

1 October 2021

Dr Keith Kendall
Chair
Australian Accounting Standards Board
Level 14, 530 Collins Street,
Melbourne, VIC 3000

Dear Dr Kendall

AASB Exposure Draft ED 311 – Management Commentary

Thank you for the opportunity to comment on AASB Exposure Draft ED 311 – Management Commentary.

The Australian Institute of Company Directors' (**AICD**) mission is to be the independent and trusted voice of governance, building the capability of a community of leaders for the benefit of society. The AICD's membership of more than 46,000 reflects the diversity of Australia's director community, comprised of directors and leaders of not-for-profits, large and small businesses and the government sector.

The AICD notes that the Australian Accounting Standards Board (**AASB**) is seeking comment on a draft put forward by the International Accounting Standards Board (**IASB**) and the International Financial Reporting Standards Foundation (**IFRS Foundation**). In addition to its engagement with the AASB, the AICD is also engaging directly with the IFRS Foundation on the Exposure Draft (**ED**) and intends to make a submission directly to them. The substance of that submission is likely to mirror that contained within this letter.

We would also be happy to have further discussions with staff at the AASB on the ED and we have indicated to the IFRS Foundation our willingness to further engage with them directly.

Executive Summary

The AICD has some concerns about the nature of the ED, particularly given the external environment in Australia and the heightened liability risks directors and entities are exposed to around the making of forward-looking statements. As a result, arrangements which may be suitable in other IFRS jurisdictions may not translate well into the Australian environment.

While generally supportive of the content of the ED, we think there is some scope for consolidation to reduce complexity and duplication.

Finally, we have some concerns around timing, given the likely effect of the IFRS Foundation Trustees' project on sustainability reporting, the effect this may have on management commentary and the substantial focus it will require from preparers.

AASB Specific Matters for Comment

The following sets out our responses to the specific matters on which the AASB has sought comment.

1. Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals by the entities that would choose to do so, particularly any issues relating to:

(a) not-for-profit entities; and

(b) public sector entities, including GAAP/GFS implications.

We are not aware of any regulatory requirements that would prevent entities from implementing proposals where they choose to do so.

2. Whether the proposals would create any auditing or assurance challenges

If adopted, the ED would likely require the disclosure of substantially more information than would currently be disclosed in a director's report and/or Operating and Financial Review (**OFR**). The ED provides for disclosure in new content areas, with a potentially lower materiality threshold and no provision for failing to disclose because of 'unreasonable prejudice'. Accordingly, this would likely increase the amount of 'Other Information' that the auditor would need to read and opine on for material misstatements.

3. Whether, overall, the proposals would result in financial statements that would be useful to users

For the reasons set out above, in our view this proposal would potentially result in the disclosure of additional information. Some of that information around resources and relationships and external environment may be of questionable utility, for the reasons we have set out below in our answers to IFRS questions 4 and 8. It is possible that preparers may react to a framework such as this with disclosures which unhelpfully detailed information which may inadvertently reduce usefulness to users.

4. Whether the proposals are in the best interests of the Australian economy

Australian preparers tend to take a more cautious approach to disclosures in management commentary, particularly around forward-looking statements, than may be common in other jurisdictions.

There are multiple reasons for this. Even with recent welcome [reforms](#), Australia's continuous disclosure laws provide greater liability risk for directors and companies than in other jurisdictions. The continuous disclosure rule has the force of law and can give rise to personal liability for directors. There is no 'safe harbour' from liability for forward-looking statements in company reports, even when statements are identified as forward-looking based on sound application of business judgement and appropriately qualified. We have a facilitative class action regime and Australian directors are subject to public enforcement of their duties.

This external environment, and the risks for directors, needs to be taken into account when considering any changes to management commentary arrangements in Australia. The natural result is that Australian directors may be less likely to make forward-looking statements in management commentary. Caution needs to be applied when seeking to implement a regime that may be more suitable to other IFRS jurisdictions.¹

¹ See [here](#) for a more detailed discussion of how the Australian system operates, noting there has been law reforms since this article was published.

