EAA Stakeholder Reporting Committee

Comment Letter

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

About the SRC

The Stakeholder Reporting Committee (SRC) is a committee of the European Accounting Association (EAA) whose mission is to actively participate in the debate about how organisations can, and should, inform their wide range of stakeholders about their activities, including their impact on society. It focuses on non-financial or sustainability reporting. Further, given that non-financial information is increasingly attracting the interest of policy makers and standard setters, the SRC also aims to create awareness of the policy issues amongst its membership, and to collaborate with policy makers and standard setters with a view to allowing the academic community's research expertise to have an impact on emerging policies and standards.

Based on the above, the SRC is pleased to accept the IASB's invitation to comment on ED/2021/6 IFRS Practice Statement Management Commentary (hereafter "ED PS1 MC"). The Comment Letter is structured in three parts:

(1) A summary of extant research on the adoption and use of the PS1 MC (hereafter "PS1 MC (2010)");

(2) General comments to ED PS1 MC;

(3) Answers to Questions set out in ED PS1 MC.

Summary of extant research

While there is a large body of research on narrative reporting (e.g., Michelon et al., 2021), including studies dealing with forward-looking disclosures, risk reporting, business model disclosures, etc., the PS1 MC (2010) itself gained little attention in academic research to date. An extensive literature search did not allow us to identify studies that explored the actual adoption rate of the PS1 MC (2010) in a particular country or even across countries. As companies hardly explicitly refer to the PS1 MC (2010), it is hard to identify the direct influence of this document on corporate reporting practice. Thus, evidence on the adoption rate of the PS1 MC on both the country and the firm level is anecdotal.

The extant literature, which refers to the PS1 MC (2010), is rather scarce, of low impact, and dominated by single-country studies (see Appendix 1). The PS1 MC (2010) is often just mentioned by the authors as a new development in narrative reporting. In several studies the PS1 MC (2010) was used as a framework to analyse narrative reporting practices according to local laws or practiced voluntarily (e.g., Ginesti et al., 2012; Joshi et al., 2013).

Based on the literature review, it is difficult to assess the awareness of the PS1 MC (2010) among companies, and the extent to which this Practice Statement influenced their disclosure decisions. However, the reviewed papers suggest that the PS1 MC (2010) would have needed a stronger enforcement (e.g., Morris and Tronnes, 2018; Bayne and Wee, 2018; Joshi et al., 2016). For example, Joshi et al. (2016) conclude that the PS1 MC (2010) provides excellent guidance on improving narrative reporting in management commentary. However, according to the authors, a mandated requirement may result in a better disclosure. Similarly, Bayne and Wee (2018), who focus on non-financial measures, suggest that the policymakers may need to consider making disclosure across some KPI categories mandatory.

General comments

1. Overall good progress compared to PS1 MC (2010)

The SRC believes that the ED PS1 MC is a good step forward as it considers recent developments in narrative reporting, in particular in sustainability reporting (including intangibles), provides more detailed requirements and guidance for preparers, is open for additional local reporting requirements and considers potential assurance for management commentary.

2. Practice Statement vs. IFRS Standard

The SRC is not convinced by the IASB's arguments to issue a revised Practice Statement instead of an IFRS Standard. The experience with the PS1 MC (2010) shows that this pronouncement gained much less attention than IFRS Standards despite the growing importance of narrative reporting. One reason for this may be that a Practice Statement is perceived by preparers as less relevant than IFRS Standards. Moreover, in the EU (and most other countries) the Practice Statement is not endorsed and therefore a nonbinding document. The benefits of using the PS1 MC voluntarily, however, seem to be rather low so that companies either follow national guidance (e.g., German Accounting Standard No. 20) or other international pronouncements (e.g., IIRC Integrated Reporting Framework).

Therefore, the SRC suggests that the IASB reconsiders its decision to issue a Practice Statement. The SRC recommends developing an **IFRS Standard** that – like IAS 34 on Interim Reporting – is applicable only to those entities that are required by local law to prepare a management commentary complementing IFRS financial statements or do so voluntarily. This would not require major changes to the wording of the ED PS1 MC as it already uses directive language ("shall"). Issuing an IFRS Standard would, however, signal an equally or similarly important role of the management commentary compared to financial statements. It would also consider its increasing relevance as a reporting instrument for sustainability information. Indeed, the IASB should coordinate the final pronouncement with the ISSB.

