IFRS Accounting

Staff paper

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Project	**Management Commentary**
Topic	**Targeted refinements—Design of disclosure objectives**
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Purpose

1. This paper discusses a targeted refinement to the design of the disclosure objectives proposed in the Exposure Draft *Management Commentary* (Exposure Draft) and asks the International Accounting Standards Board (IASB) to make a decision.

Structure of the paper

2. The paper is structured as follows:

   (a) recap of the proposals—extract from March 2022 IASB Agenda Paper 15E *Feedback Summary—Disclosure Objectives and Areas of Content* (paragraphs 4–9);

   (b) feedback received—extracts from March 2022 IASB Agenda Paper 15E (paragraphs 10–24);

   (c) subsequent developments (paragraphs 25–28);

   (d) staff analysis (paragraphs 29–39); and

   (e) staff recommendation and question for the IASB (paragraph 40).

3. This paper also contains three appendices:

   (a) Appendix A illustrates the staff's recommended targeted refinementto the design of the disclosure objectives, using the business model area of content as an example;

   (b) Appendix B provides a high-level summary of the design of disclosure objectives proposed in the Exposure Draft, compared with other designs discussed in this paper; and

   (c) Appendix C discusses some detailed aspects of the design of disclosure objectives for management commentary compared with the design of disclosure objectives for financial statements.

Recap of the proposals—extract from March 2022 IASB Agenda Paper 15E

4. The Exposure Draft proposed disclosure objectives for six areas of content.

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

   (a) a headline objective—describing the overall information needs of investors[1] for the area of content;

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

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

6. The headline and specific objectives would require information that enables investors to *understand* a particular matter, for example, how the entity's business model creates value and generates cash flows. The assessment objectives would require this

[1] The Exposure Draft used the term 'investors and creditors' to refer to 'primary users of general purpose financial reports'. This paper refers to 'investors' as a shorthand for both these terms.

information to provide a sufficient basis for investors to *assess* a particular matter, for example, the extent to which the entity's business model and management's strategy for sustaining and developing that model depend on particular resources and relationships.

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

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

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

9. The proposal for objectives-based disclosure requirements for management commentary was generally consistent with the IASB's proposal for objectives-based disclosure requirements for financial statements, as set out in the IASB's Exposure Draft *Disclosure Requirements in IFRS Standards—A Pilot Approach* (proposed Pilot Approach)[2]. However, the disclosure objectives proposed for financial statements had only two tiers—overall objectives and specific objectives—accompanied by *observations* about the matters that the disclosure objectives are intended to help investors assess. The proposed disclosure objectives for management commentary included assessment objectives set out as *requirements* to create an effective basis for assessing compliance with the Practice Statement.

[2] This project formed part of the IASB's Disclosure Initiative (see paragraph 25).

Feedback received—extracts from March 2022 IASB Agenda Paper 15E

Key messages in feedback

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

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

12. There was broad support for the proposed areas of content and for the disclosure objectives proposed for those areas of content, with investors stating that these objectives correctly identify the information that investors need.[3]

Support

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

[3] The staff will present to the IASB at a future meeting a paper analysing the proposed areas of content and related feedback.

14. As reported in paragraph 40 of Agenda Paper 15B *Feedback summary—Investor Feedback* [for the March 2022 IASB meeting], most of the investors commenting on the operationality of the proposed objectives-based approach expressed a view that the three-tier disclosure objectives would provide sufficient granularity and specificity for management to identify information that investors need.

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

Concerns

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

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

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

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

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

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

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

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

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

Comparison with the IASB's proposed Pilot Approach

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

21. Most of the respondents highlighting the differences suggested the designs should be consistent (see paragraph 22). A few respondents noted that there could be valid reasons for differences—and that both sets of proposals are at an early stage of development—but even they urged the IASB to reconsider whether disclosure objectives more like those proposed for financial statements could be sufficient to ensure the enforceability and auditability of information in management commentary.

Suggestions for alternative designs

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

    (a) would be easier to apply;

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

    (c) would be better aligned with:

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

        (ii) the structure of requirements in the Integrated Reporting Framework.

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

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

Subsequent developments

Guidance from the IASB's Disclosure Initiative

25. During the development of the Exposure Draft, the IASB was also undertaking the Disclosure Initiative—Targeted Standards-level Review of Disclosures project. The IASB's Disclosure Initiative was a portfolio of projects aimed at improving the effectiveness of disclosures through improving its approach to developing and drafting disclosure requirements. The IASB exposed proposed guidance for itself in the development and drafting of disclosure requirements in IFRS Accounting Standards in the proposed Pilot Approach, which was published in March 2021, shortly before the IASB published its proposals on management commentary in May 2021.

