23 November 2021

Dr Andreas Barckow
Chair
International Accounting Standards Board
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Via online submission: www.ifrs.org

Dear Dr Barckow

Submission on IFRS Practice Statement Exposure Draft ED/2021/6 Management Commentary

As the representatives of over 300,000 professional accountants in Australia, New Zealand and around the world, CPA Australia and Chartered Accountants Australia and New Zealand (CA ANZ) thank you for the opportunity to comment on the above Exposure Draft ("the ED").

In principle, CPA Australia and CA ANZ support the development, improvement and consolidation of reporting frameworks that focus on information that users need and which enable an entity to tell its whole story. An objectives-based framework for management commentary provides a useful structure. IFRS Practice Statement 1 *Management Commentary* (2010) ("the Practice Statement") has no authoritative status in Australia or New Zealand. Therefore it has been challenging to garner significant interest from our members and other stakeholders on the ED.

Many of our members are confused about the timing of this ED in terms of its interrelation with the work that will be conducted by the International Sustainability Standards Board (ISSB). With the recent formation of the ISSB and the consolidation of the Climate Disclosure Standards Board (CDSB) and the Value Reporting Foundation (VRF) into this new board, we believe that it will eventually be well positioned to draw on the CDSB's and VRF's experience to further develop management commentary, which has similar objectives to the Integrated Reporting Framework. We strongly urge the IASB to defer this project until such time as the ISSB is firmly established. It should then work collaboratively with the ISSB to ensure the project is complementary to both work streams.

In our view a significant amount of work still needs to be done to further inform the development of the ED, and so reiterate the need to defer this project. For example, as currently drafted, it is not overly intuitive from a preparers' perspective how the disclosure objectives, areas of content, attributes, key matters and materiality all fit together. This gives rise to the risk of inconsistent application. We encourage a reconsideration of the structure of chapters and most importantly, the development of implementation guidance including a diagram that demonstrates the connections between the various aspects.

Given the ED presents a comprehensive revision, we recommend the IASB conduct field testing of the proposals in jurisdictions that have promoted the Practice Statement. In our view, this is critical to providing necessary insights into the practical application of the proposals. In addition to the field testing, research on the following may also assist the project:

- the reasons why various jurisdictions have or have not adopted the 2010 Practice Statement, and
- understanding how to effectively deliver such information given the rapid shift in how stakeholders are consuming information.

In Australia, management commentary comes in the form of an Operating and Financial Review (OFR). From an audit perspective it is treated as 'other information' in accordance with ISA 720 *The Auditor's Responsibilities Relating to Other Information*. In New Zealand, there is no regulatory framework for management commentary, but where it is provided in the annual report it is treated in the same way.

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.

Notwithstanding our recommendation to defer the project, we provide our comments based on the ED as requested. Our detailed responses to the questions raised in the ED are included in the **Attachment** to this letter. If you have any questions about our submission, please contact either Dr John Purcell (CPA Australia) at john.purcell@cpaaustralia.com.au or Amir Ghandar FCA (CA ANZ) at amir.ghandar@charteredaccountantsanz.com.

Your sincerely

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Attachment

Question 1 – The financial statements to which management commentary relates

Paragraph 2.2 proposes that management commentary identify the financial statements to which it relates. That paragraph further proposes that, if the related financial statements are not prepared in accordance with IFRS Standards, the management commentary would disclose the basis on which the financial statements are prepared. The Exposure Draft does not propose any restrictions on the basis of preparation of the related financial statements (for example, it does not propose a requirement that financial statements be prepared applying concepts similar to those underpinning IFRS Standards). Paragraphs BC34–BC38 explain the Board's reasoning for these proposals.

(a) Do you agree that entities should be permitted to state compliance with the revised Practice Statement even if their financial statements are not prepared in accordance with IFRS Standards? Why or why not?

(b) Do you agree that no restrictions should be set on the basis of preparation of such financial statements? Why or why not? If you disagree, what restrictions do you suggest, and why?

(a) No, we believe that entities should only be permitted to state compliance with the Practice Statement when the financial statements are prepared in accordance with IFRS-based Standards. In Australia and New Zealand, this would include entities without public accountability. While these entities are not permitted to state compliance with IFRS Standards, the accounting standards have the same recognition and measurements requirements as IFRS Standards, albeit with reduced disclosure requirements.

(b) No, in our view, entities preparing financial statements using an alternative framework that is not consistent with IFRS Standards should not be permitted to state compliance with the Practice Statement because they are prepared for a limited or specific purpose. In such instances, we see the reporting objectives as being incompatible.

