To the International Accounting Standards Board (IASB)

London, United Kingdom

Submitted electronically

The Hague, 18 November 2021

Ref: B21.36

Subject: Eumedion response to Exposure Draft 'Management Commentary'

Dear Members of the IASB,

Eumedion appreciates the opportunity to respond to the Management Commentary exposure draft ('ED') as issued in May 2021. Eumedion is the dedicated representative of the interests of 53 institutional investors, all committed to a long term investment horizon. Together our participants invest over € 8 trillion of capital in equity and corporate non-equity instruments. Eumedion aims to promote good corporate governance and sustainability in the companies our participants invest in. We regard globally recognised financial and sustainability standards as critical elements in a global financial infrastructure, since investors are dependent on the quality of such standards for allocating their own and entrusted capital. Global standards are instrumental for responsible and engaged investors to effectively live up to their fiduciary duties.

Our general observation is that the ED succeeds in proposing investor-relevant guidance on a great variety of topics for the management report.

We would like to highlight the following key messages from our response to the individual questions.

- Eumedion considers the announced International Accounting Standards Board (ISSB) to be the preferred standard setting body for the Management Commentary project. We see the ISSB to be primarily focused with developing standards that apply to the management report; similarly to how the IASB is primarily concerned with standards that apply to the financial report. We expect standards from the ISSB to be more auditable and more enforceable than a practice statement of the IASB. We see a stronger interconnectedness between management commentary and other topics that the ISSB will be setting standards on. Much stronger than between management commentary and the standards set by the IASB. However, there obviously is a clear interconnectedness between management commentary and the financial statements. A close cooperation between the two Boards on this topic is most likely to best address this.

- Eumedion suggests to add the following topics to the practice statement:
    - a requirement to describe the competitive landscapes of the business models operated by the reporting entity
    - a paragraph on incidents
    - and the strategy paragraph should be expanded with a capital allocation strategy, which consists of a capital structure strategy, a distribution strategy and an M&A strategy.

Please find our responses to the questions in the ED below. If you would like to discuss our views in further detail, please do not hesitate to contact us. Our contact person is Martijn Bos (martijn.bos@eumedion.nl, +31 70 2040 304).

Yours sincerely,

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Question 1—The financial statements to which management commentary relates
Paragraph 2.2 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 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?

Response to 1a and 1b: We agree. The quality of management commentaries of many entities would benefit from full compliance with the practice statement, irrespective of whether their corresponding financial report is in accordance with IFRS standards. We agree with the reasoning in the Basis for Conclusions that no restrictions should be set on the basis of preparation of such financial statements.

2.2 Management commentary shall identify the financial statements to which it relates. If the management commentary is not part of the same report as the related financial statements, it shall explain how to access those financial statements. If the related financial statements are not prepared in accordance with IFRS Standards, the management commentary shall disclose the basis on which the financial statements are prepared.

If the financial statements and the management commentary are both published in the same document, we see little added value in a requirement to 'identify the financial statements to which it relates'. The second sentence of this paragraph seems to sufficiently cover cases where it may not be evident.

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?
(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?

Response to 2a and 2b: We agree and concur with the reasoning in the Basis for Conclusions.

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?

Response to 3:

3.11 In this [draft] Practice Statement, 'ability to create value' refers to an entity's ability to create or preserve value for itself and hence for its investors and creditors. Some people refer to the value an entity creates for itself as 'enterprise value'.

We would like to suggest to remove from the practice statement this specific reference to 'enterprise value' with regard to the ability to create value for the entity in the practice statement. This paragraph does not clearly define what is meant and no reference is made to the term anywhere in the document.

We agree with the quoted paragraph 3.2. We also agree with the two bullets in paragraph 3.1. However there may be more elements. For example investors wish to understand the certain characteristics of a reporting entity, its impact on society, its governance structure, not only if these factors can be expected to influence future cash flows, but also if they are not explicitly expected to affect future cash flows. Certain characteristics of a reporting entity are often used to assess whether a reporting entity potentially meets the non-financial criteria of a specific investment portfolio.