5. **Unless already provided in response to specific matters for comment 1 to 4 above, the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative. In relation to quantitative financial costs, the AASB is particularly seeking to know the nature(s) and estimated amount(s) of any expected incremental costs, or cost savings, of the proposals relative to the existing requirements.**

Given the concerns we express below, particularly around the timing of the release of a new Practice Statement and the provision of a new sustainability reporting framework, the AICD would not be suggesting to the Australian government that it should revisit the requirements around management commentary contained in the Corporations Act at this time. Further, we would not be suggesting that the Australian Securities and Investment Commission (**ASIC**) revise the terms of Regulatory Guide 247, *Effective disclosure in an operating and financial review*.

Our suggestion would be that, if the IFRS Foundation were to release an updated Management Commentary Practice Statement (**MCPS**), that the AASB note the new Practice Statement on its website, as it does with the current version.

Response to Exposure Draft questions

The following sets out the AICD's views on the questions asked by the IFRS Foundation in the Exposure Draft. We intend to make a submission in similar terms to the IFRS Foundation, subject to further consultation with members and stakeholders.

Question 3—Objective of management commentary

We have no major concerns about the objective of management commentary as set out in the ED. We have some concerns about the definition of materiality, that is that information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that investors and creditors make based on that management commentary and of the related financial statements. We note that this is similar to the definition of 'materiality' in the accounting standards, which is incorporated into the current MCPS via the glossary. We also note following our discussions with staff of the IFRS Foundation, that the revised definition was intended to clarify the definition and make it easier for preparers to select only relevant information.

Under current Australian arrangements, there is no definition of 'materiality' for management commentary. However, s.299A(1) of the Corporations Act 2001 states that the Operating and Financial Review must contain information that members of a listed entity would 'reasonably require to make an informed assessment' of the operations, financial position, and business strategies and prospects for future financial years, of the entity reported on.

The materiality test in the Corporations Act is probably a narrower test than the definition proposed in the ED, particularly as the ED test is negatively framed. Its application would potentially lead to a significant increase in the amount of information disclosed, which may ultimately be of less value to users.

Subject to consultation with other jurisdictions, we suggest that the IFRS Foundation might consider whether paragraphs 3.2 and 3.3 be deleted and replaced with words to the effect of the following:

Information required by paragraph 3.1 shall be provided if it is material. In the context of management commentary, information is material if it is information that investors or creditors would reasonably require to make an informed assessment of the entity's key matters.

Question 4—Overall approach

While we understand the reasoning behind the structure of the ED, we believe that the separation of disclosure objectives and the inclusion of six key matters (particularly resources and relationships and external environment) is potentially unnecessarily confusing. It is questionable whether it is necessary to separate each disclosure objective into three categories, and there is also some overlap between content areas (see response to Question 6 for further details).

The duplication, both between disclosure objectives and across content areas, adds to the length and complexity of the ED. This duplication is probably most apparent in Chapter 11, for example for 'External environment' the Assessment objectives asks the preparer to consider 'how factors and trends in the entity's external environment have affected or could affect the entity' and the specific objectives asks again 'how those factors and trends have affected or could affect the entity'.

In our view consideration should be given to consolidating content under four key matters – business model, strategy, risk, financial performance – and for removing the separation between different disclosure objectives. This would clearly have significant flow on effects to the rest of the document.

Question 5—Design of disclosure objectives

The disclosure objectives as they appear in paragraph 4.4 of the ED are somewhat confusing and abstract, although they become clearer when they are applied to each content area in Part B. For the reasons set out in our answer to Question 4 we feel that the disclosure objectives are somewhat duplicative and wonder whether they might not better be combined into a single objective. This would enable an assessment of disclosure by preparers complemented by the materiality definition and using the process described in Chapter 12 on materiality judgments.

Question 6—Disclosure objectives for the areas of content

As a general rule, we support the provision of detail in the ED when that detail serves as a form of guidance rather than prescription. We believe detail assists preparers in ascertaining what kind of information they should be providing, and we commend the IFRS Foundation for its use of detail, particularly in relation to Examples (see response to Question 13).

Management's strategy for sustaining and developing that business model

We have some concerns around the specificity of the disclosure objective of 'milestones on the path towards those aims.' This is also relevant to the disclosure of metrics in paragraph 6.9. This is due to the increased personal liability risk faced by Australian directors for forward-looking statements.

