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IASB® *Investor Update*

Our newsletter for the investment community

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The IASB's Investor Update highlights market-relevant accounting topics that could affect the companies that investors follow. It also shares with investors information on the IASB's standard-setting activities and insights from our ongoing dialogue with the investment community. We invite investors seeking further detail on accounting proposals and current requirements to contact us.

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Editors' welcome

Happy July! We can hardly believe that it has been a year since the first issue of our *Investor Update*. And what a busy year it has been. Highlights of the IASB's activities during this time include: the launch of our *Investors in Financial Reporting* programme; completion of the final element of IFRS 9 *Financial Instruments*; proposals for companies to disclose a reconciliation of changes in their financing liabilities; and proposals to improve the IASB's framework for financial reporting[1].

Speaking of this framework—while this project covers a variety of concepts that underpin IFRS, we think that the proposals on the use of P&L versus other comprehensive income will give investors food for thought. So in the coming months we will be speaking more to investors about their use of the P&L. Another item that may be of interest for investors is the reference to 'prudence'—including whether, and indeed if so how, it should be used in our framework. You can find more information about this topic in Steve Cooper's Investor Perspective: A tale of 'prudence'.

With the finalisation of IFRS 9 our recent education activities have had a 'financial services sector' tone. The most recent issue of our *Essentials* series focuses on extracting insights from balance sheet disclosures that are most relevant to analysing a bank's leverage. This has coincided with some investor education sessions we have provided that discuss the new financial asset impairment requirements in IFRS 9 within the broader context of current banking industry regulatory trends.

In this issue we also feature an interview with Anne Simpson, Investment Director, Global Governance at CalPERS[2] and a Director of CII[3]. We had an insightful conversation with Ms Simpson about pertinent topics including her views on why financial reporting is relevant to institutional investors as well as on the IASB's role in integrated reporting.

With now a year's worth of newsletters behind us, we welcome your views and suggestions on these publications—to continue to make sure that they are useful to you as possible.

Barbara and Fred

In this issue:

- We need your views
- Spotlight: The *Essentials* of bank leverage
- In profile
- Stay up to date

[1] *Conceptual Framework for Financial Reporting*
[2] California Public Employees' Retirement System
[3] Council of Institutional Investors

We need your views

The IASB sets Standards for you, the investor. But we can't do it without your input. We need your help in understanding whether potential changes to the Standards will provide you with the information that is necessary for investment analysis. Below are the projects we are currently working on and for which we are seeking investor views.

Conceptual Framework

The *Conceptual Framework for Financial Reporting* underpins IFRS and helps the IASB to develop Standards that are based on consistent concepts. In May 2015 the IASB published an Exposure Draft of proposed amendments to this framework. These include proposals to: give greater prominence to the need for information to assess management's stewardship; reintroduce an explicit reference to the notion of prudence; provide guidance on the measurement of assets and liabilities; and provide guidance on when income or expenses should be reported in profit or loss, or in other comprehensive income (OCI). We are currently seeking feedback on whether these proposals will result in the provision of more useful information.

Income Taxes

Accounting for income taxes has long been criticised for being difficult to understand, with many problems in practice. The IASB is undertaking a research project to better understand the problems investors may face with tax information provided today, and how that information is used when making decisions. **Click here for the investor survey related to this project.** Your input will help us to analyse the usefulness and sufficiency of the tax information provided in the financial statements and help provide direction on how we should then proceed.

Business Combinations under Common Control[1]

Currently there is no specific guidance in IFRS on accounting for BCUCC. We are conducting a research project on this topic, and need your views to help us understand whether the information needs for such transactions are the same compared to business combinations that are not under common control.

Equity method of accounting

The IASB is considering a project that aims to simplify the equity method of accounting. We would like to understand what information you use when reviewing investments accounted for using the equity method of accounting.

[1] These are often referred to as BCUCC.

