VALUE REPORTING FOUNDATION

Response to IFRS® Practice Statement Exposure Draft ED/2021/6

Management Commentary

INTEGRATED THINKING PRINCIPLES

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Andreas Barckow, Chair, International Accounting Standards Board
By email: commentletters@ifrs.org

6 October 2021

Dear Mr Barckow,

IFRS exposure draft on Management Commentary

On behalf of the Value Reporting Foundation - which was established in June 2021 out of the merger between the International Integrated Reporting Council (IIRC) and the Sustainability Accounting Standards Board Foundation (SASB) - I welcome the opportunity to respond to this IFRS exposure draft on Management Commentary. We have provided detailed responses to the questions where we are able to provide particular insight or expertise and have therefore not answered all the questions in the consultation.

For over ten years, SASB and the IIRC have been engaged as private sector, non-profit organizations in a common endeavour to develop a corporate reporting framework and sustainability disclosure standards that meet the information needs of today's capital markets. Our resources: *SASB Standards*, the *International Integrated Reporting Framework* and *Integrated Thinking Principles* have been adopted in 75 countries. Just this month it was confirmed that over half of businesses in the S&P Global 1200 index are now using SASB Standards, spanning seven regions around the world. The Integrated Reporting Framework and SASB Standards are increasingly referenced in capital market regulations and corporate governance codes as investor demand for comparable and reliable sustainability disclosure increases.

We applaud the IASB's decision to revise the Management Commentary Practice Statement: a pragmatic response to global trends, including the changing nature of the material issues influencing enterprise value and the expanding information needs of investors. It is also responsive to emerging market-led developments and the adoption of new practices such as integrated reporting and the Strategic Report in the UK. Our detailed responses to the consultation questions are therefore intended as constructive guidance - input to a process of evolution and improvement, the direction of which we fully endorse.

However, this period of change in the corporate reporting landscape is far from over. While much of the recent focus has been on the IFRS Foundation's evaluation of the need to establish an International Sustainability Standards Board (ISSB), the Value Reporting Foundation believes the role of the IASB will acquire even greater strategic significance within an enhanced corporate reporting landscape, where the need for conceptual and practical connectivity between the IASB and the proposed ISSB will become critically important in achieving a cohesive and simplified corporate reporting system. We therefore believe it would be advantageous to all stakeholders to pause this process of revising the Management Commentary Practice Statement until the proposed ISSB has been established.

This pause could be used to assess how the Management Commentary Practice Statement might be combined with the International <IR> Framework and the recommendations of the Task Force on Climate-Related Financial Disclosure (TCFD) to provide a robust conceptual basis for connecting the IASB and proposed ISSB. This would simplify the landscape and strengthen disclosure on certain key matters, for example on corporate governance and board oversight. We believe the pause would have two very clear advantages:

- First, it would provide sufficient time to align key conceptual issues and definitions that could be used by both Boards, for example the concepts of 'value creation' and 'enterprise value'. We recommend that the IASB and ISSB use a common definition of 'enterprise value' as a means of identifying that information which has the greatest relevance to investor decision-making. It is our belief that, in creating value for its key stakeholders, a business will also create enterprise value over the long-term.

- Second, it would give time for the proposed ISSB to become established, including the appointment of key personnel, enabling a more strategic assessment of the conceptual and practical proposals for connecting the work of both Boards.

The majority of the businesses and investors involved in the Value Reporting Foundation's work support the IFRS Foundation's leadership in evolving the corporate reporting landscape, and we share an ambition for a globally-accepted and comprehensive corporate reporting system. It is why we are supporting the IFRS Foundation, as part of the Foundation's Technical Readiness Working Group, to support the establishment of an International Sustainability Standards Board (ISSB). We believe the ISSB will only be successful if strong connectivity with the IASB is designed from the start. A revised and repositioned Management Commentary Practice Statement is a key element of establishing that connectivity.

Many detailed aspects of the revised Management Commentary Practice Statement are recognizable from an International <IR> Framework and SASB Standards perspective, including a focus on intangible sources of value creation. However, in broadening the scope of information, we believe the IASB may have created additional tensions that have the potential to undermine its core objective. Much of the content proposed is intended to provide commentary on the business and its long-term prospects, yet Management Commentary provides contextual information from management on the financial statements only, <u>not</u> the business, its performance and prospects. We believe the Management Commentary Practice Statement should be repositioned to clearly provide overall commentary on the business, not only the financial statements, and that it should be jointly issued by the IASB and the ISSB.