3. Wording

In several cases, the wording of the ED PS1 MC should be revised to avoid redundancies and misunderstanding. Specifically, the following terms need rephrasing:

- "entity's ability to create value and generate cash flows": Given the definition of value creation in Appendix A as "the present value of the entity's future cash flows" it is redundant to add "and generate cash flows". It would be more concise to talk about "entity's ability to create value".
- headline, assessment and specific objective: The SRC proposes to simplify the design of disclosure objectives and to align the terminology with ED/2021/3 Disclosure Requirements in IFRS Standards.
- 'resilient' and 'durable' in respect of the business model (ED PS1 MC.5.6): How are these terms defined?

Comments related to ED PS1 MC Questions

Question 1 - The financial statements to which management commentary relates
Paragraph 2.2 of the ED 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 to the ED 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) The SRC agrees that entities should be permitted to state compliance with the revised PS1 MC even if their financial statements are not prepared under IFRS. This might be relevant for jurisdictions that mandate financial statements under national GAAP, but lack any national standard or guidance on management commentary. Mixed reporting regimes also exist in the opposite way, e.g., IFRS financial statements complemented by management reports under national standards (such as German Accounting Standard No. 20 in Germany). Although this works well in general, there might arise some issues with redundancy when the same or similar disclosures are required in the notes to the financial statements (e.g., by national GAAP) and management commentary (according to PS1 MC).

(b) The SRC agrees that no restrictions should be set on the basis of preparation of the financial statements in such a situation, as they can raise unnecessary barriers to PS1 MC adoption. The SRC supports the IASB's opinion that an entity, which prepares financial statements in accordance with very different concepts from the ones included in IFRS, is unlikely to apply the PS1 MC.

Question 2 - Statement of compliance
(a) Paragraph 2.5 of the ED 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 to the ED explain the Board's reasoning for this proposal. Do you agree? Why or why not? (b) Paragraph 2.6 of the ED 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 to the ED explains the Board's reasoning for this proposal. Do you agree? Why or why not?

(a) The SRC agrees that management commentary that complies with all of the requirements of the PS1 MC includes an explicit and unqualified statement of compliance.

(b) The SRC agrees that management commentary that complies with some, but not all, of the requirements of the PS1 MC may include a qualified statement of compliance listing the departures and reasons for them. The requirement to provide reasons may make entities reluctant to include such a qualified statement, though.

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?

The SRC agrees in principle with the proposed objective of management commentary. However, the SRC does see the need for some clarifications:

- The stewardship objective is not considered prominently enough. The SRC suggests integrating it upfront in paragraph 3.1 (e.g., "An entity's management commentary shall provide useful information to investors and creditors and help them assess the entity's prospects for value creation and management's stewardship of the entity's resources. The information provided shall (a) enhance investors and creditors' understanding of the entity's financial performance and financial position reported in its financial statements; and (b) provide insights into factors that could affect the entity's ability to create value."
- "entity's ability to create value and generate cash flows": as explained above, given the definition of value creation in Appendix A as "the present value of the entity's future cash flows" it is redundant to add "and generate cash flows". It would be more concise to talk about "entity's ability to create value".
- In paragraph 3.1 the reference to the primary user is not always clear. While part (a) explicitly refers to investors and creditors, this is not the case for part (b). Hence, the SRC suggests adopting a more consistent approach for both parts. Further, the expression "across all time horizons, including in the long term" appears to be too generic and amenable to different interpretations by companies. The SRC believes that a different formula, such as "in the short, medium and long term (as defined by the entity)" could represent an appropriate balance between specificity and flexibility.

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?

The SRC agrees with an objectives-based approach in general. As regards the three-level design of the proposed approach, the SRC recommends simplifying the approach and making it consistent with the two-level approach proposed in ED/2021/3 Disclosure Requirements in IFRS Standards – A Pilot Approach. For details, please refer to our comments to question 5.

Although providing discretion, the SRC believes that an objectives-based approach could provide a suitable and sufficient basis for auditing and enforcement. However, the SRC recommends field tests to verify this view.

