22 November 2021

Mr. Andreas Barckow
Chair
International Accounting Standards Board
Columbus Building, 7 Westferry Circus, Canary Wharf,
London E14 4HD, United Kingdom

<u>Re: Exposure Draft "Management Commentary"</u>

Dear Mr. Barckow:

The Corporate Accounting Committee (CAC) of the Securities Analysts Association of Japan (SAAJ) is pleased to comment on Exposure Draft "Management Commentary" (hereinafter referred to as the "ED") published in May 2021.

The SAAJ is a not-for-profit organization for professionals in the areas of investment and finance, offering education and certification programs in these fields. Its certified member analysts (holding the CMA designation) number around 28,000.

The CAC is a standing committee of the SAAJ composed of 12 members, most of whom are users of financial reports including equity and credit analysts, portfolio managers, and a few academicians and public accountants.

We would like to thank Ms. Rika Suzuki, a member of the IASB, for holding an online seminar for pertinent members of the SAAJ on 29 September 2021 to explain the content of the ED. From among seminar participants, a questionnaire was sent to the 16 holding the CMA—this comment letter is based on the answers of 11 CMA respondents (making for a response rate of 69%) and discussions among members of the CAC and the Sustainability Reporting Committee, which was established in March 2021 and is composed of eight members such as equity and credit analysts, ESG specialists, public accountants, and academicians. Please see the attached questionnaire results.

General Comments

When the IASB began addressing the revisions to IFRS Practice Statement 1: *Management Commentary* (Practice Statement) which is the basis of the ED, the IASB had only to consider the relationship between management commentary and IFRS Accounting Standards. It was not envisioned that the IFRS Foundation would establish the International Sustainability Standards Board (ISSB) and take on the development of IFRS Sustainability Disclosure Standards. As we explain in our comments to **Questions 8 and 9**, we propose that, in order to avoid unnecessary confusion to users and preparers, the IASB should issue the revised Practice Statement after it does its best to analyze/formalize the relationships/consistency among management commentary, financial reports (based on IFRS Accounting Standards), and sustainability reports (based on IFRS Sustainability Disclosure Standards) so as to improve the ED.

Below are our comments on each question.

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?

Comments

We agree with the proposed objective of management commentary. All respondents to Q1 of our questionnaire agreed to this proposal. The proposed objective of (a) and (b) in **Question 3** clearly focuses on users of financial information and is consistent with IFRS Accounting Standards. As more financial statement numeric data is based on estimates and forecasts, the ED clearly explains that an entity's management commentary provides information that complements information in the entity's financial statements. Paragraphs 3.5-3.19, which are supporting explanations of the objective, would help management of an entity understand what to explain in the entity's management commentary.

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?

Comments

We think that the proposed objectives-based approach would be capable of being operationalized and enforceable. 91% of respondents to Q2 of our questionnaire agreed to this proposal. As Paragraphs BC69–BC71 explain, the proposed objectives-based approach would be appropriate whilst a prescriptive approach may pose risks that users cannot identify important information among too much generic information.

Nevertheless, the proposed approach cannot completely solve the fundamental problem where management of an entity is reluctant to disclose negative information. Therefore, the IASB should continuously consider improving disclosure of risk information.

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?

Comments

We agree with the proposed design of the disclosure objectives for the six areas of content and three components. 82% of respondents to Q3 of our questionnaire thought that the proposed design of the disclosure objectives could provide sufficient information through an entity's management commentary. The proposed design of the disclosure objectives for the six areas of content and three components would be acceptable to both users and preparers. Nevertheless, the quality of an entity's management commentary depends largely on management's commitment to engage with investors and creditors. Therefore, the effectiveness of the proposed approach would be ultimately assessed based on the level of engagement between investors/creditors and management of an entity.

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?

Comments

We agree with the proposed disclosure objectives for the six areas of content (a) to (f) in **Question 6**. 73% of respondents to Q4 of our questionnaire answered that there was no disclosure objective they did not agree with among those for all areas of content indicated in Chapter 11.

Nevertheless, regarding "(d) risks to which the entity is exposed", we received a comment that the Practice Statement should explain how to address not only risks but also opportunities for the entity. Also, regarding "(f) the entity's financial performance and financial position", we received a comment that the IASB should further clarify the objective of (f) by showing specific cases as sustainability matters can only be reflected in (f) after a long period of time.

