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Response to the IFRS Exposure Draft (ED2021/6) *Management Commentary*

1. Introduction and key points

1.1 The UK Shareholders' Association and ShareSoc represent the views of individual investors. Between us we have over 22,000 members. We welcome this review, which is very timely. The Exposure Draft on the Management Commentary a commendably thorough piece of work by the IASB and we welcome the chance to submit our views. We are happy that you post our response on your website.

1.2 The proposed updated practice statement for the Management Commentary is an excellent piece of work by the IASB. We agree that the Exposure Draft provides 'comprehensive, clear and structured requirements' (BC32) for preparers when writing their management commentary. It is clear also that these requirements are framed with the information needs of investors in mind.

1.3 The IASB correctly identifies the current shortcomings with many management commentaries that boards currently produce (IN8). Regardless of other changes that have taken place over the last eleven years, such as the increased interest in ESG matters, updated guidance is long overdue.

1.4 The Exposure Draft forms an important and very significant part of the guidance that is going to be needed for the practical implementation of the FRC's proposals on the future of corporate reporting (A Matter of Principles – October 2020). This is particularly true in relation to Chapter 6 of the FRC's discussion paper (Non-financial Reporting).

1.5 We recognise that, because it covers many jurisdictions with differing local laws and approaches to corporate reporting, making the practice statement enforceable across all jurisdictions would not be appropriate.

1.6 However, as far as the UK is concerned, we would like to see much greater incentives for companies to apply the practice statement on a 'comply or explain' basis. Making it a requirement for companies to apply the practice statement under the terms of the UK

Corporate Governance Code 2018 would be helpful. However, adoption of the Corporate Governance Code is not mandatory and the practical linkage between the Code and the Companies Act 2006 (with reference to Section 172) is tenuous. It is much too easy for companies to claim that they have met their legal obligations under Section 172 of the CA without coming anywhere near meeting many of the requirements of the proposed 2021 Management Commentary practice statement.

1.7 Even on a comply-or-explain basis there are far too many 'get-outs' for companies faced with the requirement of providing clear and comprehensive information that meets the needs of investors. Too often companies hide behind the smokescreen that information on their business model, business strategy or key business metrics is commercially sensitive or confidential. In most cases these claims are spurious. We discuss this further in our response to Q2 below.

1.8 The IASB and the FRC need to find a way of taking a much firmer line with companies in the preparation of their reports. This is particularly true of the Management Commentary which, as the IASB recognises, is often lamentable in terms of its usefulness to investors. The UK government is already diluting proposals for tighter boardroom rules which followed the Kingman and Brydon reviews and subsequent consultations. The UK Shareholders' Association, ShareSoc, the Chair of the Corporate Reporting Users Forum (CRUF) and the Chief Executive of the CFA recently wrote to the Financial Times about this. The letter ('Investors are let down by the decision to dilute boardroom rules') was published on 12th November (https://on.ft.com/3HnK2d2). On the same day the FT also commented on this issue in its Editorial column – 'A missed opportunity for reform of corporate governance' (https://on.ft.com/31UEp5D).

1.9 For as long as the IASB's Practice Statement on the Management Commentary is allowed to be treated by UK companies as a footnote to the UK Corporate Governance Code – which the good follow and the bad neglect - there is very little chance that the principles and guidance that it provides will be comprehensively adopted.

1.10 Finally, there are two areas in which we think that the current Exposure Draft could be improved:

1.10.1 It would be helpful for users if it provided embedded links to relevant reports and documents that the FRC has produced (for example on sustainability reporting, business model reporting and risk reporting) to make it easier for users of the Practice Statement to access these. Specific useful guidance from other sources should also be referenced and tagged. We acknowledge that these links would need to be updated – probably on an annual basis. This, however, would be worth doing.

1.10.2 The Practice Statement should encourage companies reporting in English to sign up to the Plain English Campaign's Crystal Mark and Honesty Mark. They should also consider using the Campaign's 'Drivel Defence' software.

