but also a few accountancy bodies and preparers of financial statements—suggested adding an exception for commercially sensitive information. In support of this view, they argued that:

(a) disclosure of some material information—in particular, about an entity's resources and relationships or management's strategy for sustaining and developing the entity's business model—could undermine the entity's competitive position, which would ultimately harm investors.

(b) without an exception for commercially sensitive information, the Practice Statement might be viewed as commercially naïve. The absence of an exception could discourage adoption of the Practice Statement.

(c) although in most circumstances, an entity should be able to disclose commercially sensitive information at a sufficiently high level to avoid prejudicing its interests, a limited exception is needed for the circumstances in which that is not possible.

(d) the arguments in the Basis for Conclusions are inconclusive. They acknowledge the exception in IAS 37 for information in financial statements. There could be a greater need for an exception for management commentary—both qualitative and quantitative information in management commentary could be commercially sensitive.

49 Suggestions for exceptions included:

(a) providing an exception like that in IAS 37 for information whose disclosure would seriously prejudice the interests of the entity;

(b) limiting such an exception to information about impending developments or matters in the course of development; or

(c) combining an exception with a requirement to disclose summarised information about the matter if such information could be disclosed without seriously prejudicing the interests of the entity.

50 A group representing preparers in Australia suggested providing an exception for information that could result in ‘unreasonable prejudice’. Regulatory guidance for management commentary in Australia suggests that the consequences would be unreasonable if, for example, disclosing the information is likely to give third parties (such as competitors, suppliers and buyers) a commercial advantage, resulting in a material disadvantage to the entity.

Other comments

51 A standard-setter suggested that, whatever the IASB decides, the Practice Statement should avoid ambiguity by explicitly stating its requirements regarding disclosure of commercially sensitive information.

Question for IASB members

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