As regards the areas of content, the SRC feels that some terms and concepts need clarification and further elaboration. This is particularly the case for business model, intangibles and risks. Compared to other frameworks such as the IIRC's framework for integrated reporting, both the business model and intangibles are neither defined nor conceptualised. Preparers could simply refer to other guidance and standards in this respect, but it would mean that the PS1 MC is lacking important guidance. The SRC, therefore, recommends adding definitions to Appendix A and considering further elaboration. The IASB might consider the literature on business model and intellectual capital reporting for this.

As regards the content area "risks", the SRC misses a clear definition of risk. Apparently, the understanding of risk has changed compared to the current version of the PS1 MC (2010) in which the term "risk" is used in a broad sense comprising both opportunities and risks in a narrow sense (upside and downside risk). From the wording "risks that could disrupt the entity's business model, management's strategy for sustaining and developing that model, or the entity's resources and relationships" (ED PS1 MC.8.1, p. 45), it seems that the revised PS1 MC only requires reporting on downside risk. However, this is not explained in the Basis for Conclusions. Moreover, further questions arise from the wording "could disrupt". Does it mean that only risks threatening the going concern are to be reported? How can a focus on downside risk lead to a balanced view on the entity's exposure? Investors and creditors need to understand both risks and opportunities.

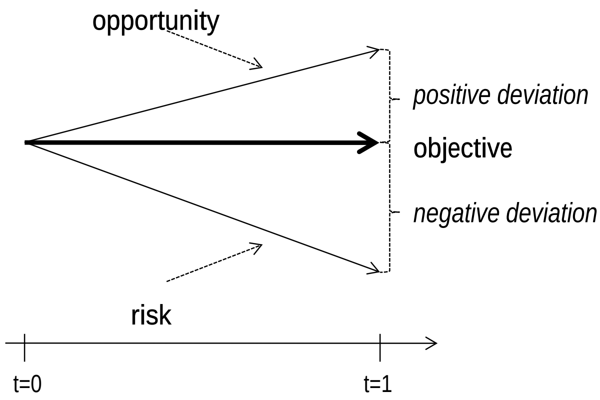
For opportunities, the "Link" on p. 45 refers to the content area of strategy. However, here "opportunities" are not well elaborated either. From ED PS1 MC.6.6 (p. 40) it can be inferred that the term "opportunities" is used to mean "options", "potentials" or "paths" that management has chosen to pursue. This notion of "opportunities" is different from the upside risk, though.

The lack of a definition and underlying concept of risk would certainly lead to confusion and heterogeneous reporting practice. The SRC, therefore, suggests defining risk and opportunities as follows:

> risks (opportunities) = potential future developments or events that could negatively (positively) affect the achievement of corporate objectives (e.g. value creation)

This definition considers that risks and opportunities are two sides of the same coin. It focuses on the external or internal sources (causes) of risks and opportunities and enables a balanced view of the entity's exposure. The definition refers to corporate objectives as a point of reference for the negative or positive deviation. As the ED PS1 MC focuses on value creation, it would imply reporting about potential developments and events that might positively or negatively affect value creation.

Figure 1 illustrates this definition and concept of opportunities and risks. It is used in German Accounting Standard No. 20 and follows the broad notion of risk used by the COSO Enterprise Risk Management Framework that is widely used by companies for designing risk management systems (www.coso.org).



Finally, as regards Appendix B, the SRC believes that the appendix in its present form is of little help to preparers. It is in many respects repetitive and the illustrative examples are in general too generic and simple to be useful for preparers. The SRC, therefore, suggests better highlighting matters related to ESG and intangibles throughout the PS1 MC.

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) The SRC does not agree with the proposed design comprising three components. Assessing three levels of objectives (headline, assessment and specific objectives, or even four if the objective of management commentary is included) is quite complex. The SRC doubts that the assessment objectives are really necessary to determine the disclosures. Moreover, assessment practices may differ between investors and creditors (valuation vs. credit worthiness) and may change over time. The SRC recommends focusing on two components, overall and specific objectives. Such an approach would be simpler and thus easier to apply. Furthermore, it would be in line with the two-level approach proposed in ED/2021/3 Disclosure Requirements in IFRS Standards – A Pilot Approach. The SRC also recommends using the same terminology (the term "headline objective" is not intuitive to us).