Notwithstanding our fundamental comments on the process, and our recommendations on both timing and connectivity I would, in conclusion, emphasize four key matters on which we believe particular attention is needed:

1. We recommend **greater precision in the definition of value creation** and, especially, its link to the concept of enterprise value. In our view, the current treatment of these concepts in the exposure draft has the potential to cause market confusion and that there should be consistency between the IASB and proposed ISSB.
2. The matter of governance and, in particular, a current lack of recognition for the distinctive **role of those charged with governance** is of fundamental concern. We believe this issue could easily be resolved through the incorporation of section 4B of the International <IR> Framework or a provision that has the same effect. A distinct statement in the primary report noting how those charged with governance contribute to value creation is important for establishing clear accountability.
3. We believe **Management Commentary needs a conceptual basis** and that the Board should consider integrating the principles and concepts in the International <IR> Framework, the current Management Commentary principles and the governance, strategy and risk management components of the TCFD recommendations, to establish a comprehensive conceptual framework fit not only for commenting on financial statements, but also for corporate reporting as a whole.
4. From a strategic perspective, given the current momentum behind the creation of the ISSB, we believe **there is a strong case for pausing this project** until the ISSB has been established, creating a window to develop an overarching framework that connects the IASB and ISSB, using the resources identified above. This would be in line with contemporary investor information needs and provides a path to simplifying the landscape for preparers.

I hope this letter, and our detailed responses to select consultation questions, are valuable as the IASB works through these complex matters. Thank you for the opportunity to contribute to the IFRS Foundation's work in revising the Management Commentary Practice Statement, and I look forward to our continued dialogue.

Yours sincerely,

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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. Do you agree? Why or why not?*

Yes. We agree that the existing requirement should be retained on the basis of its **intent** (to provide insight into the basis of preparation), **logic** (full compliance as a necessary condition for an unqualified statement) and **application** (the statement of compliance should be provided on a required, rather than voluntary, basis).

(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. Do you agree? Why or why not?*

No. While we agree with the proposal's **intent** (to identify and explain departures from the Practice Statement's requirements) and underlying **logic** (partial compliance warrants a qualified statement), we disagree with its **application** as presented in the Exposure Draft. In particular, we disagree with the phrase 'may include' in paragraph 2.6, as this positions the statement as voluntary in cases of partial compliance. We believe a qualified statement of compliance – *identifying and explaining departures from the Practice Statement's requirements* – provides equally important insight to investors and creditors and, on this basis, should also be required.

Relatedly, the International <IR> Framework (2021) requires a *'statement of responsibility for the integrated report'* from those charged with governance [paragraph 1.20]. The intent and application of this requirement is comparable, but not equivalent, to the proposed statement of compliance. During the recent revision of the International <IR> Framework, public feedback supported an expansion of the required statement of responsibility to include an opinion/conclusion about *'whether, or the extent to which'* the integrated report is presented in accordance with the <IR> Framework. This approach accommodates all compliance scenarios, drives transparency and accountability within the entity and fosters the credibility of, and trust in, the entity's disclosures. It also acknowledges the reality that full compliance is often achieved over multiple reporting cycles.

Question 3 – Objective of management commentary

Do you agree with the proposed objective of management commentary? Why or why not? If you disagree, what do you suggest instead, and why?

No. While we agree with the overall objective, we have three concerns with the proposal as written.

1. **Interpretation of the term 'ability to create value'**

We have observed confusion over the use of the terms *'value creation'* and *'enterprise value'*. We therefore urge that the two concepts be clearly defined, their relationship explained and their connection to prevailing interpretations clarified. Attention to these matters will, we believe, avoid misinterpretation and misapplication down the line.

Several governance codes (e.g. Dutch, UK, Japan, ICGN Governance Principles and, to a lesser extent, the ICGN Stewardship Principles) refer to value creation, yet none include the adjective 'enterprise'. We would suggest the IASB review definitions and uses of the term 'value creation' in governance codes and consider the implications for the Practice Statement.

Certain academic literature[1] distinguishes between two axes of value creation: *internal versus external* and *economic versus social* (with *'social'* encompassing societal and environmental value). With this in mind, it is unclear whether the IASB intends the phrase *'value creation* to mean both **economic** value and **social** value.

To inform the IASB's considerations, we offer two recommendations.

A Develop a more precise alternative to the phrase 'ability to create value'

In the <IR> Framework, *'value creation'* reflects the needs and interests of direct and indirect stakeholders. The concept thus includes the entity, investors, creditors, customers, employees, supply chain partners and others. Value also extends to local communities, wider society and the natural environment. So, the <IR> Framework is intended to guide clear communication about how an entity creates value *for the entity* by creating value *for others*. The <IR> Framework's interpretation of value creation includes outcomes for six forms of capital (resources and relationships) and, through a business model discussion, shows how an entity creates enterprise value by creating value for others. This does not appear to be the case in the Practice Statement. We note 60+ references to *'ability to create value'* in the draft Practice Statement and believe this phrase will frequently (and instinctively) conjure the <IR> Framework's interpretation, despite the *'for the entity'* qualification in paragraph 3.11. We therefore encourage more deliberate use of terminology to avoid conflicting interpretations and inadvertently altering the intended scope of disclosures. In this respect, we should also point out that the <IR> Framework (2021) has moved away from the term *'value creation'* in favour of the full term *'value creation, preservation or erosion'*. The former, with its inherent positive bias, was found to be a deterrent to balanced reporting.