Materiality

How the concept of materiality is applied in practice is seen by many as a major cause of the 'disclosure problem'. Not making appropriate materiality judgements can result in both the disclosure of too much irrelevant (ie immaterial) information and not enough relevant (ie material) information. The IASB will issue an Exposure Draft of a Practice Statement on materiality in Q3 and we will seek investors' views on the proposals in that Practice Statement.

Structure and effectiveness review

On 7 July the Trustees of the IFRS Foundation published a Request for Views that asks stakeholders important questions about the relevance of IFRS to investors and what can be done to ensure those Standards are applied consistently around the world. Specific questions are included on the role of technology, such as digital reporting, and the scope of IFRS. Comments are requested by the end of November.

Forthcoming agenda consultation

The IASB publicly consults with its stakeholders to discuss its work programme. We believe it is important that investors contribute to this process by providing their views on: (i) the strategic direction and balance of the IASB's work, and (ii) the financial reporting issues that the IASB should be prioritising. The next public consultation document, a Request for Views, is planned to be published shortly.

Overview of topics and outreach timing

		Anticipated outreach
Topic	Project Stage	H2 2015
Conceptual Framework	Exposure Draft (comment period ends October 2015)	✓
Income Taxes	Research phase	✓
BCUCC	Research phase	✓
Equity method of accounting	Research phase	✓
Materiality	Draft Practice Statement (Targeted Q3)	✓
Structure and effectiveness review and agenda consultation	Request for Views	✓

Spotlight: The *Essentials* of bank leverage

In the last issue of *Investor Update*, we introduced readers to *The Essentials* – a new publication series that aims to help investors make the most of IFRS financial statements.

Comparing leverage across banks

Issue 3 of the *Essentials* has a narrower focus than usual. It discusses a specific set of disclosure requirements in IFRS 7 *Financial Instruments: Disclosures* that are 'essential' for investors when analysing the financial leverage of banks.

We explain why the size of a bank's balance sheet can differ significantly depending on whether it is prepared under IFRS or US GAAP. This difference makes comparing leverage ratios using only balance sheet numbers a tricky business. The disclosures required in IFRS 7 mitigate this problem.

Leveraging the notes in IFRS 7

This issue of *The Essentials* is all about investors leveraging the disclosures you receive. Indeed, it is only by using the information disclosed in the notes that investors can compare banks' balance sheets.

In this *Essentials* you will find*:*

- How to use note disclosures to make better comparisons between the balance sheets of global banks—particularly between banks reporting under IFRS relative to banks reporting under US GAAP.
- Ways in which note disclosures can help investors to better analyse a bank's management of counterparty credit risk and liquidity risk.
- How the offsetting arrangements reported in financial statements capture some of the effects of an important risk management tool used by banks.
- How these disclosures tie into current developments in the Basel III banking regulations.
- The illustrations and tables to help understand how an analyst can use the note disclosures to make adjustments that facilitate comparisons across global banks.

Look both ways before you cross the street. And look at the notes before you compare banks under IFRS with those under US GAAP.

And the banking theme continues….

The "financial services" sector tone has dominated much of our investor education activities recently. This is in part because of the number of education sessions we've hosted on the new impairment requirements found in IFRS 9 *Financial Instruments.* This Standard was finalised in July 2014.

While not required to be implemented until 2018, the new impairment model deserves attention today because (a) it affects how banks will book provisions for loan losses, which can ultimately affect a bank's capital ratios, and (b) the Standard introduces many new disclosure requirements to help investors gain a better understanding of how credit risk can affect the earnings power of a bank.

You can look forward to a profile on it in a future issue of *The Essentials.*

Are you getting the *Essentials*?

The Essentials series was launched in December 2014. As part of the IASB's ongoing investor education programme, its ambition is simple: to help investors make the most of the information reported in IFRS financial statements.

In each issue, we try to cut through the technical jargon in a particular area of accounting in an effort to address the key questions that we hear from investors around the world.