Question 2 – Statement of compliance

(a) Paragraph 2.5 proposes that management commentary that complies with all of the requirements of the Practice Statement include an explicit and unqualified statement of compliance. Paragraphs BC30–BC32 explain the Board's reasoning for this proposal. Do you agree? Why or why not?

(b) Paragraph 2.6 proposes that management commentary that complies with some, but not all, of the requirements of the Practice Statement may include a statement of compliance. However, that statement would be qualified, identifying the departures from the requirements of the Practice Statement and giving the reasons for those departures. Paragraph BC33 explains the Board's reasoning for this proposal. Do you agree? Why or why not?

(a) Yes, we agree with the proposal. However, we are concerned that the assessment process is too subjective, especially for 'information with attributes specified' as stated in paragraph BC32(c). The Practice Statement needs to clarify which areas and elements represent these requirements. At present, the information is in the Basis for Conclusions paragraph BC32 which is not appropriate.

We understand from assurance practitioners that complying with the verifiability attribute is a concern. Meeting the verifiability attribute for material information relating to forward-looking information is challenging and gives rise to questions about the appropriateness of an explicit, unqualified statement of compliance.

We also suggest that the IASB works with the International Auditing and Assurance Standards Board (IAASB) to determine what the impacts will be from this proposal. We understand that there is an increased expectation for assurance over management commentary, and therefore the relevant standards may need to be revisited, including ISA 720 and ISAE 3000 *Assurance Engagements other than Audits or Reviews of Historical Financial Information*.

(b) Yes, we agree with the principles of the proposal in recognition that this framework also applies to other jurisdictions. However, a qualified statement of compliance is not a desirable outcome, especially for companies listed on a public stock exchange. A qualified statement conveys that the framework is either not suitable for its purpose or that the management commentary is not compliant with the Practice Statement. There is no benefit in voluntarily adopting a Practice Statement which is not fit for purpose. If it is not a regulatory requirement to comply with the Practice Statement, it is probable that such a statement of compliance would be omitted altogether.

Question 3 – Objective of management commentary

Paragraph 3.1 proposes that an entity's management commentary provide information that:

(a) enhances investors and creditors' 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.

Paragraph 3.2 proposes that the information required by paragraph 3.1 be provided if it is material. Paragraph 3.2 states 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 that management commentary and of the related financial statements. Paragraphs 3.5–3.19 explain aspects of the objective, including the meaning of 'ability to create value'. Paragraphs BC42–BC61 explain the Board's reasoning for these proposals. Do you agree with the proposed objective of management commentary? Why or why not? If you disagree, what do you suggest instead, and why?

Yes, we agree with the objective but would prefer a reference to time horizons without the specific emphasis on "long term". Given its subjectivity and degree of uncertainty, it is often, at best, an estimate only. We highlight that IAS 36 *Impairment of Assets*, paragraph 35 acknowledges such limitations and lack of such forward-looking information as being part of the reporting process. For consistency, we recommend that management commentary take a similar approach.

References to “forward-looking” or “future prospect” may be considered as an alternative to “long term” which raises the expectation of a defined time frame. To ensure that material forward looking information is not omitted based on probability judgements, the ED should include principles and the use of caveats to negate liability risks. This is a significant concern for the Australian corporate environment.

We agree with the definition of ‘material’ which aligns with the definition in the IFRS Standards.

In relation to paragraphs 3.5–3.19, we do not have any further comments.

Question 4 – Overall approach

The Exposure Draft proposes an objectives-based approach that:

(a) specifies an objective for management commentary (see Chapter 3);

(b) specifies six areas of content for management commentary and, for each area of content, disclosure objectives that information provided in management commentary is required to meet (see Chapters 5–10);

(c) gives examples of information that management commentary might need to provide to meet the disclosure objectives (see Chapter 15); but

(d) does not provide a detailed and prescriptive list of information that management commentary must provide.

Paragraphs BC69–BC71 explain the Board’s reasoning for proposing this approach. Do you expect that the Board's proposed approach would be:

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

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

If not, what approach do you suggest and why?