In view of the preceding differences and given the Practice Statement's intended scope, alternatives to *'ability to create value'* could include *'ability to create, preserve or erode enterprise value'*. (Note: We agree with a single *'and hence value for its investors and creditors'* clarification.)

[1] Huse, M. (2007), Boards, Governance and Value Creation, Cambridge University Press.

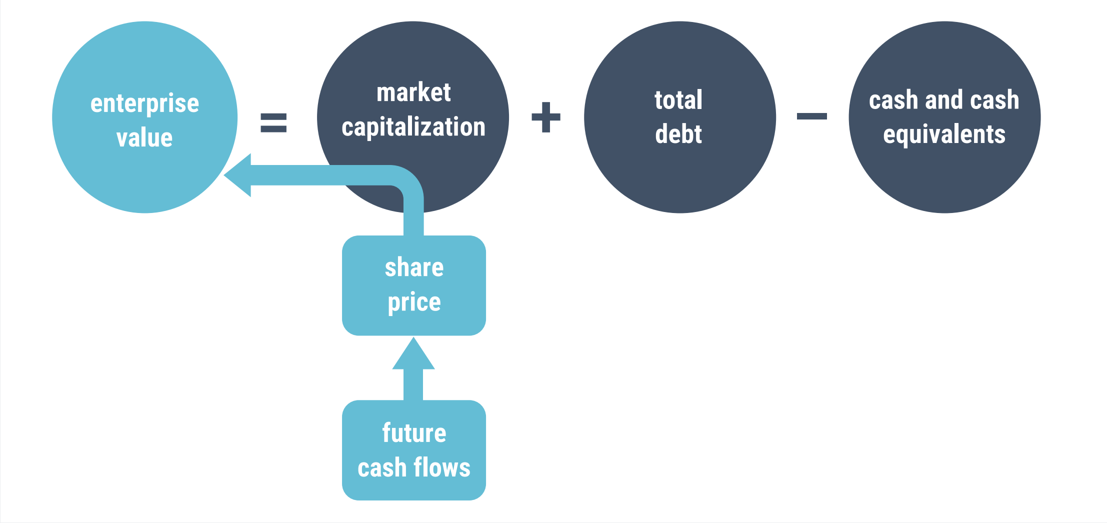
B Decide howenterprise value should be defined

Paragraph 3.11 observes that *"Some people refer to the value an entity creates for itself as enterprise value."* The Practice Statement introduces the term 'enterprise value' almost incidentally and, in doing so, invites further questions and possible misinterpretation. Colloquially, enterprise value simply refers to the value of the entity (or enterprise). However, in corporate finance and broader capital market contexts, the phrase evokes a more precise and formulaic interpretation, as follows:

Enterprise value = market capitalization + total debt – cash and cash equivalents

Capital markets, and indeed the wider public, are increasingly aware of the important role of corporate culture, innovation, social and environmental responsibility, reputation and other intangibles in enterprise value creation. With this in mind, we urge the IASB to consider the following questions:

- In noting, *"Some people refer to the value an entity creates for itself as enterprise value"*, does the IASB share this view? If so, should the phrase *'ability to create value'* not be replaced by *'enterprise value'* –making clear that the IASB is using the term as it is commonly defined in corporate finance literature? How might the definition be adapted for private companies?
- If the preceding formula is the intended anchor for the Practice Statement, how might the Practice Statement more clearly demonstrate (for the benefit of preparers of management commentary) the relationship between enterprise value and (i) value creation for stakeholders and (ii) intangibles?
- If the preceding formula is equivalent to the Practice Statement's interpretation of *'ability to create value'*, is there redundancy in paragraph 3.1(b)? In other words, is it appropriate to refer to the entity's *'ability to create value **and** 'generate cash flows'* when the formula tells us the latter drives – and is, therefore, embedded in (as shown below) – the former?



2. **Reference to the primary user**

   As presented, part (a) of paragraph 3.1 explicitly caters to investors and creditors; however, it is unclear to whom part (b) caters. Although one can infer the same audience for both parts, we would caution against relying on inference. Failure to explicitly clarify the intended user for part (b) risks broadening the scope of consideration and, therefore, the consequent disclosures. With this in mind, we suggest paragraph 3.1 be amended as follows.

   An entity's management commentary shall provide information that **enhances investors and creditors' understanding of**:

   (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~~ the factors that could affect the entity's ability to create value and generate cash flows across all time horizons, including in the long term.