- *Which financial line items rely heavily on management judgement or estimates?*
- *How can you leverage disclosures to get a better understanding of the company's results?*
- *How does it all fit in with the tools and techniques that you use to evaluate performance?*

What is *Essential* to you?

And if you have any challenging areas of financial reporting that are *Essential* to your analysis, please email fnieto@ifrs.org and we will do our best to demystify them!

Investor Education Materials on-line

IASB Webcast Series with the CFA Institute

IASB *The Essentials* series of publications

IFRS Investor Workshop presentations

In profile

Anne Simpson, Investment Director, Global Governance at CalPERS and a Director of the Council of Institutional Investors

***IASB Investor team:* Can you tell us why financial reporting in general, and being involved in the financial reporting debate in particular, is very important to CalPERS?**

The reason is simple—we are a global long-term fiduciary investor and we have over USD 300 billion of assets that we need to allocate over the coming decades. Our liability horizon is close to 70 years—and at 7.5 per cent our current target rate of return is highly demanding. As an investor, financial reporting is the window to the drivers of long-term value creation and the multi-faceted nature of risk, so we really care about high quality reporting standards. You can see this reflected in the CalPERS Global Governance Principles, where we have a section called the 'Integrity of financial reporting'.

***IASB Investor team:* CalPERS has recently refreshed its Financial Markets Principles. How do these interact with the objective of the IASB's *Investors in Financial Reporting* programme?**

We have a shared objective. In the wake of the financial crisis, when our Financial Markets Principles were drafted, we wanted a framework for engaging with regulators and legislators around the new architecture of financial market reform—in particular, in the US, around Dodd–Frank. When we refreshed the principles last year, it was really to consider what were the enduring financial markets principles that we want to highlight.

We distilled three from the original set. The first is transparency. Here, financial reporting is critical. The second is governance where we are looking for alignment of interest between providers of capital, intermediaries and boards of directors. The third is financial markets' attention to measures that address the systemic risk. Financial reporting is there to help us all assess transparency, governance and allocation of capital.

***IASB Investor team:* Why did you decide to participate on the IFRS Advisory Council?**

On the Advisory Council I'm representing the Council of Institutional Investors (CII) in the United States. This is a body whose membership is made up of a diverse group of employee benefit funds (corporate, public and union) with some USD 3 trillion in assets. Many of these investors, like CalPERS, have money invested outside the United States and so the issue of global accounting is of real importance. I think it's very important to have large US investors be part of the Advisory Council, not least because of the global exposure of their investment portfolios.

On the path to an international framework, it's also very important that we have a two-way discussion, so having the perspective of the US investors who are affected and have a common goal is a key element. I think that for all investors the question of how we achieve an international approach to financial reporting is really important—because the markets are global. CII has an important perspective to bring given the domicile of its funds—which also invest in companies that report under US GAAP. Their insight into the challenges of convergence with IFRS is vital to the debate on quality.

***IASB Investor team:* In the light of an increasing focus on integrated reporting, how do we ensure that financial reporting retains its relevance to investors?**

There is an increased investor interest in understanding the sustainability of a business. We don't just mean the old-fashioned, important issue of going concern. As a long-term investor we are looking to better understand where the drivers of value are and the sources of risk—which in turn are going to have an impact on our portfolio over the lifetime of our liabilities.

For example—as you know, CalPERS is located in, and has its pension liability in, California. Therefore the issues of water stress or water risk are a topic of day-to-day conversation for us. However, water risk is not reported and we do not have accounting standards which allow us to track this.

CalPERS completed an important project of 'deep thinking' about the issue of long-term risk and return. As a result we developed a set of investment beliefs, which highlight the prime importance of allocating assets in order to pay our liabilities.

This leads to a second belief that while having a long-term investment horizon means that we have advantages (because we can allocate capital for longer periods, or we can be counter-cyclical), it also gives us responsibilities. For example, we have the responsibility to engage the policy-makers and managers of those companies that we invest in to make sure that we are not fostering or facilitating measures that inadvertently lead to more short-term focus.