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?

Comments

The proposed Appendix B would provide a suitable and sufficient basis for management to identify material information that investors and creditors need concerning (i)-(iii) in **Question 8** (a). 55% of respondents to Q5 of our questionnaire answered that the proposed Appendix B could enable management of an entity to provide sufficient information regarding (i)–(iii) thorough the entity's management commentary. They pointed out that the proposed Appendix B would be useful for management of an entity when explaining various aspects of the entity's risk factors. Therefore, they highly evaluated the fact that the proposed Appendix B would have a certain deterrent effect on management which is reluctant to disclose negative information, and that it would help comprehensive disclosure of useful information for investors and creditors who are not familiar with the entity.

On the other hand, some commented that the proposed Appendix B would not be helpful unless the content was detailed and there were specific cases/indicators to follow or for reference. Also, some commented that the proposed Appendix B should be improved because: (1) it would make it difficult for investors and creditors to understand information on "(ii) intangible resources and relationships", such as intellectual capital and human resources, due to the concern that such information would be explained in respective two areas of content, namely "(a) the entity's business model" and "(c) the entity's resources and relationships", and (2) "(iii) environmental and social matters" would be understandable when they are explained in just one part rather than in each area of content under (a) to (f).

As related to **Question 9**, the content of the proposed Appendix B regarding "(iii) environmental and social matters" should be consistent with that of IFRS Sustainability Disclosure Standards to be developed by the ISSB.

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?

Comments

91% of respondents to Q6 of our questionnaire thought that with regard to IFRS Sustainability Disclosure Standards to be developed by the ISSB there were some matters that the IASB should consider in finalizing environmental and social matters proposed in the ED. Regarding "(iii) environmental and social matters" in **Question 8** (a), the content of the revised Practice Statement should at least be consistent with the disclosure requirements of IFRS Sustainability Disclosure Standards. Any inconsistencies between the first IFRS Sustainability Disclosure Standards to be issued by the ISSB focusing on climate change, the most important issue in terms of the environment, and the content of the revised Practice Statement would cause significant confusion to users and an undue burden on preparers.

Therefore, the IASB should finalize the revised Practice Statement after working closely with the ISSB and the first Exposure Draft on IFRS Sustainability Disclosure Standards has been published. In addition, as IFRS Sustainability Disclosure Standards covering social and governance matters will be developed following consideration of climate change/environmental matters by the ISSB, long-term collaboration with that body will be essential for the IASB. The two boards should consider and establish an appropriate collaboration mechanism so that the first IFRS Sustainability Disclosure Standards and the revised Practice Statement would be finalized at the same time.

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?

Comments

We agree with the proposal in **Question 11** (a) to require information in management commentary to be complete, balanced, and accurate. 73% of respondents to Q7 of our questionnaire agreed to this proposal. The clear requirement to be complete, balanced, and accurate would reduce the incentive of management of an entity to avoid disclosing negative information and emphasize the need to include negative information in the entity's management commentary.

On the other hand, some are concerned that the relationship and consistency between the qualitative characteristics of useful financial information defined in the Conceptual Framework for Financial Reporting of the IFRS Accounting Standards and this proposal to be complete, balanced, and accurate is unclear. It should be clearly stated in the revised Practice Statement whether or not management of an entity should consider the qualitative characteristics of useful financial information defined in the Conceptual Framework for Financial Reporting when they explain the entity's management commentary.

We cannot unconditionally agree with the proposal in **Question 11** (b) to include information in management commentary by cross-reference to information in other reports published by the entity. In Q8 of our questionnaire, no respondent disagreed with the proposal, but 54.5% of the respondents neither agreed nor disagreed, and 45.5% agreed, which is less than the majority,

Our most serious concern is "the status of information included by cross-references" in BC120 (b). For example, if there is a difference in assurance/audit requirements between an entity's management commentary and the cross-referenced voluntary disclosure documents, it is unclear to what extent an assurance/audit firm covering the entity's management commentary can assure/audit the cross-referenced information. In addition, when referring to other reports published at different times from the financial report, there is a risk that inappropriate information might be given due to the time difference and hence procedures to prevent such should be detailed.

We understand the intent of the proposal in Paragraph 13.19 setting the condition "including the information in this way rather than directly within the management commentary does not make the management commentary less clear" to avoid undisciplined expansion of cross-references. Nevertheless, the condition of "less clear" should be more detailed considering the effects on assurance/audit. Cross-references would be difficult to effectively use unless our concern is resolved.