(b) No.

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?

The SRC believes that the specific objectives provide sufficient guidance to determine disclosures for the areas of content. The more detailed the specific objectives are, the more do they resemble a prescriptive approach.

As regards the areas of content, the SRC suggests adding two areas of content, prospects and corporate governance.
Prospects: Although the SRC understands that management commentary is supposed to provide forward-looking information throughout the document, it recommends a dedicated content area to present management's view on the entity's future development. This would consider the role of management commentary to complement financial statements in terms of future oriented information. As forward-looking disclosures are a concern in some jurisdictions for liability reasons while other jurisdictions (such as the EU) require disclosures on the entity's prospects, such a content area could be optional within the management commentary framework.
Corporate governance: The SRC believes that information about corporate governance is important to meet the information needs of investors and creditors. The SRC understands that such disclosures are specific to a country's corporate governance system (see also ED PS1 MC.B12). However, some general disclosures necessary to understand the entity's governance structures and practices may be useful for investors and creditors. Moreover, the SRC notes that Appendix B addresses "ESG matters" without considering "G" matters.

A minimum requirement is also needed to align the PS1 MC to the stewardship principle in the IASB's existing Conceptual Framework and guarantee comparability of information to investors and creditors. To do so, the SRC suggests including the definition of "management" in the proposed list of Defined Terms, separately from that of "those charged with governance".

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/b) The SRC agrees that management commentary shall focus on material information. However, the SRC doubts whether introducing the concept of "key matters" will be helpful for entities to identify material information. The new terminology ("key", "fundamental") may rather increase complexity and cause confusion. The SRC understands the IASB's intention to provide more guidance in focusing on material information, but it seems not very useful to add the attribute “key” to each content area (ED PS1 MC.4.7). The list of examples about what might be material information (e.g., ED PS1 MC.5.9 for the business model) would not be different if the concept of “key matters” were not introduced. In other words, the SRC believes that introducing “key matters” is not necessary.

(c) No.

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) The SRC believes that information on long-term prospects, intangibles resources and relationships as well as ESG matters are very important contents of management commentary. However, the SRC thinks that presenting this guidance in an appendix is not a good approach because it might be perceived that these issues are less relevant. The SRC, therefore, recommends integrating the guidance of B1 to B14 in the main text (i.e. after ED PS1 MC.4.17). The examples of Table B1 would be better placed immediately after the respective requirements in Chapter 5 to 10. This would also avoid redundancy and make the PS1 MC more concise.

(b) The SRC holds the view that it would be helpful to add a conceptual framework for reporting on intangibles, e.g., a categorisation similar to that developed in the literature or the capitals used in the IIRC Framework on Integrated Reporting. The SRC also expects that more detailed guidance on ESG matters will be provided by the planned IFRS Sustainability Disclosure Standards.

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?

The SRC believes that management commentary can potentially be a good platform for sustainability reporting directed at investors and creditors. As pointed out above in our comments to Question 8, more detailed guidance on ESG reporting is needed and potentially provided by the planned IFRS Sustainability Disclosure Standards.

The SRC considers the timing of this consultation not ideal as the new ISSB is not yet established and IFRS Sustainability Disclosure Standards are not yet available. The SRC urges the IFRS Foundation to ensure consistency among the projects of the IASB and ISSB. This is particularly important for, e.g., the concept of materiality (see also Question 10).

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?

ED PS1 MC.12.1 (also in D PS1 MC.3.2) provides a "new" definition of material information[1]. This definition is slightly different from the one provided by the IASB's Conceptual Framework for Financial Reporting (CF.2.11)[2]. In particular, some differences emerge in terms of audience (e.g. "investors and creditors" *vs.* "primary users of general purpose financial reports"), context of the assessment ("consider the entity's specific circumstances" *vs.* "an entity-specific aspect of relevance"), and sources of information ("on the basis of the management commentary and of the related financial statements" *vs.* "on the basis of those reports"). The SRC believes that it would be better to directly refer to the materiality definition already established in the Conceptual Framework. This would be in line with the Practice Statement 2 "Making Materiality Judgements", which directly refers to the definition of materiality established by the Conceptual Framework (PS2 MMJ.5).