(a) We believe the objectives-based approach is useful to assist preparers identify information that investors and creditors need. However, we believe that judgement may not be adequately exercised when the required content for application is across multiple chapters. Preparers, when developing investor-focused information, apply the disclosure objectives, the content in Chapter 12 *Making materiality judgements* and the attributes in Chapter 13 *Completeness, balance, accuracy and other attributes* simultaneously. In our view the structure of the chapters in the ED needs to be re-evaluated so that they are methodically presented. Furthermore, the Practice Statement should be supported by implementation guidance to achieve greater consistency and comparability.

(b) An objectives-based approach requires more judgement, which is likely to create difficult tensions between preparers and external auditors. It could be challenging in practice for auditors to conclude that the numerous additional judgements around management commentary made by preparers are reasonable. It could also create enforcement challenges for the same reason, as regulators may find it more expensive to operate within a regime driven by objectives.

Question 5 – Design of disclosure objectives

The proposed disclosure objectives for the areas of content comprise three components —a headline objective, assessment objectives and specific objectives. Paragraph 4.3 explains the role of each component. Paragraphs 4.4–4.5 set out a process for identifying the information needed to meet the disclosure objectives for the areas of content and to meet the objective of management commentary. Paragraphs BC72–BC76 explain the Board's reasoning for these proposals.

(a) Do you agree with the proposed design of the disclosure objectives? Why or why not? If you disagree, what do you suggest instead, and why?

(b) Do you have general comments on the proposed disclosure objectives that are not covered in your answers to Question 6?

(a) No, there appears to be a degree of overlap between the three components of proposed disclosure objectives for the areas of content (i.e., the headline objective, assessment objectives and specific objectives). In our view, having just two levels of disclosure objectives would likely lead to more cohesive and succinct reporting, while applying attributes such as materiality and completeness.

(b) We see the design of the proposed disclosure objectives to be critical to this project. The development and drafting must encourage preparers to focus on the objectives and avoid generic information based on guidance or examples provided in the ED. We believe that the levels of disclosure objectives need the appropriate structure and optimum amount of guidance to assist preparers. When there are too many levels of objectives, it assumes the appearance of a checklist which we believe could be detrimental to the identification of information that investors and creditors need.

Question 6 – Disclosure objectives for the areas of content

Chapters 5–10 propose disclosure objectives for six areas of content. Do you agree with the proposed disclosure objectives for information about:

(a) the entity's business model;
(b) management's strategy for sustaining and developing that business model;
(c) the entity's resources and relationships;
(d) risks to which the entity is exposed;
(e) the entity's external environment; and
(f) the entity's financial performance and financial position?

Why or why not? If you disagree, what do you suggest instead, and why?

Subject to our response to question 5, we agree with the proposed disclosure objectives for the six areas of content.

Question 7 – Key matters

Paragraphs 4.7–4.14 explain proposed requirements for management commentary to focus on key matters. Those paragraphs also propose guidance on identifying key matters. Chapters 5–10 propose examples of key matters for each area of content and examples of metrics that management might use to monitor key matters and to measure progress in managing those matters. Paragraphs BC77–BC79 explain the Board's reasoning for these proposals.

(a) Do you agree that the Practice Statement should require management commentary to focus on key matters? Why or why not? If you disagree, what do you suggest instead, and why?

(b) Do you expect that the proposed guidance on identifying key matters, including the examples of key matters, would provide a suitable and sufficient basis for management to identify the key matters on which management commentary should focus? If not, what alternative or additional guidance do you suggest?

(c) Do you have any other comments on the proposed guidance?

(a) Yes, but it is unclear how this new concept of a 'key matter' relates to the concept of materiality, and, as currently defined, it would be difficult to envisage a key matter that is not material.

(b) We believe implementation guidance in the form of a diagrammatical representation, that demonstrates the connectivity between the disclosure objectives, areas of content, attributes, key matters and materiality, would be useful for preparers.

(c) We support the illustrations that show how an entity *might* apply a requirement in a particular circumstance.

Question 8 – Long-term prospects, intangible resources and relationships and ESG matters

Requirements and guidance proposed in this Exposure Draft would apply to reporting on matters that could affect the entity's long-term prospects, on intangible resources and relationships, and on environmental and social matters. Appendix B provides an overview of requirements and guidance that management is likely to need to consider in deciding what information it needs to provide about such matters. Appendix B also provides examples showing how management might consider the requirements and guidance in identifying which matters are key and which information is material in the fact patterns described. Paragraphs BC82–BC84 explain the Board's reasoning for this approach.

(a) Do you expect that the requirements and guidance proposed in the Exposure Draft would provide a suitable and sufficient basis for management to identify material information that investors and creditors need about:

(i) matters that could affect the entity's long-term prospects;
(ii) intangible resources and relationships; and
(iii) environmental and social matters?