Sincerely yours,

S Komiyama

Satoshi Komiyama
Chair
Corporate Accounting Committee

Attachment:
Questionnaire Results on the IASB ED "Management Commentary"

The SAAJ conducted a questionnaire survey regarding the IASB ED "Management Commentary"—from among those who participated in the online seminar held on 29 September 2021 by Ms. Rika Suzuki, a member of the IASB, the questionnaire was sent to the 16 CMA participants. Some 11 had responded by the deadline of 18 October 2021 making for a response rate of 68.8%.

Q1: Do you agree with the proposed objective of management commentary? **ED Question 3**

(a) Yes	11	100.0%
(b) No	0	0.0%
(c) Neither "Yes" nor "No"	0	0.0%
Number of respondents	11	100.0%

The ED proposes an objectives-based approach that:

(a) specifies an objective for management commentary;

(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;

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

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

Q2: Do you agree with the proposed objectives-based approach? **ED Question 4**

(a) Yes	10	90.9%
(b) No	1	9.1%
(c) Neither "Yes" nor "No"	0	0.0%
Number of respondents	11	100.0%

Regarding **Q2** (b), the proposed disclosure objectives cover six areas of content:

(a) the entity's business model—how the entity creates value and generates cash flows;

(b) management's strategy for sustaining and developing that business model, including the opportunities management has chosen to pursue;

(c) the resources and relationships on which the business model and strategy depend, including resources not recognized as assets in the entity's financial statements;

(d) risks that could disrupt the business model, strategy, resources, or relationships;

(e) factors and trends in the external environment that have affected or could affect the business model, strategy, resources, relationships, or risks; and

(f) the entity's financial performance and financial position—including how they have been affected or could be affected in the future by the matters discussed for the other areas of content.

The proposed disclosure objectives for the areas of content comprise three components:

(a) a headline objective—describing the overall information needs of investors and creditors 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 and creditors for the area of content.

Q3: Do you think the proposed design of the disclosure objectives for the six areas of content and three components could provide sufficient information through an entity's management commentary? **ED Question 5**

(a) Yes	9	81.8%
(b) No	1	9.1%
(c) Neither "Yes" nor "No"	1	9.1%
Number of respondents	11	100.0%

Q4: Are there any disclosure objectives you do not agree with among those for all the areas of content indicated in Chapter 11? **ED Question 6**

(a) Yes	2	18.2%
(b) No	8	72.7%
(c) Neither "Yes" nor "No"	1	9.1%
Number of respondents	11	100.0%

"Appendix B—Long-term prospects, intangible resources and relationships and ESG matters" is proposed to provide a suitable and sufficient basis for management to identify material information that investors and creditors need concerning: (i) matters that could affect the entity's long-term prospects, (ii) intangible resources and relationships, and (iii) environmental and social matters.

Q5: Do you think the proposed Appendix B could enable management of an entity to provide sufficient information about (i) – (iii) above through the entity's management commentary? **ED Question 8**

(a) Yes	6	54.5%
(b) No	1	9.1%
(c) Neither "Yes" nor "No"	4	36.4%
Number of respondents	11	100.0%

Q6: With regard to IFRS Sustainability Disclosure Standards to be developed by the ISSB, are there any matters that you think the IASB should consider in finalizing environmental and social matters proposed in the ED? **ED Question 9**

(a) Yes	10	90.9%
(b) No	1	9.1%
(c) Neither "Yes" nor "No"	0	0.0%
Number of respondents	11	100.0%

Q7: Chapter 13 proposes to require information in management commentary to be complete, balanced, and accurate. Do you agree with this proposal? **ED Question 11 (a)**

(a) Yes	8	72.7%
(b) No	0	0.0%
(c) Neither "Yes" nor "No"	3	27.3%
Number of respondents	11	100.0%

Q8: Paragraphs 13.19-13.21 propose that information may be included in management commentary by cross-reference to other reports if including the information in this way rather than directly within the management commentary does not make the management commentary less clear. Do you agree with this proposal? **ED Question 11 (b)**

(a) Yes	5	45.5%
(b) No	0	0.0%
(c) Neither "Yes" nor "No"	6	54.5%
Number of respondents	11	100.0%