The SRC also appreciates that the ED PS1 MC acknowledges that "*identifying material information requires management to apply judgement*" and provides some guidance on "assessing whether information is material" (ED PS1 MC.12.7-12.9). However, the SRC believes that preparers would strongly benefit from guidelines on the process to follow to assess whether information is material. This could be done, as a minimum, by referring to the "four-step materiality process" identified in the Practice Statement 2 "Making Materiality Judgements".

Further, in consideration of the debate on the materiality principle within the context of non-financial / sustainability reporting (including the debate on the IFRS Foundation's Consultation paper on sustainability reporting and the EU's proposal of a new Directive on sustainability reporting), the SRC believes that the ED PS1 MC should clarify its positioning, which appears to be driven by a "financial

[1] The ED PS1 MC.12.1 states that *"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 the management commentary and of the related financial statements"*. The PS1 MC.3.3 also adds that *"Information in management commentary influences investors and creditors' decisions by influencing their assessments of: (a) the entity's prospects for future cash flows; or (b) management's stewardship of the entity's resources—how efficiently and effectively management has used and protected the entity's resources"*.

[2] The IASB's Conceptual Framework for Financial Reporting (CF.2.11) provides the following definition of material information: *"Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial reports (see paragraph 1.5) make on the basis of those reports, which provide financial information about a specific reporting entity. In other words, materiality is an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual entity's financial report. Consequently, the Board cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation"*.

materiality"/"outside-in" perspective. The SRC believes that reference to the perspective adopted by the PS1 MC in relation to the existing debate should be highlighted at least in the Basis for Conclusions.

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) The SRC has some concerns that relate to the choice to provide guidance on materiality and the information attributes in a part (i.e. Part C) that comes after the part dedicated to the areas of content (i.e. Part B). The SRC believes that the PS1 MC needs some overarching *reporting principles* rather than information attributes. These principles should be specified in the PS1 MC before the specific requirements related to the areas of content. This would help better understand their relevance. A specific framework for narrative reporting should be identified at the beginning of the PS1 MC and guide the following assessment of the information for each area of content. This framework should incorporate (and adapt, if necessary) the information characteristics established by the Conceptual framework. Indeed, it is not easy to understand how the attributes defined in ED PS1 MC (Chapter 13) relate to the fundamental and enhancing characteristics stated in the Conceptual Framework.

In case the PS1 MC would not endorse/cross-reference to the information characteristics established by the Conceptual framework, the *terminology* adopted by the ED PS1 MC for materiality and the information attributes needs to be reconsidered. Indeed:

- *Completeness* seems to replicate what is already included in the description of materiality;
- *Balance* also contains aspects related to materiality (ED PS1 MC.13.8.a and 13.9.b);
- *Coherence* seems to be a mixture of completeness, clarity and comparability. As such, it sounds redundant.
- What is the difference between *well-integrated* and *coherent* information? Please consider that the "connectivity" principle stated by the IIRC Framework on Integrated Reporting would be a good label for well-integrated and coherent information. The connectivity of information is not adequately discussed within the ED PS1 MC.
- How does *materiality* relate to the reporting attributes? Is materiality an attribute of the information or something more?
- Why is "management's view" not included in the list of attributes/reporting principles? It is one of two reporting principles in PS1 MC (2010) and it is unclear why it is not considered explicitly as such in the revised ED PS1 MC. The SRC recommends mentioning "management's view" as a reporting principle.

(b) The SRC agrees with the proposal.

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?

The SRC is supportive of the need to insert metrics in the management commentary. However, the SRC believes that the content of Chapter 14 is quite generic in the sense that it does not provide sufficient guidance about the process to be followed to identify specific metrics.

As indicated in our reply to Question 11, the SRC suggests adding "management's view" as a fundamental reporting principle in the preparation of management commentary. Explicitly including this principle would also help preparers define the metrics to be disclosed. Indeed, the management would rely on the KPIs that are internally used to manage the business and/or that are reported regularly to the Board. The SRC also believes that it would be important to clarify that an entity is not required to calculate and disclose metrics that are not used internally. On the contrary, metrics that are used internally should be disclosed externally (possibly by aggregating some measures for competitive reasons).