Why or why not? If you expect that the proposed requirements and guidance would not provide a suitable or sufficient basis for management to identify that information, what alternative or additional requirements or guidance do you suggest?

(b) Do you have any other comments on the proposed requirements and guidance that would apply to such matters?

(a) Yes, the requirements and guidance are useful. We welcome more application guidance on material information relating to long-term prospects, intangible resources and relationships, and ESG matters. This is a specific example where the IASB could leverage the existing work of the CDSB and VRF.

(b) No.

Question 9 – Interaction with the IFRS Foundation Trustees' project on sustainability reporting

Paragraphs BC13–BC14 explain that the Trustees of the IFRS Foundation have published proposals to amend the Foundation's constitution to enable the Foundation to establish a new board for setting sustainability reporting standards. In the future, entities might be able to apply standards issued by that new board to help them identify some information about environmental and social matters that is needed to comply with the Practice Statement. Are there any matters relating to the Trustees' plans that you think the Board should consider in finalising the Practice Statement?

Many of our members are confused about the timing of this ED with the recent formation of the ISSB and the consolidation of the CDSB and the VRF into the new board. We believe that it is necessary to draw on the CDSB's and VRF's experience in this revision of management commentary, a project aligned with the objectives of the Integrated Reporting Framework. We strongly urge the IASB to defer this project and adopt a measured approach on resumption when the ISSB (incorporating CDSB and VRF) are established in the organisation. We understand that the next stages of combined work will be critical and complex. We therefore support a collaborative approach to ensure the progress and priorities are complementary to both boards' work streams.

Question 10 – Making materiality judgements

Chapter 12 proposes guidance to help management identify material information. Paragraphs BC103–BC113 explain the Board's reasoning in developing that proposed guidance. Do you have any comments on the proposed guidance?

The examples in Chapter 15 *Examples of information that might be material* are useful but may be better located as part of Chapter 12 to assist preparers to better understand the application of 'materiality'. Paragraph 12.4 provides indicators that information might be material, but this approach could be misleading because it generalises the attribute. It is necessary to consider materiality from an entity-specific perspective and the relevance of the information at the reporting date.

We agree with paragraph 12.9, which requires the materiality judgement to be reassessed each reporting period. In fact, with reference to paragraph 12.4, some information that might be material during the year, could have its relevance diminished by the reporting date.

In our view, aggregation (paragraphs 12.10 and 12.11) is not sufficiently discussed in the ED. More practical guidance would be well received because aggregation relates to materiality. This attribute provides useful information for entities with segment operations experiencing different economic conditions and which have different business cycles. However, how much of it should be aggregated or disaggregated is judgemental. Additional principles and guidelines could be useful to preparers.

Question 11 – Completeness, balance, accuracy and other attributes

(a) Chapter 13 proposes to require information in management commentary to be complete, balanced and accurate and discusses other attributes that can make that information more useful. Chapter 13 also proposes guidance to help management ensure that information in management commentary possesses the required attributes. Paragraphs BC97–BC102 and BC114–BC116 explain the Board's reasoning for these proposals. Do you agree with these proposals? Why or why not? If not, what do you suggest instead and why?

(b) Paragraphs 13.19–13.21 discuss inclusion of information in management commentary by cross-reference to information in other reports published by the entity. Paragraphs BC117–BC124 explain the Board's reasoning for these proposals. Do you agree with these proposals? Why or why not? If not, what do you suggest instead and why?

(a) We support requiring the information in management commentary to possess appropriate attributes. However, we do not support the introduction of new concepts or terminology for such attributes. We believe the qualitative characteristics in the *Conceptual Framework for Financial Reporting* are equally as relevant for non-financial reporting, such as management commentary, as they are for financial reporting.

Some of the illustrations (e.g. paragraphs 13.8, 13.9 and 13.15) in Chapter 13 are expanding on the attributes rather than illustrating the application. More illustrative examples would assist preparers to identify useful information for investors.

(b) We are strong proponents of integrated reporting – a single report that brings together financial and non-financial information about how the entity creates value over time and that is for use by all stakeholders.

For entities that are not at that stage yet, and still produce multiple reports, we support cross-referencing to information in other reports published by the entity. However, there is a need to be cognisant that cross-referencing can make information hard to find, which in turn can make a report hard to understand and time consuming to analyse. Therefore, a balance needs to be struck in terms of the level of detail that is cross-referenced and what is duplicated.