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?

Response to 4a: Yes, we see great merit in the described objectives-based approach as a starting point for standard setting in the management commentary. We agree with the reasoning in the Basis for Conclusions.

The ISSB should however not become dogmatic on the objectives-based approach and if necessary on particular topics revert to a (more) prescriptive approach if that is, or turns out to be, more appropriate. We refer to our response to question 7b on competitive landscape.

We would like to note that investor decisions not only include buying, selling, holding and voting on securities, but also include engagement with management on various topics like strategy, sustainability topics, corporate governance and remuneration. This could be reflected in the text box on page 24 of the ED.

Paragraph B13 rightfully suggests reporting entities should consider reporting metrics that are published by industry bodies. These may be reported irrespective of whether the reporting entity actually uses these metrics. Some metrics may be too 'high level' or too aggregated for management, while they still are very useful for investors. This seems in contrast with paragraph 3.18 (a) *'information in management commentary derives from information used by management'*. We suggest to drop 3.18 (a).

Response to 4b: We are quite hopeful, but not sure whether the objectives-based approach will provide a suitable and sufficient basis for auditors and regulators to determine compliance. The objectives-based approach will need to be evaluated.

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?

Response to 5a: We agree.

Response to 5b: We refer to our response to question 9.

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?

Response to 6: We agree, in particular with the emphasis that ED gives to sustainability risks and the attention to long term risks and the long term resilience of a business model.

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?

Response to 7a: We agree.

Response to 7b: We agree with the provided examples of key matters in chapter 5 to 10. We would also like to make a few suggestions:

Strategies

Eumedion expects a reporting entity to have a Capital allocation strategy and an Operational strategy. The Capital allocation strategy consists of three related strategies: a Capital structure strategy, a Distribution strategy and an M&A strategy.

The Capital structure strategy: Herein a reporting entity can explain what leverage or credit rating is targeted and what maximum leverage is considered acceptable in case of adverse market conditions or the financing a large acquisition. It can explain how it expects to bridge a possible gap between the current capital structure and the target capital structure. It can also indicate whether it is actively seeking to spread and/or lengthen the maturity schedule of its debt obligations and what kinds of debt (senior, secured, hybrid/convertible, bank, supply chain financing) it is considering to use.

The Distribution strategy explains how a reporting entity will seek to distribute capital or profit to its shareholders. For example through a dividend policy and/or a share buyback policy.

The M&A strategy elaborates on information on future, current and past acquisitions. It explains what kind of acquisition and divestitures the reporting entity considers. This would include any criteria, both strategic and financial, to which acquisition proposals will be judged. Investors are also keen to understand the dilutive effects of current M&A, the forecasts for the combined entity that justified the price paid for the target, and post-transaction reviews that compare and contrast actual performance with those expectations, both for significant individual acquisitions and for the pursued M&A strategy as a whole.

The ED already is quite comprehensive on what some would call the Operational strategy.

Incidents

The risk paragraph could be complemented with an incidents section, or a ‘What still went wrong’ section that lists the key incidents that materialised in the reporting period. Additionally, of particular interest are health safety & environmental incidents, cases of fraud, corruption, and material cyber-attacks.

Competitive landscape

Understanding the competitive landscape and market positioning of a business model is of critical importance for investors. Few organisations pay sufficient attention to describing their competitive landscape and market positioning. The concentration of competitors and competing technologies can greatly affect the prospects of a reporting entity. This is very company-specific information and even within a single sector, there are significant differences in the competitive landscapes of the business models operated by a reporting entity. It currently takes a considerable amount of time for analysts to desk research this information. We question whether all reporting entities feel the proper pressure to report sufficiently elaborate on their competitive landscapes when they cross the proposed ‘external environment' paragraphs 9.5 - 9.12. We would like to challenge the Board to redraft this section to make sure all compliant management commentaries provide insight in the various aspects of competitive landscape and market positioning of the key business models of the reporting entity.

