Meeting notes—CMAC meeting

The Capital Markets Advisory Committee held a meeting on 10 October 2019 at the London offices of the International Accounting Standards Board (Board).

Members discussed the following topics:

- Rate Regulated Activities (paragraphs 1–7)
- Post-implementation reviews of IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements; and IFRS 12 Disclosure of Interest in Other Entities. (paragraphs 8–10)
- Agenda Consultation (paragraphs 11–16)

Rate Regulated Activities

1. The purpose of this session was:

    a. to provide CMAC members (members) with an overview of the accounting model for regulatory assets and regulatory liabilities developed by the Board that will be included in a forthcoming exposure draft;

    b. to address any questions that members may have on the model;

    c. to seek members' feedback on whether the material presented at the meeting is helpful for communicating the purpose and principles of the model to users; and

    d. to seek members' advice on how best to reach out to generalist users during the comment period of the exposure draft for a topic that is highly specific.

The model

2. The staff provided an overview of the model. Members had the following comments and questions:

    a. a member asked how the model ensured robustness and consistency in decisions about when to recognise regulatory assets. The staff replied that the model would apply when the regulated entity (entity) and the rate regulator (regulator) are bound by a regulatory agreement.

    b. a member commented that when a regulator is a sovereign authority, this may raise questions about whether the regulatory framework is binding on this party.

    c. another member expressed concerns regarding recognising regulatory assets and regulatory liabilities that are still being negotiated with the regulator at the time the financial statements are being prepared. The staff responded that the model proposes requirements to disclose any risks and uncertainties related to regulatory assets and regulatory liabilities. Thus, entities would need to disclose and risks and uncertainties arising from negotiations with the regulator.

d. some members asked how the model deals with demand risk, impairment and changes in regulatory agreements. The staff said that the model does not need a separate impairment test for regulatory assets because measurement is based on estimates of future cash flows. Those estimates have to be updated at each reporting date, and entities would be required to disclose any uncertainties relating to those cash flows.

e. a member asked what discount rate the model uses to measure regulatory assets and regulatory liabilities. The staff said that in most cases the discount rate would be the regulatory rate, but if that rate does not sufficiently compensate the entity for the time value of money and risks inherent in the cash flows, the discount rate would need to reflect the time value of money and risks inherent in those cash flows.

f. a member asked whether the outcome sought by the model was matching. The staff answered that the model seeks to provide information that would enable users to distinguish volatility in financial performance that will be compensated through the rates charged to customers from volatility that will not be compensated through the rates.

Communication material and approaching generalist users

3. Most members said that the material presented was useful in helping them understand the purpose and principles of the model.

4. A few members suggested that the staff should include case studies or real life examples in the communication materials. Some members also recommended using numerical examples to explain the main concepts of the model as this improves understandability.

5. A member recommended explaining upfront the effects of the model on the statement of cash flows and on the statement(s) of financial performance as this is key information for users.

6. A few members commented that generalist users may be interested in:

   (a) understanding how the regulatory asset base reconciles with the amounts in IFRS financial statements;

   (b) distinguishing revenue that an entity has charged during the period from compensation which the entity is entitled to but has not charged during the period;

   (c) understanding the sensitivity of the measurements of the regulatory assets or regulatory liabilities around discount rate(s) and the corresponding effects in the statement(s) of financial performance; and

   (d) receiving a practical example that indicates the line item in which any impairment of regulatory assets would be captured in the statement(s) of financial performance.

Next steps

7. The staff will consider the comments and suggestions from the members in drafting the exposure draft and in developing communication materials for planning outreach.

Post-implementation reviews of IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements; and IFRS 12 Disclosure of Interest in Other Entities

8. CMAC members shared views on the planned Post-implementation reviews (PIR) of IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interest in Other Entities*.

9. Some CMAC members made the following comments on the information provided in the IFRS 10, IFRS 11 and IFRS 12:

   a. one CMAC member said additional information on wholly-owned subsidiaries is not needed because no adjustments are made in relation to these entities. However, significant non-controlling interests are normally adjusted to fair value and deducted in the valuation model (ie Enterprise Value framework commonly used by investment analysts) as if they were liabilities to arrive at an estimate of equity value.

   b. the following information relating to subsidiaries is useful:

      i. better disclosure of non-controlling interests, especially in relation to their impact on cash flows; and

      ii. disclosures on significant inter-group transactions.

   c. mixed views were expressed on the consolidation exemption for investment entities. One member did not find it useful, while others thought that it was a significant relief and offered better information than the result of consolidation. One member expressed the view that some companies were in practice treating the exemption as a voluntary election, instead of as a requirement.

   d. IFRS 10 and IFRS 9 *Financial Instruments* potentially conflict. IFRS 10 requires an entity that has lost control of a subsidiary to remeasure any residual interest at fair value through profit and loss. IFRS 9 *Financial Instruments* allows an entity to elect to carry equity instruments at fair value with the changes recognised in other comprehensive income. One member viewed this presentation of the gain or loss from initial recognition and the subsequent changes in different parts of the financial statements as a conflict.

   e. it is important for users to understand the level of subordination of the different liabilities in a group to construct models of their value for the entity. This information is not visible in the consolidated financial statements.

   f. it was not always clear if subsidiaries were applying IFRS Standards or using local GAAP.

   g. the Standards require insufficient disclosure relating to the basis of the control assessment, especially when the control assessment was complex and required significant judgement.

   h. when entities reach different conclusions about consolidation applying IFRS Standards and regulatory requirements (for example, those of the Basel Committee on Banking Supervision) it would be useful to disclose this fact in the financial statements.

   i. the Board should consider reintroducing proportionate consolidation because it provides more useful information than does the current Standard, especially for the construction industry.

j. equity-method accounting requires more analysis from users, but a single line item on the balance sheet is better for comparing results under proportionate consolidation that affect all line items on the balance sheet.

k. more information than currently required is needed about interests in joint ventures and associates for valuation purpose. This information includes:

    i. contingent liabilities;

    ii. information about loss-making associates;

    iii. debts owed by associates or joint ventures in real estate industry;

    iv. information to enable analysts to forecast dividend cash flow from the equity accounted investees or from subsidiaries to the parent; and

    v. more detailed information on assets and liabilities compared to what required in IFRS 12.

l. the Standards require insufficient information on put options held by parties in a joint venture.

m. the Standards should require more information on how current shares of the different joint venture partners may change based on performance targets. Especially in the pharmaceutical industry, each party's share in a joint operation depends on how one partner's pipeline performs relatively to the other partner's pipeline.