Question 12 – Metrics

Chapter 14 proposes requirements that would apply to metrics included in management commentary. Paragraphs BC125–BC134 explain the Board's reasoning for these proposals. Do you agree with these proposals? Why or why not? If not, what do you suggest instead and why?

Yes, however,the selected metrics should be required to possess the attributes listed in Chapter 13 (which we believe should be the same as the qualitative characteristics in the *Conceptual Framework for Financial Reporting* as referred to in our response to question 11).

Question 13 – Examples of information that might be material

Material information needed to meet the disclosure objectives set out in Chapters 5–10 will depend on the entity and its circumstances. Chapter 15 proposes examples of information that might be material. Paragraphs BC80–BC81 explain the Board's reasoning for these proposals. Do you expect that the proposed examples would help management to identify material information that management commentary might need to provide to meet disclosure objectives for information about:

(a) the entity's business model;
(b) management's strategy for sustaining and developing that business model;
(c) the entity's resources and relationships;
(d) risks to which the entity is exposed;
(e) the entity's external environment; and
(f) the entity's financial performance and financial position? If not, what alternative or additional examples do you suggest?

Do you have any other comments on the proposed examples?

Yes, but only when the examples are considered holistically after applying the disclosure objectives and other requirements.

Question 14 – Effective date

Paragraph 1.6 proposes that the Practice Statement would supersede IFRS Practice Statement 1 Management Commentary (issued in 2010) for annual reporting periods beginning on or after the date of its issue. This means that the Practice Statement would be effective for annual reporting periods ending at least one year after the date of its issue. Paragraphs BC135–BC137 explain the Board's reasoning for this proposal.
Do you agree with the proposed effective date? Why or why not? If not, what effective date do you suggest and why?

As stated above, our overarching recommendation is to defer this project.

If the project is not deferred, the proposed effective date is not reasonable. For jurisdictions that mandate the Practice Statement, this revision will present a significantly different approach to management commentary. Entities will need a transition period in which to implement new data gathering systems and processes. The effective date should provide a similar transition time as any new IFRS Standard.

Question 15 – Effects analysis

(a) Paragraphs BC139–BC177 of the Basis for Conclusions accompanying the Exposure Draft analyse the expected effects of the proposals in this Exposure Draft. Do you have any comments on that analysis?

(b) Paragraphs BC18–BC22 discuss the status of the Practice Statement. They note that it would be for local lawmakers and regulators to decide whether to require entities within their jurisdiction to comply with the Practice Statement. Are you aware of any local legal or regulatory obstacles that would make it difficult for entities to comply with the Practice Statement?

(a) We believe that the revised Practice Statement's benefits, if any, will be derived on a case-by-case basis and some of these benefits may be difficult to attribute and quantify. Based on previous experience, changes to reporting requirements are usually more costly than initially anticipated. Therefore, we do not agree with paragraph BC168 which suggests "the implementation and ongoing application of the proposals are unlikely to lead to significant costs".

We note the need for this project as explained in paragraphs BC2–BC5, but, given the ED presents a comprehensive revision, we recommend that the IASB conducts field testing of the proposals in jurisdictions that have promoted the Practice Statement. In our view, this is essential to providing practical insights into the effects of the proposals.

Paragraph BC140 states the "Board has little evidence of entities applying the 2010 Practice Statement" on management commentary. So, in addition to the field testing, we recommend the IASB conducts more research to determine the reasons why some jurisdictions have adopted the 2010 Practice Statement, and why some other jurisdictions have not. The findings from this research can then be used to further inform the development of this ED. This is important if there is a desire to encourage more jurisdictions to apply the Practice Statement.

We note that paragraphs BC159–BC161 discuss a long-term view that corporate reporting needs a standardised approach for digital reporting purposes. In our view, this is probably one of the more compelling reasons for change, and so should be clearly stated in the ED rather than in the Basis for Conclusions. To support this, we recommend more research be conducted to understand how to effectively deliver such information.

(b) We are not aware of any specific regulatory obstacles that will make compliance with the Practice Statement difficult.

Question 16 – Other comments

Do you have any other comments on the proposals set out in the Exposure Draft?

Our members have observed that the ED appears to confuse the responsibilities of management with that of directors or individuals described as 'those charged with governance'. Accordingly, management commentary relates directly to the directors' corporate constitution, or other legally-based, powers of management. On this basis, the title reference to management commentary is misleading.

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