1.11 Our responses to the specific questions in the Exposure Draft are given below in red text.

2. Responses to the IASB's Questions

Question 1—The financial statements to which management commentary relates

Paragraphs BC34–BC38 explain the Board's reasoning for these proposals.

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

Yes, provided that the company complies with requirements set out in Chapter 2 of the Exposure Draft.

(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?

Yes, as for the response to 1a above.

Question 2—Statement of compliance

(a) Paragraph 2.5 proposes that management commentary that complies with all of the requirements of the Practice Statement include an explicit and unqualified statement of compliance.

Paragraphs BC30–BC32 explain the Board's reasoning for this proposal.
Do you agree? Why or why not?

Yes, this will help in holding companies to account (i.e. if they make a false or misleading statement in relation to their compliance). However, we have real concerns that there will be plenty of scope for companies to dissemble on this issue by failing to adhere to the spirit of the practice statement.

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

(b) Paragraph 2.6 proposes that management commentary that complies with some, but not all, of the requirements of the Practice Statement may include a statement of compliance. However, that statement would be qualified, identifying the departures from the requirements of the Practice Statement and giving the reasons for those departures.
Paragraph BC33 explains the Board's reasoning for this proposal.
Do you agree? Why or why not?
We agree. However, please note our concerns above (Question 2a).

Question 3—Objective of management commentary

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

(a) enhances investors and creditors' understanding of the entity's financial performance and financial position reported in its financial statements; and

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

Paragraph 3.2 proposes that the information required by paragraph 3.1 be provided if it is material. Paragraph 3.2 states that, in the context of management commentary, information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that investors and creditors make on the basis of that management commentary and of the related financial statements.
Paragraphs 3.5–3.19 explain aspects of the objective, including the meaning of 'ability to create value'.

Paragraphs BC42–BC61 explain the Board's reasoning for these proposals.

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

Yes – and we believe it is clear and appropriate. However, the notes and supporting explanations provide an insight into just how ambitious the practical realisation of the objective is likely to be. It would be helpful to know what steps might be taken to help and encourage companies to meet the requirements set out in Chapter 3. These might include some form of assurance – possibly as part of the statutory audit or perhaps as part of a regulatory system of sampling a number of management commentaries to monitor quality. Approved training for preparers of the management commentary might also be helpful.

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?

We suspect that it is going to be very difficult to ensure that the Board's approach is fully operationalised. From an investor point of view all the requirements set out in Chapter 4 are entirely appropriate and very welcome.

However, we fear that companies are likely to use the excuse of commercial sensitivity and confidentiality to withhold useful information from the public domain. This is likely to be particularly true in the area of corporate strategy, despite of the fact that in nearly all cases companies' competitors know what their strategy is. We have never heard of a case in which a competitor has 'stolen' a company's strategy by finding out what they are planning and implementing the strategy themselves before the company itself has chance to do so. If a company wants a new and innovative strategy it will engage the services of one of the well-known strategy consultants. Nonetheless, many companies will argue that saying anything that provides much insight into their strategy or the risks and rewards associated with its implementation represents an unacceptable commercial risk.

Similarly, companies seem very reluctant to say much, if anything, about key supplier relationships and dependencies. This includes information about who their top-ten suppliers are, how dependent they are on these suppliers and how they manage the relationships so as to minimise the risks of over-dependence.

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?

Yes, but see our comments and concerns above – particularly in the context of 'specific objectives'.

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

Yes, we agree that this is an excellent analysis of the key areas in which investors want information and the type of information they require. Our doubts centre on the willingness of companies to meet many of the requirements set out in Chapters 5 - 10.

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?

Yes – in the interests of brevity and focusing on what matters.

(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?

Yes, in so far as the proposed guidance is commendably comprehensive. The risk is that, although the IASB said in the webcast on Disclosure Objectives that it does not want to adopt a 'checklist' approach to the content that companies should include in their management commentary, there is a risk that preparers will use the guidance for this purpose. There needs to be a system to monitor whether this is happening and agreement on what action can be taken to discourage it.