All of these lead directly into the consideration of financial reporting—the way that assets and liabilities, and contingent liabilities, are expressed—or not—in financial reporting. An example is climate change which poses both long-term risk and opportunity.

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In Profile with Anne Simpson—continued

There is a long way to go on this. At the moment there is a range of reporting on matters such as carbon, water or labour rights/standards through the global supply chain. But there is a lack of connectivity between the issues themselves, and they are not integrated into the financial report. If we had a framework that would support integrated reporting, it would bring into the financial report the relevant, material elements of the company's claims on assets and liabilities and risk and returns.

***IASB Investor team:* In your role as Investment Director, Global Governance at CalPERS, what are the main governance issues that you encounter today when evaluating investments? Which ones, if any, overlap with financial reporting?**

CalPERS has a framework of core issues which we think drive the governance agenda. Our view is that the quality of overall governance supports and proves the performance of companies. It also helps with better risk management. So it is fundamental to the investment proposition.

We see these five issues, as interconnected. The first consideration is investor rights. An important factor in this is obviously for a company to have an accountable board, approved auditors, and approved financial statements.

The second consideration for us is the quality of boards of directors. We define quality as a mix of independence, competence and diversity. With respect to independence—obviously we want an objective consideration of what management is doing on our behalf as the owners. Secondly we want competence, because the board needs to function with relevant expertise. I think that was well understood and expressed in Sarbanes-Oxley around the concept of the financial expert being necessary for operation of the audit committee. But we think that this is now a much broader discussion. Companies really need to have people on their board that can bring risk management and industry understanding. Diversity on boards is increasingly understood to underpin high quality decision-making. The International Monetary Fund identified 'group think' as a corrosive element that contributed to the financial crisis. Diversity brings fresh thinking talent and challenges to board rooms.

The third issue is compensation. We are very concerned to get incentives aligned, with this long-term approach we are taking. That's a huge challenge, and there's a lot of work to be done there.

The fourth issue is squarely in the IASB's bailiwick—corporate reporting. We want integrated reporting, which is relevant to these long-term sustainability questions and also to risk management.

The final issue is regulatory effectiveness: a regulatory regime which gives investors the rights they need to protect themselves (eg boards of high quality, compensation which is aligned with our long term-interests, and integrated corporate reporting).

We don't think these five core issues should be tackled individually. And we believe that when all are functioning correctly, the interconnected nature of those issues creates a virtuous circle. The five reinforce each other well. If any one of them fails we have a broken spoke in that wheel, and the governance system won't work properly.

***IASB Investor team:* As you know, the IASB investor team's focus is to ensure that the investor voice is heard in the standard-setting process. What do you think we do well, and what can we do to improve this interaction?**

First of all, I think you are doing well in communicating news, developing a newsletter and a statement for the investors to sign up to via the *Investors in Financial Reporting* programme—this is new and very important.

Regarding investor interaction—an important step that we've spoken about before is continuing to build relationships with the major users of the accounts. Understanding the difference between asset owners and asset managers is important in the investment chain.

But I think you [the IASB] have a good grip on this. You've understood and responded to the fact that all this work is meant to be for the benefit of the investors and we need to encourage more to engage on accounting standards. Many do not in part because the debate seems remote, they're not clear on what their contribution might be, and for some it's viewed as too technical.

So it's important to find an appropriate place for investors, and to understand that financial reports are a vital source of information that investors use. So the quality of accounting standards is a market fundamental.

The IASB Investor team thanks Anne for taking the time to speak with us.

Anne leads CalPERS' sustainability project to integrate environmental, social, and governance factors across the Total Fund. She is a member of the Investor Advisory Group of the Public Company Accounting Oversight Board and a Director of the Council of Institutional Investors, which she represents on the International Financial Reporting Standards Advisory Council. Earlier this year Anne also received the *ICGN Life-time Achievement Award*.

