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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 new year and welcome back to work. We hope you passed an enjoyable (and preferably warm and dry) holiday season and now have plenty of energy to tackle accounting issues for 2015! In this edition of the *Investor Update* we give you a preview of our upcoming projects for which we are seeking investor views. Knowing that we are heading into the 'busy season', we hope to provide you with enough warning so you can fit in talks with the teams between earnings reviews.

Speaking of earnings, in the 'Spotlight' section Fred provides more insight into our new revenue Standard by highlighting areas of judgement and estimates—items that, while they may often cause havoc for your analyses, will hopefully be somewhat easier to understand as a result of the new requirements.

We continue our discussions with Board member Pat Finnegan on various items of interest to investors. Here the revenue requirements make yet another appearance. We hope you find this interview informative. Don't forget to contact us if the revenue articles raise questions on which we can start to help you before the effective date.

Finally, we give a hearty welcome to three new members of the Capital Markets Advisory Committee (the IASB's investor advisory group). We also bid farewell to two CMAC members, Peter Elwin and Jane Fuller. You will be missed!

Barbara and Fred

In this issue:

The IFRS Foundation is an independent, not-for-profit organisation working in the public interest. One of the principal objectives of the IFRS Foundation is to develop a single set of high quality, understandable, enforceable and globally accepted International Financial Reporting Standards (IFRS) through its standard-setting body, the International Accounting Standards Board (IASB). This newsletter has been prepared by the staff of the IFRS Foundation and does not represent the views of the IASB or any individual member of the IASB. Comments on the application of IFRS do not purport to set out acceptable or unacceptable application of IFRS. For more information see www.ifrs.org.

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 analyses and that ultimately drives your investment decisions. Below are the projects we are currently working on and for which we are seeking investor views.

Overview of topics and outreach timing

Topic	Project Stage	Anticipated outreach Q1 2015	Anticipated outreach Q2 2015
Changes in debt	Exposure Draft[1] → Q4 2014	✓	
Rate-regulated Activities	Discussion Paper[2] → Q3 2014	✓	
Changes in accounting policies and estimates	Research phase	✓	
Business combinations under common control	Research phase	✓	✓
Taxes	Research phase	✓	✓
Conceptual Framework	Exposure Draft → Q2 2015		✓

Changes in debt[3]

This narrow-scope project[4] is part of the Disclosure Initiative. Its objective is to respond to investor requests to improve understanding of changes in a company's debt, including non-cash movements, by providing a reconciliation of these items. It also seeks to improve disclosures about restrictions on cash and cash equivalents.

Rate-regulated Activities

In many countries, governments regulate pricing and supply in key industries (ie gas, water or electricity supply). We refer to this as 'rate regulation'. We are currently seeking input from investors and analysts about the information they would like to see in the financial statements of companies that are involved in rate-regulated activities.

[1]For more information about this type of document click here.

[2]*Ibid.*

[3]This project is also profiled in our December newsletter.

[4]The Exposure Draft *Disclosure Initiative* (Proposed Amendments to IAS 7) was published on 18 December 2014.

Changes in accounting policies and estimates

Today's accounting requirements make a distinction between the presentation and disclosure of changes in an accounting policy versus changes in an accounting estimate. The Italian standard-setter, Organismo Italiano Contabilità (OIC), is conducting an investor survey which aims to understand whether these requirements generate the information that investors need, and whether the related distinction is useful or necessary. The results of the OIC's work will be fed back to the IASB as part of the Disclosure Initiative.

Business combinations under common control[5]

There is no specific guidance on accounting for 'BCUCC' in IFRS. We are conducting a research project on this topic, which includes reaching out to investors to understand whether the information needs for such transactions are the same or different compared to business combinations that are not under common control.

Income Taxes

IAS 12 *Income Taxes* has long been criticised for being difficult to understand, with many problems in practice. We are now undertaking research to better understand the needs of stakeholders regarding income taxes. This includes consulting investors on the problems with the tax information they receive today and on how that information is used when making decisions. Your views will help us analyse the usefulness and sufficiency of the information provided in the financial statements, and will provide direction on how we should then proceed.

Conceptual Framework

The *Conceptual Framework for Financial Reporting* (Conceptual Framework) sets out the concepts that the IASB uses to set Standards. We aim to publish proposed amendments to the Conceptual Framework in March. These will include an increased prominence of stewardship, reintroducing an explicit reference to prudence, and additional guidance on the selection of both a measurement basis and the use of other comprehensive income.

Click here to keep up to date on outreach activities and here for the IASB's complete work plan.

[5]These are often referred to as 'BCUCC'.

Spotlight: judgements & estimates in revenue recognition

Investors don't analyse investments in a vacuum. Comparing a company's financial performance with that of its peers is a critical step in making informed investment decisions. After all, it's difficult for an investor to argue that a company's financial performance was 'good' without clarifying the basis for comparison.

Existing requirements for revenue recognition (see table opposite) have resulted in diverse practices. Part of that diversity results from the need to apply judgement without having sufficient guidance. Investors may not be aware of this, and as a result may end up comparing apples to oranges—reminding us of a popular quote that's relevant to investment analysis:

"It ain't what you don't know that gets you into trouble. It's what you know for sure that just ain't so."