The entity's resources and relationships

We have some concerns about the inclusion of this content area as it is not information that would typically form part of an Australian OFR. We question its utility and whether users require this information and would reasonably rely on it. For example, some of the resources that it seeks disclosure around – specialist employees, raw materials with only one supplier – seem more suited to a risk disclosure. Others, such as employee engagement scores, may be difficult to verify and might have little reliance placed on them by users.

We suggest that consideration be made as to whether this content area might be subsumed into other content areas – particularly around risk.

The entity's external environment

Similar to our concerns around resources and relationships, we struggle to see how this content area might lead to disclosures that the entity would not already be making in risk and business model sections. We believe that the IFRS foundation could consider consolidating this content area into those sections.

Question 7—Key matters

We refer to our comments on question 6 with respect to our concerns around the resource and relationship and external environment key matters.

Question 8 — Long-term prospects, intangible resources and relationships and ESG matters

We agree that management commentary should provide information on matters that could affect the entity's long-term prospects, intangible resources and relationships, and environmental and social matters, where these are material and relevant to any of the content areas.

There is an inherent difficulty in making statements about long-term prospects in any report given the uncertainty that necessarily attaches to any such statement. This might mean that preparers are reluctant to make long-term statements with the requisite degree of confidence. It might be reasonable for entities to simply acknowledge and disclose uncertainty about the future. This is particularly the case in jurisdictions such as Australia where, as discussed, there is no safe-harbour from liability for forward looking statements. So while we agree they should be included, in practice there may be limited disclosures in these areas.

Statements about long-term prospects in management commentary is an emerging area of practice that is particularly relevant to disclosures such as those recommended by the TCFD around scenario analysis and stress testing. We expect those developments will affect the nature of these disclosures in coming years.

Question 9—Interaction with the IFRS Foundation Trustees' project on sustainability reporting

We recognise that the IFRS Foundation's review of management commentary is a long-standing project dating back to around 2017. However, we do hold some concerns about the timing of this ED and its interaction with the project on sustainability reporting.

The proposed introduction of the International Sustainability Standards Board and the binding standards that might flow from it may be expected to cover some of the matters set out in the ED. Implementing these standards will be a major project that will require attention and focus from IFRS jurisdictions, including Australia. A simultaneous formal overhaul of narrative reporting would not be ideal.

Further, the release of mandatory quantitative sustainability reports is likely to lead to many entities redefining their approach to narrative reporting, to assist with explanation of matters contained within that sustainability report. It is possible that standards around management commentary may need to be amended to reflect that.

The timing and interaction of ED and the sustainability reporting project are better known to the IFRS Foundation than to stakeholders. We suggest that the IFRS Foundation is best placed to consider these factors in its deliberations.

Question 10—Making materiality judgements

We view this Chapter as a helpful explanation of how materiality judgments might be made.

Question 13—Examples of information that might be material

It is extremely useful to preparers to have non-binding examples contained in Practice Statements and we support the inclusion of these examples. We think it be important that the ED make clear that these are not intended to be prescriptive, merely illustrative.

Question 16—Other comments

In Australia, the statutory scheme allows an entity to omit material including if it is likely to result in 'unreasonable prejudice' to an entity or part of a consolidated entity. The Australian Securities and Investments Commission, which regulates management commentary, in their regulatory guidance state:

We think a useful approach to considering whether the publication of information would result in unreasonable prejudice is to identify the adverse consequences that are likely to occur (i.e. the prejudice), and then consider whether these consequences are unreasonable. We suggest that the consequences would be unreasonable if, for example, disclosing the information is likely to give third parties (such as competitors, suppliers and buyers) a commercial advantage, resulting in a material disadvantage to the entity.²

This includes confidential information that is commercially sensitive and where the disclosure of that information would unreasonably damage the entity's business. For example, if an entity, as part of its business strategy, has planned the hostile takeover of a rival they would be unlikely to disclose that in the OFR.

We think the consideration of a similar exemption would be useful for consideration in the ED.

Next steps

We hope our response will be of assistance. If you would like to discuss any aspects further, please contact David McElrea, Senior Policy Adviser, at dmcelrea@aicd.com.au

Yours sincerely,



Christian Gergis GAICD
Head of Policy

² ASIC, Regulatory Guide 247, [Effective disclosure in an operating and financial review](#), paragraph RG247.67.