While the ED PS1 MC does not require management commentary to include forecasts or targets, the SRC believes that management's view on the future development of the entity is a core content element of management commentary. The SRC, therefore, suggests adding a specific (optional) content area "prospects" (see our comments to Question 6) and providing guidance for preparers in this respect (e.g., time horizon, precision of forecasts).

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?

Chapter 15 "Examples of information that might be material" provides lists of potential material information linked to a specific disclosure objective for one of the areas of content (business model, strategy, resources and relationships, risks, external environment, financial performance and position). Since this chapter does not propose a process to assess the materiality of the information and somehow repeats what is already stated before, it seems to create duplication with the disclosure objectives defined in the previous chapters 5-10. As such, the SRC believes that the content of Chapter 15 should be incorporated in the previous chapters (5-10) or moved into an Appendix. The same suggestion applies to Chapter 11 "Overview of disclosure objectives" since the SRC believes that single chapters with similar contents do not help preparers in their assessment of the material information. The entire ED PS1 MC could be shortened and more concise as a result.

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?

The SRC agrees with this proposal. However, based on the experience with PS1 MC (2010) and our literature review (see Appendix 1), the SRC recommends issuing an IFRS Standard instead of a Practice Statement (see our general comment no. 2 above). This would help increase the relevance and comparability of information. It would be up to individual jurisdictions to decide which entities are required to prepare a management commentary in addition to financial statements. In such a case, the effective date should provide entities sufficient time to prepare for the new reporting requirements.

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) As the IASB acknowledges, comparing the effects of the proposed PS1 MC is difficult because the Board has little evidence of entities applying the PS1 MC (2010). As the SRC's literature review shows, no substantial research has been conducted on the effects of PS1 MC (2010). Obviously, it is not possible to provide evidence-based scientific evidence on the effects of the ED PS1 MC. However, the literature review developed on PS1 MC (2010) indicates that it has not contributed much to improving the quality of management reporting practice. According to some authors, the companies' disclosures were inconsistent over time and future oriented information (objectives, strategies, prospects) has been identified as one of the least disclosed.

When it comes to the PS1 MC effects analysis provided by the IASB in paragraphs BC139-BC177, the SRC supports the IASB's approach to focus on the likely effects on the information quality, benefits for jurisdictions and likely costs of the proposal. However, when it comes to "clarity about interaction with other requirements and guidelines" (BC166-BC167), the SRC is not sure if it has to be included in the effect analysis, as it does not directly refer to the PS1 MC effects.

Below the SRC refers to the selected aspects included in the IASB effects analysis.

In general, the SRC agrees that costs and benefits of implementing the proposals and of their ongoing application are likely to vary among stakeholders, and their quantification is difficult (BC142). However, SRC believes that the current proposal can benefit the reporting entities as regards the quality of their reporting and its usefulness, in particular for investors and creditors.

The SRC shares the view that investors and creditors' increasingly demand information about (a) matters that could affect an entity's long-term prospects; (b) intangible resources and relationships; and (c) ESG matters (BC149). Therefore, as indicated in response to Question 10, SRC recommends integrating the guidance of B1 to B14 in the main text, instead of presenting it in the appendix. The SRC believes that in this way, the IASB better supports its declared view that management commentary is an appropriate location for ESG-related information that is material to investors and creditors.

The SRC is not convinced that ED PS1 MC actually helps „entities navigate this [complex narrative reporting landscape, in particular in sustainability reporting landscape] by explaining how the revised Practice Statement relates to requirements and guidelines issued by other standard-setters" (BC166-BC167) much. As mentioned in the replies to Questions 8 and 9, more detailed guidance on ESG reporting is needed and expected to be provided by the ISSB.

As indicated in the general comments provided at the beginning of this response, the SRC is not convinced by the IASB's arguments to retain the status of the Practice Statement (B162) and recommends issuing it as an IFRS Standard (see also point (b) below).

The SRC generally agrees with the IASB's views on the potential costs of the proposal for preparers, investors and creditors. As regards the overall assessment of benefits compared with costs (BC173-BC174), the SRC recommends future consultations and field tests to verify the IASB expectations. The more extensive and high-quality scientific research, as well as increased mutual cooperation between IASB and academia, also seems relevant and could be encouraged. Receiving the PS1 MC related feedback could also be important in the context of the future ISSB operations and the development of IFRS Sustainability Disclosure Standards.