Mark Twain

For this reason, we believe investors can look forward to when results are prepared under a single Standard—IFRS 15 *Revenue from Contracts with Customers*.

Principles and guidance—a balancing act in support of comparability

On the surface, the core principle of IFRS 15 makes sense to many investors—a company should recognise revenue to depict the transfer of promised goods or services to the customer in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. But without sufficient guidance for companies to implement this principle, there could be too much diversity in how financial results are prepared.

For investors analysing the numbers, this diversity can make it more difficult to compare results across companies, and reduce investors' confidence that management has exercised the appropriate judgements in preparing the results. We believe that IFRS 15's single framework (for determining when to recognise revenue and how much revenue to recognise) will provide management with sufficient guidance to exercise appropriate judgement in recognising revenue consistently. Reducing diversity in practice should ultimately benefit investors seeking to compare companies' reported revenues – within or across sectors, and within or across jurisdictions that use IFRS.

For example, a company may struggle to determine if it should recognise revenue for some goods or services at a point in time, or over time, because of a lack of clear and comprehensive guidance today.

A case in point is the sale of residential real estate in multi-unit developments. A company may have difficulty determining whether the construction of such assets is a service that is provided over time (and, hence, revenue is recognised over time) or a good that is transferred to the customer when construction is completed (and, hence, revenue is recognised at that point in time). IFRS 15 clarifies this by providing specific criteria that must be met for a company to be able to recognise revenue over time. In all other cases, a company will recognise revenue at the point in time when the customer obtains control of the promised good or service.

Revenue Recognition requirements[6]

Today	From 1.1.2017
2 Standards - IAS 18 - *Revenue* - IAS 11 – *Construction Contracts*	**1 Standard** IFRS 15 – *Revenue from Contracts with Customers*
4 Interpretations - IFRIC 13 *Customer Loyalty Programmes* - IFRIC 15 *Agreements for the Construction of Real Estate* - IFRIC 18 *Transfers of Assets from Customers* - SIC 31 *Revenue – Barter Transactions Involving Advertising Services*	

Disclosures—giving investors insight into management's judgements and estimates

To provide investors with a better understanding of the nature, amount, timing and uncertainty of revenue and cash flows from contracts with customers, IFRS 15 not only requires quantitative information about revenues (eg disaggregation of revenues into appropriate categories[7]) but also qualitative information about the significant judgements and changes in judgements made in applying the revenue recognition requirements.

By not only requiring management to explain its decision to apply a certain accounting treatment, but also to discuss the reasons behind that decision, we believe the new disclosure requirements should provide investors with enhanced transparency into management's decision-making.

Closing the loop

Through the combination of a single revenue model and specific disclosure requirements, we believe that IFRS 15 will help investors better understand and compare a company's revenue—across reporting periods and with its peers.

Where can I find out more about IFRS 15?

Investors can find more detail on IFRS 15 by reading the IASB's Project Summary or listening to our webcast with the CFA Institute.

[6] IAS refers to International Accounting Standards; IFRIC refers to the Interpretations Committee, and SIC refers to the former Standing Interpretations Committee.

[7] For example, by type of good, service, geography, or market.

In profile

Patrick Finnegan: IASB member

In this issue we feature the second of a two-part interview with IASB member Patrick Finnegan, in which we discuss developments in IFRS and how they relate to investment analysis.

***IASB Investor team*: Continuing the theme from the last time we spoke, what are other changes to Standards that should appeal to investors?**

Investors have frequently asked us to improve the effectiveness of disclosures in financial statements, particularly the notes. We've tackled a part of this issue through the recent amendments to IAS 1 *Presentation of Financial Statements*[8] , which clarify the Standard's objectives. For example, the amendments clarify that materiality applies to the whole of the financial statements, and therefore that the inclusion of immaterial information can inhibit the usefulness of financial disclosures. We hope that the amendments will increase the quality and completeness of disclosures for investors, as well as making them more relevant to the company in which they are investing.

***IASB Investor team*: Speaking of disclosures—our new Standard IFRS 15 *Revenue from Contracts with Customers* contains a significant overhaul of revenue-related disclosure requirements. How will these requirements improve the information that investors receive?**

In general, the new Standard requires more disaggregation within the disclosures. We hope this will result in better information about the nature, product, and geographical distribution of revenues. In addition, we expect companies to provide information about the nature of the promises they have made, the time horizons over which they expect to fulfil those promises, and, as a result, the amount and timing of revenue that has been or is expected to be recognised.

***IASB Investor team*: Can you further describe what you mean by 'promises' (referred to as 'performance obligations' in the Standard)?**

Yes. For example, a supplier [company] makes a promise to deliver a product to a customer. The contract determines the parties' respective rights and obligations. The contract might state that the supplier promises to deliver the product in working condition, that the product will have specified functionality, and, upon delivery, that the supplier is entitled to consideration. If the product is delivered in accordance with those terms, the supplier has met its performance obligation (or promise) and is entitled to consideration from the customer. We believe the new Standard provides a clear and consistent framework by which investors can assess the various rights and obligations between a company and its customers and how they are ultimately reflected as revenue.