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

It is hard to tell at this stage. The draft allows preparers plenty of discretion in how to present information and, for example, whether a particular issue relates to, say, the business model or strategy and whether it is particularly relevant in the context of, say, resources and relationships and / or ESG matters. It also allows plenty of discretion in terms of what information to present (e.g. the basis of an identified opportunity, the risks of pursuing the opportunity and the metrics for measuring progress towards objectives).

There is helpful content in Appendix B to give preparers a clear indication of the types of issues they need to consider. An overly-prescriptive approach is unlikely to work. Nor should the IASB be drawn into adopting a 'spoon-feeding' approach.

We suggest reviewing the success of the guidance after, say, two to three years and considering whether further consultation with preparers and investors is necessary and whether amendments to the guidance are needed.

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

The FRC regularly publishes reports on a wide range of different aspects of corporate reporting. For example, the Reporting Lab has recently published a report on mandatory TCFD disclosures. It has also recently published a report on Climate Scenario Analysis (in conjunction with the Alliance Manchester Business School). Wherever relevant, these FRC reports should be referenced in the Management Commentary Guidance document with a link to take the used directly to the document.

Many (but by no means all) of the FRC's reports are primarily concerned with the financial statements rather than the narrative element of reporting. This should be an advantage as it should help companies to ensure that their reporting in the management commentary supports and complements the reporting in the financial statements.

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?

We have no comments to make on this.

Part C—Selection and presentation of information

Chapters 12–15 contain additional requirements and guidance on the selection of information to include in management commentary and on the presentation of that information.

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?

No. We believe that the guidance given is sound and appropriate.

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?

We agree with the proposals. They are comprehensive and clear. We particularly like the fact that the guidance gives examples of poor practice that should be avoided as well as good practice that should be adopted.

(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?

We agree. With increasing use of electronic documents, the insertion of links into the text to related documents is an easy and practical way of avoiding duplication and repetition.

It would, however, be advisable to caveat comments in paras 13.19 -13.21 by adding that key material information in cross-referenced documents should be summarised in the Management Commentary. It is not acceptable for readers to be given a link to a lengthy document which they have to read in full to understand its importance and relevance. The IASB could make it clear that the guidance given on Coherence (paragraphs 13.27 -13.30) also applies when preparers cross-reference other documents as well as when they cross-reference other sections within the Management Commentary.

Question 12—Metrics

Chapter 14 proposes requirements that would apply to metrics included in management commentary.
Paragraphs BC125–BC134 explain the Board's reasoning for these proposals.

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

Yes, we agree with the proposals. The proposed guidance address all the key issues relating to the selection and use of metrics.

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 picks out the right issues under each of the reporting areas for a - f above. However, it would be helpful if the practice statement could give preparers clearer guidance on appropriate methods of presentation and use of diagrams. Preparers often use diagrams where a simple commentary would be better. They also have a habit of presenting diagrams that are nonsensical. A good example of this can be found in Hill and Smith's 2020 annual report. Page 4 of the report (Group at a Glance) provides useful information in a format that is easy to digest. The diagram on Page 8, 'Our Sustainable Growth Model', (which the company also claims is its business model) is essentially generic boilerplate and tells us nothing useful.

Other comments

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?

Yes.

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?

We think that this is a good analysis. However, paragraph BC 140 is very telling:

'Comparing the effects of the Board's proposals on practice with the effects of applying the current requirements in practice would be difficult, because the Board has little evidence of entities applying the 2010 Practice Statement'.

Will entities take any more notice of the new Practice Statement (2021 / 22) than they have tended to do of the 2010 Statement? A key question for the IASB, regulators and investors is: what can be done to try to ensure that preparers do take more notice?

(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?

No.

Question 16—Other comments

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

We urge the IASB to consider encouraging all preparers who report in English to join the Plain English Campaign and apply for a Crystal Mark and, ideally, an Honesty Mark. Companies achieving a Crystal Mark should display this on their reports.

Sue Milton - Director, UK Shareholders' Association

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