   Such amendments not only clarify the scope of consideration and disclosures, to the benefit of entities that prepare management commentary, but they also align the presentation of paragraph 3.1 with others in the Practice Statement [ref: paragraphs 3.10, 5.6, 5.7, 6.6, 7.6, 7.7, etc.].

3. **Time frame**

   In paragraph 3.1(b), we believe the phrase *'across all time horizons'* lacks sufficient precision to guide the preparation of management commentary. We therefore recommend that the term *'all time horizons'* be replaced with *'in the short, medium and long term (as defined by the entity)'*. In our view, this alternative encourages entities to select time frames that are appropriate to their industry, size, region, planning cycle and other unique parameters.

Question 4 - Overall 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 the requirements of the Practice Statement? If not, what approach do you suggest and why?

Yes. We agree with the proposed objectives-based approach for two reasons. In particular, it:

1. Aligns with the framing of management commentary as a voluntary accompaniment to the financial statements [ref: paragraphs IN6 and IN7]
2. Supports universal application by providing entities the flexibility to reflect their industry, size, region and other unique attributes or circumstances.

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. With respect to enforceability, we believe the Practice Statement will not be suitable criteria for assurance under ISAE 3000.

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. With respect to **enforceability**, we believe the Practice Statement can be suitable criteria for assurance under ISAE 3000 with two important adjustments. The core question of the assurance engagement will be, *'Does this report fairly reflect the complete business story, including its resilience?'* In our view, this can be achieved only if the Practice Statement requires:

- Reporting on the board's contribution to value creation through, for example, influencing and monitoring the entity's strategic direction and risk management, or promoting and enabling its innovation. [See also our response to Question 8(b).]
- Disclosures about the significant standards or frameworks used (e.g. IFRS, SASB Standards, ISSB standards), methods used to quantify or evaluate material matters, or self-determination of business-critical metrics not required by either IFRS, SASB Standards or ISSB standards. [See also our response to Question 16, Item 5.]

Question 6 – Disclosure objectives for the 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?

Yes. We generally agree with the disclosure objectives as presented, and offer the following suggestions:

(a) **The entity's business model.** Based on part 3 of our response to **Question 3**, it would be useful to include a time-horizon perspective within the disclosure objective. We therefore suggest that *'in the short, medium and long term (as defined by the entity)'* be inserted at the end of paragraph 5.5.

(b) **Management's strategy for sustaining and developing that business model.** As the Practice Statement positions *opportunities* as part of *strategy* (rather than as a natural counterpart to *risks*, as in Section 4D of the <IR> Framework), it might be helpful to highlight this pairing in the disclosure objectives as follows:

> *6.4 Management commentary shall provide information that enables investors and creditors to understand management's strategy, **including opportunities**, for sustaining and developing the entity's business model.*

(c) **The entity's resources and relationships.** It would be useful to include in the disclosure objective an 'inside-outside' perspective (i.e. the effects of the entity on key resources and relationships that influence enterprise value). The following is one of several alternatives:

> *7.5 Management commentary shall provide information that enables investors and creditors to understand the resources and relationships on which the entity's business model and management's strategy for sustaining and developing that model depend, **or on which the entity's business model and management's strategy have an effect, to the extent that those effects influence enterprise value**.*

Question 7 – Key matters

(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?

Yes. The sentiment presented in paragraph 4.8 (namely *"Because key matters are fundamental to the entity's ability to create value and generate cash flows, it is likely that much of the information that is material to investors and creditors will relate to key matters"*) reflects our own rationale. We believe that focusing on key features or aspects of the six areas of content (helpfully mapped in Figure 1) provides important structure to entities as they prepare management commentary. Notwithstanding this support, please see part (c) for implementation/communication considerations.

(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?

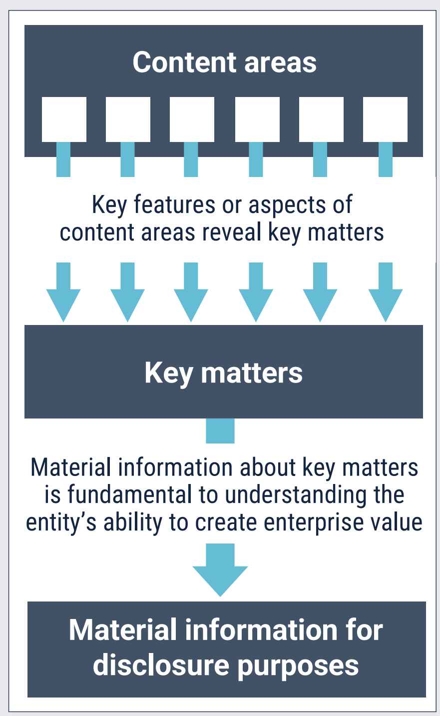
Qualified yes. We believe the guidance provided in paragraphs 4.7–4.14 and Chapters 5–10 is thorough and illustrative. Of minor note, we believe the figure presented in paragraph 4.12 can be improved in two ways:

1. **Consider labeling the cluster of six grey blocks *'content areas'*.** We believe continued reinforcement of the connection between content areas, key matters and material information is important to preparers of management commentary. (See also part (c) of this response for our views on the phrase *'areas of content'*.)
2. **Consider sequencing the layers in the same order they are introduced in Chapter 4.** This modification not only provides internal consistency with other Practice Statement content, but it also mimics the likely (and presumably encouraged) thought progression among preparers of management commentary.

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

Yes. We acknowledge the effort taken to navigate **terminology** (e.g. key, fundamental, material) and **concepts** (e.g. areas of content, matters, information). As noted in part (a), we support introducing key matters and resulting mental construct. However, the breadth of concepts, terminology and layers introduced in paragraphs 4.1, 4.7, 4.8 and 4.12 is challenging to digest on first read. So critical is this mental construct that we offer three recommendations:

1. Replace the term *'areas of content'* with *'content areas'*. Not only does this describe the underlying concept more directly and succinctly, but it also aligns with the writing style adopted elsewhere in the Practice Statement (e.g. *'material information'* rather than *'information of materiality'* and *'key matters'* rather than *'matters that are key'*).
2. Introduce a simple diagram to paragraph 4.1, one that connects the concepts of **content areas**, **key matters** and **material information** (see suggestion to right). This would be in addition to the existing Figures 1 and 2.
3. Clarify, within the Practice statement itself, that *'materiality is an attribute of information, not an attribute of matters'* [ref: paragraph BC78].



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

(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?

Qualified yes. The requirements and guidance proposed in the Exposure Draft will provide a suitable and sufficient basis for management to identify material information that investors and creditors need on long-term prospects, intangible resources and relationships, and environmental and social matters. Of minor note, the examples provided in relation to intangible resources/relationships and environmental and social matters are limited to companies already operating in intangible-, environmental- and social-intensive industries. It would be helpful to provide examples related to 'less obvious' industries.

Beyond the Appendix B proposals, we suggest careful consideration of an effective *Conceptual Framework for Corporate Reporting*, one that allows management commentary to evolve with the market's understanding of intangible resources and ESG matters. As elaborated in Item 5 of our Question 16 response, we feel the *Conceptual Framework for Financial Reporting* is not, and cannot be, the conceptual basis for management commentary's ESG and intangible resources related content. In our view, the <IR> Framework (notably its *Chapter 2 – Fundamental Concepts* and related content on ESG matters and intangibles) provides an ideal conceptual basis for the Practice Statement and could provide a basis for a conceptual framework.

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

Yes. We believe governance-related elements should not be left to local laws alone. Rather, some minimum level of disclosure should be included in management commentary. Although we recognize this information will be included in any case if material, investors and creditors will benefit from a clear view of how the entity is governed, not least for responding to the stewardship principle in the IASB's existing Conceptual Framework.

As a starting point, we recommend including the term *'management'* in the *Defined Terms* section. It is unclear whether this refers to *'executive management'* or more generically to both management and those charged with governance (typically the entity's board). In our view, the two should be treated separately, as in the International <IR> Framework. The <IR> Framework defines *'those charged with governance'* in its glossary, noting that in some circumstances this includes executive management.

Management commentary is just that: management's perspective. It is not the perspective of the board, which actively contributes to value creation in a way that is distinct from management. This includes its work in the boardroom (e.g. developing strategy, managing risk, overseeing management's performance) and approving the perspectives presented in external reporting. Its other contributions are listed in paragraph 4.9 of the <IR> Framework. The board also represents the entity with investors and certain other stakeholders. In integrated reports, the board shows its accountability via a responsibility statement [ref: paragraph 1.20 of the <IR> Framework]. With this in mind, we urge the Practice Statement to recognize the distinctive contribution of the board by:

- Preferably, incorporating the <IR> Framework's content on governance [ref: Section 4B] and separately defining *'those charged with governance'* and *'management'* in the Defined Terms section, or
- Requiring an overarching report adding the board's perspective (potentially as a component of today's *'corporate governance statements'*) to *'management's perspective'* in management commentary.

Secondly, we suggest re-ordering the examples to improve readability and navigation of the document. In this respect, hyperlinks to related paragraphs could also be added.

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

Are there any matters relating to the Trustees' plans that you think the Board should consider in finalising the Practice Statement?