26. In March 2023, the IASB completed its Disclosure Initiative—Targeted Standards-level Review of Disclosures project and published the *Guidance for Developing and Drafting Disclosure Requirements in the IFRS Accounting Standards* (Guidance), taking into account feedback received on the proposed Pilot Approach.

27. The Guidance explains that disclosure requirements of an IFRS Accounting Standard that has been drafted in accordance with the Guidance will typically:

    (a) include an overall disclosure objective that provides context of the overall user information needs to enable an entity to make materiality judgements and apply the requirements about specific disclosure objectives and items of information;

    (b) require an entity to comply with specific disclosure objectives;

    (c) support each specific disclosure objective with explanations of user assessments that rely on information an entity would disclose in satisfying the specific disclosure objective; and

    (d) link a specific disclosure objective with items of information that an entity is required to disclose to satisfy that specific disclosure objective.

28. Since the IFRS Practice Statement 1 *Management Commentary* (Practice Statement) is not an IFRS Accounting Standard that deals with information in the financial statements, the Guidance does not directly apply to the disclosure objectives in management commentary. However, the IASB's intention was for the proposed disclosure objectives for management commentary to be broadly aligned with the approach in its proposed Pilot Approach (see paragraph 9) and some respondents suggested that the design of the disclosure objectives should be even more closely aligned (see paragraphs 20–22). Therefore, the staff think it is useful to refer to the Guidance when considering a targeted refinement to the design of the proposed disclosure objectives.

Staff analysis

29. When developing the Exposure Draft, the IASB intended the design of the disclosure objectives to be broadly aligned with the approach for developing and drafting disclosure requirements for IFRS Accounting Standards that the IASB was in the process of developing as part of the Disclosure Initiative. However, the IASB decided that deviations from this approach could be justified to reflect differences between the nature of IFRS Accounting Standards (which contain disclosure requirements that are mostly focused on information about specific assets, liabilities, income and expenses) and that of the revised Practice Statement (which contains disclosure requirements that cover a much broader range of information).

30. In developing the design of the disclosure objectives proposed in the Exposure Draft, the IASB decided to modify the approach developed as part of the Disclosure Initiative by:

    (a) not requiring items of information to be provided to meet the specific objectives, and instead providing examples of information that might be material, to ensure that the information provided in management commentary would be entity-specific; and

(b) proposing assessment objectives expressed as requirements (rather than as explanations) to create an effective basis for assessing compliance with the revised Practice Statement (as explained in paragraph BC76 of the Basis for Conclusions on the Exposure Draft).

31. As mentioned in paragraph 13 of this paper, many respondents—including almost all investors who commented on the design of the disclosure objectives—expressed complete or broad support for the proposed three-tier design in the Exposure Draft. Moreover, there was broad support for the content of the disclosure objectives, with investors stating that these objectives correctly identify the information that they need However, many others—including most preparers and some accounting firms—expressed concerns about the complexity of the three-tier design, specifically about the workability of the assessment objectives expressed as requirements (see paragraphs 16–17). The feedback indicated the desirability of:

(a) simplifying the design;

(b) reconsidering the role of the assessment objectives in that design; and

(c) exploring ways to align the design more closely with that developed in the proposed Pilot Approach as part of the IASB's Disclosure Initiative.

32. Given concerns about the workability of the assessment objectives expressed as requirements, the proposed three-tier design of disclosure objectives might not achieve the IASB's aim of creating an effective basis for assessing compliance with the revised Practice Statement.

33. The staff think that the concerns about the workability of the objectives may be due to a misunderstanding of the IASB's intention when including the assessment objectives. For example, one concern was that different users need different information when making their assessments. However, the IASB intended for management to identify information to meet the common information needs of investors, not the specialised needs of particular investors. Another concern related to the requirement for management to identify the information needed to provide 'a sufficient basis' for

investors' assessments. That requirement could have been misunderstood as implying that the IASB intended management commentary to be the sole source of information used in investors' assessments. However, that was not the IASB's intention. For example, to assess how effective an entity's business model is at creating value and generating cash flows, investors might wish to compare the entity to other entities in the same industry, using information provided by other entities. As noted in the *Conceptual Framework for Financial Reporting*, general purpose financial reports do not and cannot provide all of the information that investors need—they also need information from other sources.

34. Given these misunderstandings of the IASB's intentions, reframing the assessment objectives as explanations rather than requirements should help address these concerns. Also, reframing these objectives as explanations would make it clearer that the IASB intends for these explanations to help management identify information that would be useful for investors in making these assessments, not for management to make these assessments themselves.