Expectations

We disagree with paragraph 10.5(b) that a reporting entity should compare and contrast actual performance to analyst expectations. We suggest to rewrite this paragraph to suggest a comparison between actual performance with management's earlier expectations.

Response to 7c: We have no further comments.

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?

Response to 8a:

Governance

BC83 The Board does not propose to require comprehensive or detailed reporting on an entity's governance because governance is typically regulated by local laws.

B12 Management commentary may provide insights into some aspects or consequences of an entity's governance. For example, some insight may be drawn from management's description of its strategy, from information on progress in managing key matters or from information about differences between metrics used for incentive plans and metrics used for monitoring progress in implementing management's strategy. Investors and creditors might need such information to assess management's stewardship of the entity's resources. However, this [draft] Practice Statement does not require comprehensive or detailed reporting on an entity's governance. Governance is typically regulated by local laws, which may also require entities to provide specified information about governance.

We disagree. The governance characteristics of a reporting entity are of great importance to investors. Even though the domicile of a reporting entity provides the basic boundaries for a reporting entity to set its governance structure, ultimately the reporting entity specific articles of association generally determine to a high degree the effective governance characteristics. Eumedion strongly believes that the management commentary practice statement should require a reporting entity to explain its governance structure.

Response to 8b: We have not.

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?

Response to 9: Eumedion considers the ISSB to be the preferred standard setting body for the Management Commentary project. We see the ISSB to be primarily focused with developing standards that apply to the management report; similarly to how the IASB is primarily concerned with standards that apply to the financial report. We expect standards from the ISSB to be more auditable, and more enforceable than a practice statement of the IASB. We see a stronger interconnectedness between management commentary and other topics that the ISSB will be setting standards on. Much stronger than between management commentary and the standards set by the IASB. However, there obviously is a clear interconnectedness between management commentary and the financial statements. A close cooperation between the two Boards on this topic is most likely to best address this.

If the IASB were to publish the final practice statement for management commentary, it may even be confusing for investors. It is not unthinkable that a reporting entity could rightfully claim compliance with an IASB practice statement for the management report, while not adhering to the standards of the ISSB.

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?

Response to 10: We agree with the proposed guidance. We do suggest to align the concept of materiality with how a future ISSB will define materiality. In our response to the Trustees' proposed changes to the constitution, we coined the term 'investor materiality' as an intuitive way for referring to materiality.[1]

[1] https://www.eumedion.nl/clientdata/215/media/clientimages/Response-to-Changes-in-IFRS-Constitution.pdf?v=210715111633

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?

Response to 11a: We agree with the proposals and the reasoning in the Basis for Conclusions.

Response to 11b: We disagree. The risk of cross-referencing is that important information is not found by investors when sought for in the management commentary. However, we do see the benefits of cross-referencing as well. We would be in favour of cross-referencing if the management commentary retains a summary of the key messages of the report that is cross-referenced.

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?

Response to 12: We agree with the proposals and with the reasoning in the Basis for Conclusions.

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?

Response to 13: We kindly decline to provide specific feedback on the various examples due to time constraints.

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?

Response to 14: We refer to our response to question 9.

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?

Response to 15: In line with the Board's assessment in the Basis for Conclusions, we expect the proposed practice statement to be very beneficial for investors. As an investor representative body, it is more difficult for us to assess the cost for preparers.

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

Response to 16:

recognised (when describing assets or liabilities)	4.1	Included in the assets and liabilities recorded in an entity's statement of financial position. Recognition criteria in IFRS Standards prevent entities from recognising some types of assets and liabilities—for example, some internally generated intangible assets.

The ED refers to 'intangible resources' to indicate unrecognised internally generated intangibles. We suggest that the definition on page 95 is made consistent with this approach as these resources do not qualify as assets under IFRS.