Yes. We are following the Trustees' plans with interest, as they have potential to lend further support to preparers of management commentary. The IFRS Foundation Trustees' *Feedback Statement on the Consultation Paper on Sustainability Reporting (Apr 2021)* establishes a clear focus on enterprise value, with links to societal and environmental impacts and dependencies that are relevant to enterprise value (with which we agree).:

Bearing in mind the Feedback Statement's emphasis on *'enterprise value'*, we encourage the Practice Statement to adopt more clear language on the concept. As observed in our response to Question 3 – Objective of management commentary (part 1B, in particular), the Practice Statement makes only passing reference to enterprise value and appears to use the terms enterprise value and value creation interchangeably. Given different, and at times divergent, interpretations of these concepts, it is important to establish clear definitions of both terms, ideally shared across IASB and ISSB pronouncements.

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Per the IFRS Foundation Trustees' *Feedback Statement*, the proposed International Sustainability Standards Board (ISSB) will focus on *"information that is material to the decisions of investors and other participants in the world's capital markets"*.

For entities applying the Practice Statement and (in time) ISSB standards, does the management commentary become the preferred – or indeed *default* – vehicle for all ISSB-generated disclosures? With their shared investor focus, it follows that information prepared in accordance with ISSB standards must (as opposed to 'might' or 'can') appear in management commentary. The IASB could helpfully clarify this relationship, if only in principle and/or outside of the Practice Statement itself.

Question 10 – Making materiality judgements

Chapter 12 proposes guidance to help management identify material information. Do you have any comments on the proposed guidance?

Yes. We generally support the guidance offered in Chapter 12 and are especially pleased with the phrasing and intent of paragraphs 12.4(b) and 12.5. Notwithstanding our support for the proposed guidance, we believe efficient and effective materiality judgements require a clearly-defined 'materiality lens'. As noted in our response to Question 3, we see significant opportunity to clarify the meaning of, and relationship between, *value creation for stakeholders*, *value creation for the entity* and *enterprise value*. Where there is overlap or equivalency in any of these terms, this should be made quite clear.

1. If the IASB favours the phrase *'the entity's ability to create value'*, then it should qualify *'value to whom'* with each reference
2. If the IASB equates *'the entity's ability to create value (for itself)'* to *'enterprise value'*, then it might consider the simpler and more intuitive and expressive phrase, *'the entity's ability to create enterprise value'.*
3. The relationship between *value creation for stakeholders* and *enterprise value creation* should be more explicitly discussed. We believe the IFRS Foundation Trustees' *Feedback Statement on the Consultation Paper on Sustainability Reporting (Apr 2021)* establishes a good starting point for linking enterprise value (or value created for the entity) to wider stakeholder interests:

   The Trustees recognise that, in the context of sustainability reporting, information that is deemed material to investors and other participants in the world's capital markets addresses the <u>interdependency between enterprise-value creation and value created for society and the environment</u>…. Investors' information needs may include information about the company's impact on society and the environment and how that impact affects the company's business model. [p. 28]

   Notably, we suggest replacing *'society and the environment'* with *'others'* then clarifying that this includes, for example, *'customers, employees, supply chain partners and other direct stakeholders, as well as broader society and the natural environment.'*

Question 11 – Completeness, balance, accuracy and other attributes

(c) 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. Do you agree with these proposals? Why or why not? If not, what do you suggest instead and why?

Qualified yes. We generally agree with the proposed attributes; however, we believe the **coherence** attribute warrants clarification. We understand that <u>connected information</u> is inferred, but the explanation overlooks the internal-external feedback loop underpinning integration (i.e. tying factors in the external environment to the entity's resources/relationships, business model, strategy and risks and opportunities). These real connections in businesses should be explicitly disclosed to improve investor understanding. Secondly, and notwithstanding the illustrations in paragraphs 13.8 and 13.9, we believe that to effectively adhere to the attribute of **balance**, entities require further guidance on <u>how this looks in practice</u>. Finally, we notice that whereas the IASB's *Conceptual Framework for Financial Reporting* lists **timeliness** as an enhancing qualitative characteristic [ref: para. 2.33], the Practice Statement includes no such attribute. Given the purpose of management commentary, and its potential to influence investor and creditor decisions, we believe reference to this attribute is important.

(d) 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 and why?

Yes. We agree with measures taken to reduce volume, duplication and boilerplate in management commentary. We further believe that entities should apply professional judgment to distinguish between **core** and **supplementary** information. The former introduces and explains material matters, puts those matters into context and, wherever possible, provides quantitative and assurable information to support their inclusion or to illustrate a fundamental point. Such information critically informs the decisions of investors and creditors.

By contrast, supplementary information – which might take the form of corporate policies, white papers, case studies or third-party evidence – provides further depth, but is unlikely to substantively inform the decisions of investors and creditors. On the contrary, including such information in management commentary could compromise readability, obscure truly material information and add volume with little incremental benefit.