Next steps

10. In phase one of the PIR, the technical staff will consult different types of stakeholders to collect information about their concerns regarding IFRS 10, 11 and 12. In the end of the phase one, the staff will present to the Board the suggested contents (questions) included in Request for Information for phase two of the PIR project.

Agenda Consultation

11. The purpose of this session was to brief CMAC members on the status of the 2020 Agenda Consultation and ask for their help in developing a request for information (RFI).

12. CMAC members discussed:

    a. suggestions for potential projects to include in the RFI for stakeholder comment (paragraphs 13-14); and

    b. high-level messages for the Board to consider during the agenda consultation (paragraph 15).

Suggestions for potential projects

13. CMAC members were asked in advance of the meeting to provide up to three new potential projects to include in the RFI for stakeholder comment—see Agenda Paper 4A. At the meeting, members discussed these potential projects, explaining the problem and their importance.

14. CMAC members suggested the following new potential projects that the Board should include in the RFI for stakeholder comment:

    a. Many members suggested that the Board undertake a project on segment reporting. Most of these members said that the project should consider whether to provide more segment line items. These members said that information about, for example, the capital expenditure and depreciation/amortisation by segment would be helpful for their analysis. In addition, a few of these members added that segment information for a financing subsidiary within a manufacturing company needs better disaggregation. A few members said that the project should consider whether to replace the existing management approach in IFRS 8 *Operating Segments* with a different approach.

    b. Many members suggested that the Board undertake a project on intangibles; however, they expressed different views on the scope of such a project. One member suggested that the project should explore all aspects of accounting for intangibles; that is, the definition, recognition and measurement of intangible assets. Another member suggested that the project should focus on better presentation and disclosure of the effect of intangible assets on the financial statements. Some other members suggested that the project should focus on providing definitions and better disclosures about intangible assets; in particular, information to allow users to differentiate between intangibles arising from acquired and those arising from internally developed businesses, processes or systems. Many members added that the scope of IAS 38 *Intangible Assets* should not be changed to allow more intangibles to be recognised. Some members also suggested that better disclosure about expenditure on research and development, advertising and IT should be required.

    c. Some members suggested that the Board undertake a project that considers providing better disclosures about the effect of non-cash transactions on the financial statements. These members said that the lack of relevant information about non-cash transactions makes it difficult to link the cash flow statement with the other primary financial statements and to properly forecast future cash flows. They added that information is needed to understand what the non-cash transactions are, the risks they pose to the entity and why they have no impact on the entity's cash flows. When questioned, some members said that they prefer the indirect cash flow method required by IAS 7 *Statement of Cash Flows* over the direct method and that they would have significant concerns about changing the structure of the statement of cash flows.

    d. A few members suggested that the Board undertake a project that would consider amending the presentation and disclosure requirements in IFRS 5 *Non-Current Assets Held for Sale and Discontinued Operations*. These members expressed concerns that the existing requirements do not provide users with information to understand what constitutes discontinued operations and to evaluate their impact on the ongoing operations of the entity. Therefore, these members suggested that there is a need for better disclosures and that discontinued operations should be presented in the statement of financial performance using a column method rather than a line item method.

e. One member suggested that the Board undertake a project that would consider whether to change how a lease liability applying IFRS 16 *Leases* is reflected in the statement of cash flows. IFRS 16 requires repayment of principal on a lease liability to be presented in financing activities and the interest portion to be presented as operating or financing cash flows. This member said that the interest portion of a lease liability should instead be required to be presented as operating cash flows in the statement of cash flows. The member added that such an approach would make it easier for users to analyse the effect that leases have on the cash flows of the entity.

f. One member suggested that the Board undertake a project that considers whether to change the presentation requirements in IFRS Standards for other comprehensive income. This member suggested that other comprehensive income should be separated into items that will be subsequently reclassified to profit or loss and items that have been revalued in the period.

High-level messages

15. CMAC members made the following high-level comments for the Board to consider during the agenda consultation process:

    a. a few members observed that electronic reporting using XBRL could provide users with the opportunity to better analyse financial information. However, these members expressed concerns that users are still not able to capitalise on this opportunity consistently today. Therefore, these members noted that, for users to be able to use and rely on electronic information, there needs to be detailed and appropriate tagging of the information across all companies globally.

    b. one member said that the asset/investment management industry is rapidly changing, specifically, that the industry is moving towards technology oriented investment approaches. Therefore, this member advised the Board to consider this development in thinking about the information that users would need in financial statements for its 2022-2026 timeframe.

    c. one member observed that the need for better disclosures was a key element in many of the suggestions summarised in paragraph 14. Therefore, this member advised the Board to consider a holistic approach to improving the development, and application, of disclosure requirements in IFRS Standards.

Next steps

16. The technical staff will report the feedback from CMAC members at a future Board meeting and consider their feedback in the Board’s deliberations about which potential projects to include in a request for information for stakeholder comment.

Next meeting

The next CMAC meeting will be held on 26th March 2020.