35. Furthermore, in the staff view, expressing the assessment objectives as explanations rather than requirements would not affect the information provided in management commentary and would not mean that the disclosure objectives, as a whole, would provide a less effective basis for assessing compliance with the revised Practice Statement. Although this change would remove one tier of *requirements*, it should be noted that:

(a) the *content* of the disclosure objectives would be retained as supporting explanations for both the headline objective and the specific objectives for each area of content. As such, those explanations would help management to identify material information to meet the headline objective and the specific objectives.

(b) entities would still be required to meet the headline objective, the top tier of the proposed three-tier design. That headline objective was designed to serve as a 'catch-all' requirement for management to evaluate whether the information needed to meet the specific objectives and the assessment objectives is sufficient to meet the headline objective and, if insufficient, identify the additional information needed. The reframing of the middle tier—assessment objectives—as explanations rather than requirements does not change the requirement to meet the headline objective.

36. The staff further note concerns about the three-tier approach resulting in 'disclosure overload'. The IASB did not intend the assessment objectives to require the provision of additional information that would not be required to meet the specific and headline objectives. Rather, the assessment objectives were intended to act as a link between the specific objectives, which specify the detailed information needs of investors for that area of content, and the headline objective, which describe their overall information needs. It would therefore be aligned with the IASB's original intention to reposition the content of the assessment objectives as explanations of the assessments that rely on the information provided for each area of content, to help management identify what information investors need to understand that area of content (in addition to the information that is provided to meet the specific disclosure objectives).

37. As noted in paragraph 22, some respondents suggested that a two-tier design for the disclosure objectives would be simpler for preparers to apply. The staff considered specific suggestions from respondents on how to achieve a two-tier design:

(a) omit the assessment objectives. While this approach would simplify the design of the disclosure objectives and would also resolve concerns about the workability of the assessment objectives, it would result in removing the content of the assessment objectives. That outcome would be inconsistent with investor feedback, which supported all three components of the disclosure objectives because they would help management to identify information that investors need. Similarly, the Guidance developed as part of the IASB's Disclosure Initiative notes that explanations of user assessments help an entity to identify material information that is required to be disclosed to meet disclosure objectives. Therefore, the removal of the explanations of user assessments that are included in the assessment objectives would also be inconsistent with that Guidance.

(b) merging the assessment objectives into the headline objective or specific objectives for each area of content. In the staff view, either of these approaches would not necessarily simplify the design of the disclosure objectives or improve the workability of the assessment objectives. For example, if the assessment objectives continued to be expressed as requirements and were simply relocated to become part of the headline objective or specific objectives for each area of content, such an approach might give the appearance of simplifying the design of the disclosure objectives but might not actually do so.

38. In summary, in the staff view, an approach that retains the content of those assessment objectives but expresses them as explanations (rather than requirements) would:

(a) simplify the design of the disclosure objectives, to be a two-tier design comprising the headline objective and specific objectives for each area of content;

(b) resolve concerns about the workability of the assessment objectives when expressed as requirements; and

(c) align the design of the disclosure objectives for management commentary more closely with the Guidance developed as part of the IASB's Disclosure Initiative.

39. An example of the staff's recommended approach is illustrated in Appendix A. Appendix B contains a high-level summary of the staff recommended approach compared with the Guidance and the proposals in the Exposure Draft. Although the staff's recommended approach would align the revised Practice Statement more closely with the Guidance, the staff note that some differences would remain, which the staff think are appropriate, as discussed in Appendix C.

Staff recommendation and question for the IASB

40. The staff recommend that the IASB simplifies the design of the proposed disclosure objectives by expressing the proposed assessment objectives as explanations, which support the headline and specific objectives, rather than as requirements.

Question for the IASB
Do you agree with the staff recommendation in paragraph 40?

Appendix A—Illustrating the staff recommendation

This appendix illustrates the staff's recommended targeted refinement to the design of the disclosure objectives, using the business model area of content as an example.

Disclosure objectives

5.5 Management commentary shall provide information that enables investors and creditors to understand how the entity's business model creates value and generates cash flows.

~~5.6~~ **[Assessment objectives repositioned as explanations—see below]**

5.~~7~~6 The information about the entity's business model shall enable investors and creditors to understand:

- (a) the range, nature and scale of the entity's operations;
- (b) the entity's cycle of creating value and generating cash flows;
- (c) the environmental and social impacts of the entity's activities if those impacts have affected or could affect the entity's ability to create value and generate cash flows, including in the long term; and
- (d) progress in managing the entity's business model.

5.~~6~~7 ~~Information in management commentary shall provide a sufficient basis for~~ The <u>information required to meet the objectives in paragraphs 5.5–5.6 is intended to enable</u> investors and creditors to assess:

- (a) how effective the entity's business model is at creating value and generating cash flows;
- (b) how scalable and adaptable it is; and
- (c) how resilient and durable it is.