(b) The scarce prior research demonstrates the little impact of the current PS1 MC (2010) on both the country and firm level. As such, the SRC believes that an IFRS Standard, rather than a Practice Statement, would have a greater impact on corporate reporting practices (see also our general comment 2 above). The SRC is aware that, particularly in some contexts (e.g., U.S.A.), entities are more reluctant to provide forward-looking information due to possible litigation issues. However, the SRC is not aware of any specific local legal or regulatory obstacles in this regard. On the contrary, the SRC is aware of a number of initiatives that expand the regulation of narrative reporting (e.g., the EU's NFRD and the proposed CSRD, the U.S.'s Dodd–Frank Wall Street Reform and Consumer Protection Act).

Question 16 – Other comments
Do you have any other comments on the proposals set out in the Exposure Draft?

The SRC has some additional comments and questions that, in our view, deserve your attention. In particular:

- The SRC recommends expanding the glossary of Appendix A "Defined terms". For instance, the SRC suggests providing a definition of the following terms: business model; strategy (at present it is not clear if strategy refers to corporate or competitive level); risks (at present it is not clear if risks are considered for their negative effects only), management.

- The SRC recommends printing paragraphs defining requirements in bold letters and illustrative guidance in normal letters throughout the document. This would help distinguish between both as it is usual practice in IFRS Standards.

- While the SRC generally supports cross-references, the SRC urges the IASB to consider implications for the assurance of the management commentary. A cross-reference to information outside the management commentary raises the question whether this information is an integral element of the management commentary and consequently audited or not.

- The ED PS1 MC does not address the reporting entity of management commentary. The SRC believes that it would be helpful to clarify that the reporting entity is the same as that for the related (IFRS) financial statements.

- Further in this respect, the SRC wonders if it is possible to prepare a "combined management commentary" according to ED PS1 MC? Such a management commentary would integrate both the management commentary of the parent company as a single entity and the consolidated management commentary for the group. Please note that some jurisdictions (e.g. the EU) allow such combined management reports. The SRC, therefore, suggests explicitly addressing this issue and allowing a combination under the following conditions: (a) the title management commentary states that it is a "combined management commentary", and (b) the information is presented in such a way that information that relates to the parent company can be clearly distinguished from information that relates to the group.

- The SRC also misses clear guidance as to whether the PS1 MC is also applicable for interim management reports (e.g. half-yearly or quarterly management reports). If so, is compliance with all requirements of ED PS1 MC necessary? Please note that some jurisdictions (as the EU) require interim management reports and it would be helpful to position the PS1 MC clearly in this respect.

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Appendix 1: Literature review on management commentary

General attention of PS1 MC in the literature

A Google scholar search with the simultaneous use of keywords such as “Management Commentary” and “IFRS Practice Statement” showed 498 results (excluding citations). In comparison, the similar search using such keywords as “IIRC” and “integrated reporting” provided 7,530 results[3].

Summary of extant literature

Table 1. Selected papers including references to the 2010 IFRS Practice Statement 1 Management Commentary (PS1 MC)

Research problem	Author (year) and main aim/findings
Adoption of the PS1 MC (2010) (on a country and firm level)	• Ginesti et al. (2012) state that Italian firms are not receptive to the PS1 MC (2010), and the disclosures are driven by the local requirements (Italian civil code and specific requirements of the Italian Security Commission). • Ginesti et al.’s (2013) results show that the level of disclosures provided by the Italian listed firms does not seem to be affected by the PS1 MC (2010). • Macchioni et al. (2013) provide evidence that the level of disclosure compliance to the PS1 MC (2010) guidance in Italy is low, ranging from 10% to 76%, with an average of 39%. • Joshi et al. (2013) found that the tendency to comply with the PS1 MC (2010) in Bahrain is moderate; the compliance levels range from 40% to 97%, with an average of 72.4%. • Bayne and Wee (2018) find that Australian companies do not disclose KPIs in a way that could suggest that they are following the guidance in the PS1 MC (2010).
Determinants of PS1 MC (2010) related disclosures	• Arshad (2011*) find that managers in government-owned companies in Malaysia avoid detailed disclosure of MC information in order to evade close monitoring by outside investors. • Ginesti et al. (2013) show that industry and size influence the sample companies’ disclosures. • Joshi et al. (2013) state that profitability, financial leverage, and industry types are positively and significantly related to the disclosure provided in MCs and that the board size affects the disclosures negatively. • Macchioni et al. (2013) provide evidence that firm size and ownership diffusion are positively related to the extent of disclosure compliance with PS1 MC (2010) guidelines; the leverage and profitability were found to be unrelated. • Tutino et al. (2014*) show that government ownership, the number of outside directors on board, and the foreign funds’ presence among shareholders impact the forward-looking disclosures in MC. • Morris and Tronnes (2018*) find that total strategy disclosures are more prevalent in stakeholder-oriented countries, in countries with greater levels of financial transparency, but are less prevalent in countries with a culture of secrecy; and on the company’s level, strategy disclosures are more likely to occur in companies with more significant economic