Stay up to date

Events and announcements

Hans Hoogervorst, Chairman of the IASB, delivered the following speeches:

- *Historical cost and fair value as measurement models* at the IFRS Foundation conference in Paris. Mr Hoogervorst spoke about these measurement models for assets and liabilities, and how they are not as far apart as many believe.
- *Financial reporting standards for the world economy* at the IFRS Foundation Trustees stakeholder event in Toronto, Canada. Mr Hoogervorst presented the IFRS Foundation's and the IASB's newly developed mission statement and provided an update on the progress of IFRS adoption around the world.
- *Mind the Gap (Between non-GAAP and GAAP)* at the Korean Accounting Review International Symposium in Seoul, Korea.
- *Bad accounting breeds bad policies* at the NAPF[1] Investment Conference in Edinburgh, Scotland.
- A presentation to the Accounting and Auditing Practices Committee at the ICGN[2] Annual Conference 2015. The topics discussed included projects currently in the IASB pipeline and the IASB's engagement with investors.

In April the IFRS Foundation Trustees and the Canadian Accounting Standards Oversight Council jointly hosted an event to discuss Canada's perspective on IFRS and global standards. The video recording of the event is available here.

In April IASB member Philippe Danjou delivered a speech at the EFFAS[3] and BBVA[4] *Financial Reporting and Financial Markets: New Trends* conference in Madrid, Spain. Mr Danjou spoke about mega-trends shaping the IASB's technical work, global adoption of IFRS and whether IFRS has delivered on expected benefits.

In May the IASB published a proposal for a one-year deferral of the effective date of the revenue Standard[5]. The IASB expects to make a final decision on whether to change the effective date at its July meeting.

In June the IASB completed its Post-implementation Review of IFRS 3 *Business Combinations*. The review shows general support for the accounting requirements in the Standard but identifies some areas where further research will be undertaken, including accounting for goodwill.

In June the IFRS Foundation hosted the second annual Tommaso Padoa-Schioppa Memorial Lecture. The keynote speech was delivered by Lord Turner, Chairman of the Governing Board of the Institute for New Economic Thinking and former Chairman of the UK Financial Services Authority.

Reading material for investors

Guest contributors Nick Anderson, Gunnar Miller and Tanya Branwhite discuss the merits of the IASB's proposed amendments to provide more information about changes in debt in the Investor Perspectives article *Helping Investors Better Understand Cash Flow*.

IASB member Sue Lloyd discussed the challenges of accounting for financial instruments in the article *Big changes ahead: accounting for financial instruments.*

IASB member Steve Cooper published an Investor Perspective titled *A tale of 'prudence'* where he explains the IASB's proposals in the *Conceptual Framework for Financial Reporting* Exposure Draft to reintroduce an explicit reference to prudence.

Investor events

Steve Cooper spoke about financial statement presentation format, including profit and loss and other comprehensive income, at a CFA Society UK Financial Analysts conference 2015 titled: *Confidence in corporate reporting.* More details are available here behind a pay wall.

In June the IASB held an investor-focused session at its IFRS Conference in Paris. At this session IASB member Patrick Finnegan and a panel of analysts discussed the effects of accounting standards and financial reporting-related topics that are pertinent to investment analysis.

In June the annual joint meeting was held between two of the IASB's advisory groups: the Capital Markets Advisory Committee and the Global Preparers Forum.

In July the IASB, EFRAG[6], EFFAS and ABAF[7] held a joint investor outreach event titled: *Could profit or loss become more useful? And what is the role of other comprehensive income?.* This event sought input from investors on the IASB's proposed changes to its *Conceptual Framework for Financial Reporting.*

Register for investor alerts

Click here to register for investor email alerts to stay up to date with accounting changes, investor-focused activities and other IFRS Foundation events.

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1 National Association of Pension Funds
2 International Corporate Governance Network
3 European Federation of Financial Analysts
4 Banco Bilbao Vizcaya Argentaria
5 IFRS 15 *Revenue from Contracts with Customers*
6 European Financial Reporting Advisory Group
7 The Association Belge des Analystes Financiers