Appendix B—High-level comparison of the design of disclosure objectives

	Exposure Draft *Management Commentary*	***Guidance for developing and drafting disclosure requirements in IFRS Accounting Standards***	**The revised IFRS Practice Statement 1 *Management Commentary* reflecting the staff recommendation**
Disclosure objectives describing the overall information needs of users (see Appendix C)	Each area of content has a **headline objective** set out as a requirement	Each Accounting Standard has an **overall disclosure objective** set out as non-prescriptive context-setting paragraph(s)	Each area of content has a **headline objective** set out as a requirement
Disclosure objectives describing user assessments	Each area of content has a**ssessment objectives** set out as requirements	n/a	n/a
Disclosure objectives describing the detailed information needs of users	The headline objective and assessment objectives are accompanied by **specific objectives** set out as requirements	The overall disclosure objective is accompanied by **specific disclosure objectives** set out as requirements	The headline objective is accompanied by **specific objectives** set out as requirements
An explanation of user assessments (see Appendix C)	n/a	**Explanations of user assessments** that rely on information an entity would disclose in satisfying **each specific disclosure objective**	**Explanations of user assessments** that rely on information an entity would disclose in satisfying the disclosures objectives **for each area of content (both headline and specific objectives)**
Items of information that an entity is or may be required to provide to satisfy the disclosure objectives	**Examples of information that might be material** for each specific objective	**Items of information that an entity is required to disclose** to satisfy each specific disclosure objective	**Examples of information that might be material** for each specific objective

Appendix C—Detailed aspects of the comparative design of disclosure objectives

This appendix discusses some detailed aspects of the design of disclosure objectives for management commentary compared with the design of disclosure objectives for financial statements.

Headline objectives and overall objectives

C1. When developing the *Guidance for Developing and Drafting Disclosure Requirements in the IFRS Accounting Standards* (Guidance), the IASB proposed using the prescriptive language 'shall' when drafting an overall disclosure objective in an IFRS Accounting Standard, to require an entity to comply with that overall objective. The IASB also proposed a similar approach for drafting the headline objective for each area of content in the Exposure Draft *Management Commentary* (Exposure Draft).

C2. However, when finalising the Guidance, the IASB decided to use non-prescriptive language for the overall disclosure objective in an IFRS Accounting Standard. The IASB noted that the main purpose of the overall disclosure objective is to make entities disclose material information beyond the information disclosed applying the specific disclosure objectives. However, a similar requirement already exists within paragraph 31 of IAS 1 *Presentation of Financial Statements*. The IASB therefore decided to draft overall disclosure objectives as non-prescriptive, context-setting paragraphs.[4]

C3. Therefore, there is now a difference in how an overall disclosure objective in an IFRS Accounting Standard will be drafted compared with the drafting of the headline objectives in the revised IFRS Practice Statement 1 *Management Commentary*

[4] For more information, see paragraphs 11–17 of October 2022 IASB Agenda Paper 11B.

(Practice Statement). In the staff view, this difference is appropriate. The staff note that the rationale for using non-prescriptive language for the overall disclosure objective in an IFRS Accounting Standard relies on a requirement in IAS 1. However, the Practice Statement is not an IFRS Accounting Standard that deals with information in the financial statements and therefore cannot rely on or be linked to a requirement in IAS 1 (or IFRS 18 *Presentation and Disclosure in Financial Statements*).

Explanations of user assessments—relationship with headline objectives and specific objectives

C4. In the Guidance, each specific disclosure objective is to be accompanied by an explanation of user assessments that rely on information an entity would disclose in satisfying the specific disclosure objective. The explanation is intended to help an entity identify material information that an entity is required to disclose to satisfy that specific disclosure objective. Hence, the explanation of user assessments relates to the respective specific disclosure objective.

C5. However, in the Exposure Draft, the assessment objectives related to both the headline objective and the specific objectives for each area of content. Similarly, even if assessment objectives are reframed as explanations rather than as requirements (as recommended in paragraph 39 of this paper), those explanations of user assessments would continue to relate to both the headline objective and the specific objectives for each area of content.

C6. In the staff's view, this difference between the Guidance and the disclosure objectives for management commentary is reasonable and helpful. By supporting the headline objective in addition to the related specific objectives, the explanations of user assessments will help management to identify material information to be disclosed to meet the headline objective and the specific objectives, and will therefore also help to provide an effective basis for assessing compliance with the Practice Statement. The staff also note broad support for the proposed disclosure objectives, with investors stating that these objectives correctly identify the information that investors need (see paragraph 14).