***IASB Investor team*: What determines the timing of revenue recognition and therefore of payment to the company?**

A company recognises revenue as it fulfils its promise to transfer goods or services to its customers. We say that a transfer occurs when a customer obtains control of a good or service (eg has the ability to direct the use of the good or service, and enjoy the benefits). Under the new Standard, a company will determine at the beginning of a contract whether it will satisfy the performance obligation over time or at a point in time. If the performance obligation will be satisfied over time, the company selects an appropriate measure of progress, such as milestones reached or time elapsed, to determine how much revenue should be recognised as the promise is satisfied. Often a company has an unconditional right to payment when goods or services are delivered to a customer. However, investors should pay attention when a company has a conditional right to payment (contracts with multiple performance obligations).

***IASB Investor team*: What else should investors pay attention to when looking at the new Standard?**

For most companies, implementation of the new Standard will occur over the next few years. I recommend that investors become familiar with the key principles of the Standard so they can ask informed questions about matters such as whether contracts have multiple performance obligations and how prices are allocated in such contracts, whether revenue is recognised at a point in time or over time, and why, whether contracts contain significant amounts of variable consideration and, if so, how much and how is it estimated, and, of course, the timing of cash collected compared to when revenue is recognised. Many companies may experience little or no change in their revenue recognition patterns. However, companies involved in long-term construction (real estate or equipment) or with contracts involving the delivery of multiple goods and services over more than one period, may be significantly affected. I recommend that investors start their education early so they can assess the effects of the new Standard on the amount, timing and presentation of revenues.

[8] *Disclosure Initiative* (Amendments to IAS 1) was issued on 18 December 2014.

Stay up to date

Recent events and announcements

The Capital Markets Advisory Committee (CMAC) has appointed three new members, with effect from January 2015.

Paul Lee

Paul Lee is Head of Corporate Governance at Aberdeen Asset Management and responsible for co-ordinating the firm's stewardship activities—dialogue and engagement at board level.

Paul was previously Head of Investment Affairs at the National Association of Pension Funds, combining leadership of the NAPF's work on corporate governance and stewardship with leading its approach to policy issues in relation to investment matters. Prior to that, Paul spent over a dozen years at Hermes (now Hermes Investment Management), the fund manager owned by the BT Pension Scheme. Throughout that time he carried out governance and stewardship activities. In later years he also had a more general policy role, ensuring that pension schemes have a voice in the key public policy debates around investment.

Paul is a public member of Network Rail and a member of the Financial Stability Board-fostered Enhanced Disclosure Task Force on bank risk reporting. He is a founding participant in the Corporate Reporting Users' Forum (CRUF) and a co-chair of the Financial Reporting and Analysis Committee (FRAC) of the CFA Society of the UK. He was for several years a member of the Audit and Assurance Council (the audit regulatory arm of the UK's Financial Reporting Council, formerly known as the Auditing Practices Board).

Marietta Miemietz

Marietta, who is a co-founder and Director of Pharmaceutical Advisory Services at Primavenue, has more than fifteen years' experience as a European pharmaceutical and healthcare analyst. Previously, she led Société Générale's successful effort to build a top-10 rated pharmaceutical franchise with pan-European stock coverage and global client reach. Her responsibilities include the preparation of detailed forecasts and research reports on individual companies and industry trends as well as business development and general management.

Marietta is currently co-chairing the FRAC of the CFA UK and is a member of the CRUF.

Glen Suarez

Glen Suarez has been Deputy CEO and Director of Investments at Knight Vinke since 2006, and was appointed Vice Chairman in 2014.

Previously Glen worked at Kleinwort Benson, where he was a key member of the team that advised the UK government on the privatisation of the UK electricity supply industry. Before that, Glen worked at Morgan Stanley where he headed the European utilities group.

Prior to that Glen was a partner at Soditic Ltd, a corporate finance and investment firm, and during this time he worked closely with Knight Vinke as a financial adviser on its investment in GDF Suez SA.

About the CMAC

The CMAC is an independent advisory group that provides the IASB with regular input from the international community of investors and analysts. It meets with IASB representatives in London three times a year, including one joint meeting with the Global Preparers Forum. The CMAC members are drawn from a variety of industry sectors and geographical regions and have extensive practical experience in analysing financial information.

On behalf of the CMAC, we would like to welcome Paul, Marietta and Glen. We would also to thank Peter Elwin and Jane Fuller, who both completed their terms as CMAC members at the end of 2014. Peter and Jane, you will be missed!

The next CMAC meeting takes place on 27 February at the IASB's offices in London. For further information about the CMAC click here.

Other investor information

- Click here for the IASB's investor education webcast series with the CFA Institute.
- European Financial Reporting and Advisory Group (EFRAG) and the Institute of Chartered Accountants of Scotland are sponsoring a Pan-European academic study, which includes interviewing investors on their use of financial information.
- The University of St. Gallen is conducting a 15-minute online questionnaire to better understand whether and how note disclosures provide investors with information to make investment decisions or recommendations.

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