[3] While these results are indicative for the scientific research interests, they are rough estimates and should be considered with caution. It should be noted, that a mere reference to PS1MC (2010) identified in the publication does not necessarily mean that the empirical research was based on this document and provides insights into how it is used in corporate practice.

	incentives to disclose, with a Big 4 auditor, or which are listed in New York. • Bayne and Wee (2018) show that company size is associated with the non-financial KPIs disclosures.
Consequences of PS1 MC adoption	• Pisano and Alvino (2015*) conclude that Italian companies' MC disclosure quality is significantly and positively related to analysts forecast accuracy; out of the all MC disclosure elements, financial analysts are mainly interested in accounting data to forecast earnings.
PS1 MC disclosure areas and principles	• Ginesti et al. (2012) identify the following PS1 MC (2010) disclosure items to be least often disclosed by the sample companies: entity's structure and how it creates value (within the section *nature of business*); the relationship between objectives, strategy, management actions and remuneration (within the *section objective and strategies*), significant relationships between the entity and main stakeholders (within the section *resources, risks and relationships*), discussion of the targets for the non-financial measure to achieve (within the section *results and prospects*); comparison of performance indicators (both financial and non-financial) adopted during the year to prior periods (within the section *performance measures and indicators*). • Ginesti et al. (2013) find the higher level of compliance to PS1 MC (2010) in the reporting section the *nature of the business*; in general, the most disclosed areas were the areas required by the local (Italian) law. • Joshi et al. (2013) identify two areas – *resources, risks and relationships* and *performance measures and indicators* – as areas in which the compliance with PS1 MC (2010) could be improved; they also find that the companies place greater emphasis on disclosures regarding the *internal aspects* than *external factors and influences* that can have an impact on their current and future performance. • Carini et al. (2014*) show that the least disclosed aspects are linked to the two PS1 MC (2010) disclosure areas – *objectives and strategies* and *performance measures*; companies in Italy and the UK concentrate mainly on describing the *nature of the business* followed by *results achieved*. *Strategies, company objectives, and performance measures* are presented less extensively. • Krasodomska (2014) compared MC disclosures provided by two selected companies and identified an increase in the quality of their disclosures over the years 2009-2013; disclosures related to such content elements as *prospects* and *relationships* were identified as having the lowest quality. • Tutino et al. (2014*) show that Italian companies provide limited *forward-looking disclosures* and do not disclose the information *consistently* over time. • Saitua et al. (2015*) assess how Spanish companies' MC disclosures comply with the qualitative characteristic of the *relevance*; information disclosed were *non-consistent* over time. • Bayne and Wee (2018) aim to provide input into the revision of the IFRS PS1 MC (2010) regarding the *non-financial KPIs disclosures*; the authors find that provision of comparators is low, with only 28% of non-financial KPIs disclosed with prior-year results and 24% disclosed with a target. • Morris and Tronnes (2018*) find that *strategy disclosure items* are present in over 80% of investigated reports.
Other	• Theis et al. (2012*) find that the order in which management provides information about a firm's risks and chances has a significant influence on individuals' assessment of the economic position and prospects of the firm.

	• Alvarez et al. (2014) show how the research yields different perceptions that can add to the analysis of comment letters in the deliberations of the IASB with the use of PS1 MC (2010) project as an example.

* management commentaries investigated in the empirical part of the paper were published *before* the introduction of the IFRS PS1 MC in 2010.

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