The above sentiments underpin paragraph 1.16 of the <IR> Framework (*"An integrated report can provide an 'entry point' to more detailed information outside the designated communication, to which it may be linked…"*.) and closely mirror those presented in the *Note* box on page 69 of the Practice Statement.

Question 12 – Metrics

Chapter 14 proposes requirements that would apply to metrics included in management commentary. Do you agree with these proposals? Why or why not? If not, what do you suggest instead and why?

Yes. We agree with the substance of Chapter 14, including the requirements (or attributes) that apply to all metrics. Of minor note, and along the lines of presentation, we offer three observations:

1. **Measures versus indicators.** Paragraph 14.1 defines metrics as *'measures used to…'* and parts (a)-(c) of paragraph 14.2 refer to *'measures'*; however, parts (d)-(e) of paragraph 14.2 introduce the term *'indicators'*. We checked the Practice Statement for a formal distinction between the terms *'measure'* and *'indicator'* to no avail, then tested a few theories of our own (e.g. direct measurement versus calculation/ extrapolation, quantitative versus qualitative, financial versus non-financial, cumulative versus point in time). To simplify matters for preparers of management commentary, we suggest the Practice Statement either maintain the term *'measures'* or clarify the difference between the terms *'measures'* and *'indicators'*.
2. **Links, notes and illustrations.** We find the various boxes provided in Chapter 14 particularly helpful in connecting concepts to practice. At times, however, we were unclear about the distinction between a *'note'* and an *'illustration'*, as both appeared to include effective illustrative examples.
3. **Paragraph 14.11 terminology.** In our view, the phrase *'or other measure'* in this paragraph distracts rather than clarifies. We know from its definition that a metric is a measure; but is a measure always a metric? The word 'other' would suggest not. In lieu of defining the term *'measure'* or explaining what might constitute *'another measure'*, we recommend removing the phrase altogether from paragraph 14.11.
4. **Paragraph 14.13 terminology.** As above, we wonder if the words *'metric'* and *'measure'* are used synonymously. In a field where metrics, measures and indicators can, at one extreme, be used interchangeably or, at the other, hold special meaning individually, we recommend selecting a single term, defining that term, and applying that term consistently (if not repetitively).

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. 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?

Qualified yes. We generally agree with the examples, and propose the following changes to Chapter 15:

(a) **The entity's business model**

- Paragraph 15.5 draws attention to the social and environmental impacts of entities' activities, and we support this emphasis. However, we believe the effects of activities on intangibles (e.g. the entity's tacit knowledge, intellectual capital, brands, reputation) should also receive attention in the business model section of Chapter 15. These resources/relationships are significant drivers of enterprise value.
- Paragraph 15.5(a) notes that social and environmental impacts can be positive and negative, and this is an important reminder. We suggest paragraph 15.5(a) also reinforce that impacts of activities can be felt *internally* or *externally*. In the absence of this clarification, we suspect that most will focus exclusively on external consequences and potentially overlook significant internal impacts (e.g. related to continued access to key raw materials or changes to employee morale or corporate culture).

(b) **The entity's resources and relationships**

- We recommend inserting the following text between parts (c) and (d) of paragraph 15.13: *"An explanation of the critical interdependencies, including trade-offs, between the resources and relationships".*
- We recommend that paragraph 15.15(a) encourage entities to consider how changes to intangibles (e.g. brands, reputation) might affect continued access to a resource (or the quality of a resource).

Question 16 — Other comments

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

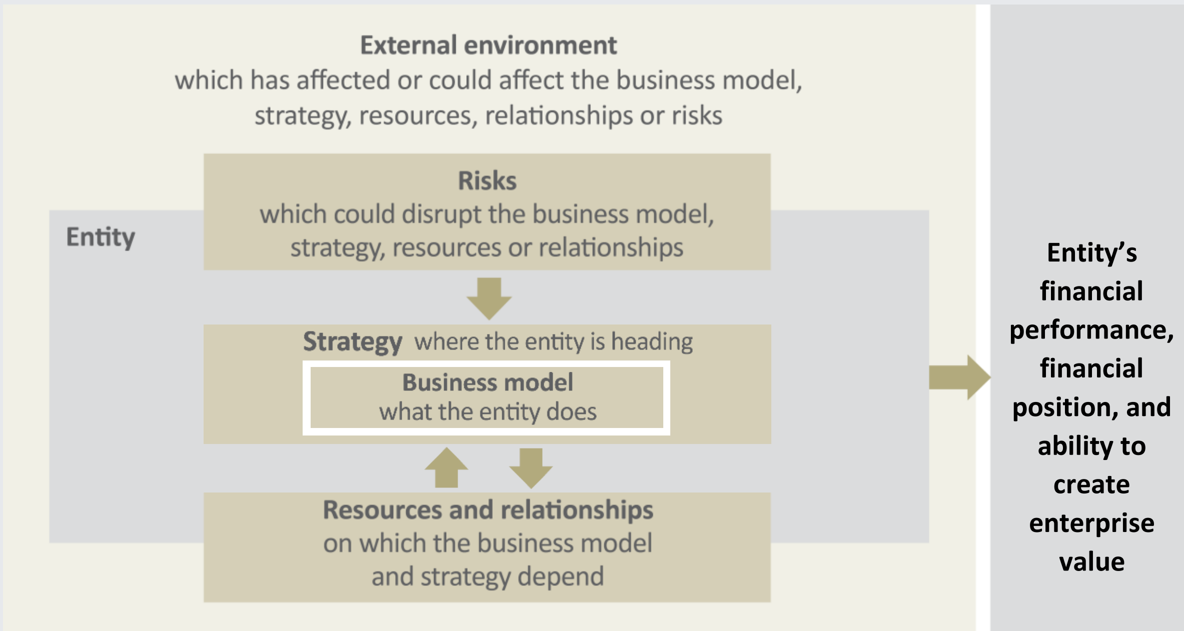
Yes. We offer the following five additional suggestions for IASB consideration:

1. In relation to the **authorization statement** [ref: paragraph 2.4 and, peripherally, paragraph 13.20(c)], we believe the respective roles of management and the governing body/board should be clarified. Paragraph 2.4 assigns responsibility for authorizing management commentary to the 'entity', 'body(s)' or 'individual(s)' without establishing expectations vis-à-vis the separate responsibilities of the board and management.

2. We see opportunities to align **Figure 1** [paragraph 4.2] with other elements of the Practice Statement. Our recommendations, shown in a mock-up on the next page, relate to the: (a) emphasis on the entity's *'ability to create value'* and (b) relationships within and between the *'areas of content'*. In particular, we suggest:

- Moving the *business model* box into the *strategy* box, in line with paragraph 6.4 of the Disclosure Objectives *("Management commentary shall provide information that enables investors and creditors to understand management's strategy for sustaining and developing the entity's business model."*). In our view, the entity's strategy does not simply 'co-exist' with its business model, as the current configuration would suggest. Rather, it drives and is, in fact manifested in the business model. In other words, it is through the business model that strategic objectives are fulfilled.

- Inserting an arrow from *resources and relationships* to the *strategy and business model*, to: (1) acknowledge continuous interaction between the entity's internal and external environments and (2) align with paragraph 4.1(e) (*"factors and trends in the external environment that have affected or could affect the business model, strategy, resources, relationships or risks"*).
- Inserting a reference to the entity's *'ability to create enterprise value'* alongside the *'entity's financial performance and financial position'*.



3. We encourage a revision of Chapters 12 and 14 of the Practice Statement to include content on the materiality determination process, summary of significant frameworks used and methods used to quantify or evaluate material matters. We suggest modelling these revisions on Section 4H – **Basis of preparation and presentation** of the International <IR> Framework (2021), specifically including a required paragraph such as paragraph 4.41 and the guidance in paragraph 4.43.
4. We recommend including a definition of the term **impact** in the *Defined Terms* section.
5. Looking beyond the Exposure Draft's proposals, we recommend careful consideration of an effective **Conceptual Framework for Corporate Reporting**, one that allows management commentary to continuously improve as business conditions and models evolve. In our view, the *Conceptual Framework for Financial Reporting* is not (and in its present form cannot be) the conceptual basis for management commentary's ESG- and intangible resources-related content. The *Conceptual Framework for Financial Reporting* is not sufficient to guide disclosure on ESG matters and intangible resources, because it generally focuses on recognition and measurement in the financial statements, instead of on more comprehensive disclosures about drivers of enterprise value. For example, expenditure on ESG matters and intangible resources must generally be:
   - Expensed in the profit and loss statement to comply with IFRS[1]
   - Not recognized as an asset or prematurely impaired, or
   - Recognized as liabilities without any recognition of the corresponding capitals and their contribution to enterprise value.

[1] ESG expenditures are often implicitly treated as 'bad' rather than as capitals or stores of value. This might be a call for a change to the current *Conceptual Framework for Financial Reporting* to accommodate the disclosure areas included in the Practice Statement, particularly those related to ESG and intangible resources. This would allow the *Conceptual Framework for Financial Reporting* to embrace these critically important contemporary drivers of enterprise value.

This results in a general bias towards treating ESG matters and intangible resources as instruments of **value destruction** rather than instruments of **value creation**.

In our view, the <IR> Framework (most notably its *Chapter 2 – Fundamental Concepts* and related content on ESG matters and intangibles) provides the ideal conceptual basis for the Practice Statement on Management Commentary and could be integrated into the Practice Statement and/or an accompanying conceptual framework.