# IASB® *Investor Update*

## Our newsletter for the investment community

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*The IASB* Investor Update *highlights market-relevant accounting topics that could affect the companies that investors follow. It also shares with investors information on the International Accounting Standard Board® (the Board'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 end of first quarter 2016! Amidst a tumultuous market environment, we hope that you have all survived earnings season.

In this issue we are pleased to feature an interview with Mr Jin Liqun, President of the newly formed Asian Infrastructure Investment Bank (AIIB). In his interview Mr Jin discusses numerous issues, including the potential for co-operation between development banks and the private sector, and the potential impact of the work of the AIIB on capital markets. We found the conversation with Mr Jin fascinating and we hope you do too.

We are also excited to announce the issuance of the new Standard on Leases. Our Spotlight focusses on this new Standard, including key changes that you should expect to see when companies start preparing for the 2019 effective date. Many of you may recall that the Board's previous Chairman, Sir David Tweedie, is famously known for saying that he would like to fly on an airplane that actually appears on the airline's balance sheet. With the publication of the long-awaited Standard on lease accounting, that wish may finally come true!

Finally, I am sad to say that this will be my last *Investor Update*. After six and a half years of working at the IFRS® Foundation (including the last three leading our investor engagement programme), I have decided that it is time to move on and consider the next steps in my career.

I will miss working with the investment engagement team as well as with all of you in the investment community who have taken the time and energy to interact with us. Thank you for your contributions, patience and enthusiasm and I wish you the best for the future.

*All the best,*
*Barbara*

## In this issue:

# In profile

## Meet Jin Liqun, first President of the Asian Infrastructure Investment Bank (AIIB)

*Recently, in celebration of the first anniversary of the [Investors in Financial Reporting] programme, the IFRS® Foundation and CFA Institute hosted an investor event entitled 'Asia and the Balance of Power in the Global Economy'. Held in London, it featured a Q&A session with Jin Liqun, who has been a Trustee of the IFRS Foundation since 2011 and is the recently elected President of the Asian Infrastructure Investment Bank.*

*In this article, finance journalist Liz Fisher captures the highlights of the wide-ranging discussion, which covered the value of the Chinese currency, the structure and scale of debt in China, the potential for co-operation between development banks and the private sector, along with the potential impact of the work of the AIIB on capital markets.*

The establishment of the Asian Infrastructure Investment Bank (the AIIB) has been one of the most significant events in international finance in recent years. The speed with which it has been built, the large membership and the high quality of its policies are signs of serious intent. The idea of a multilateral development bank (MDB) based in Asia, which would promote interconnectivity and economic integration in the region in co-operation with existing development banks, was first announced by Chinese President Xi Jinping in October 2013. Just over two years later, in January 2016, the AIIB's Board of Governors held its inaugural meeting.

The balance of the global economy has changed since Bretton Woods and even since the Asian Development Bank (ADB) was founded in 1966. The AIIB will co-operate with the World Bank and other MDBs, not compete with them. As the AIIB's first President, Mr Jin has the challenging task of getting the AIIB up and running, living up to its mandate of a new bank for the 21st century.

### Lean, clean and green

The idea from the outset was that the AIIB would do things differently. It calls itself a development bank 'conceived for the 21st century', which will be built on the experience of existing international development banks and the private sector. The motivation for setting up the AIIB is to meet the funding demands for infrastructure in Asia, including energy, transport, water, sanitation, agriculture and communications. The need for good infrastructure is particularly critical in Asia. Realistically, MDBs are the institutions that have the resources and long-term mind-set to fund such huge projects.

The mantra of the AIIB is to be 'lean, clean and green'—with a small, efficient management team and highly-skilled staff, no tolerance for corruption and built on respect for the environment. It has capital of USD 100 billion to invest (about 40 per cent that of the World Bank) and 57 founding members including Australia, Germany and the UK.

### Co-operation with private investors

Some observers have questioned the record of existing development banks in enabling private investment in infrastructure projects, particularly in emerging markets. The nature of such investments, including the underlying currency, politics, and time to maturity, often discourages or prevents private capital from flowing to what are often viewed as highly profitable projects.

Mr Jin urged investors not to be so quick to judge. Citing the success of China which benefited greatly from World Bank, ADB and other MDB contributions, he argued that these banks have been strong contributors to economic growth, financing and stability in many parts of the world. It is important first to be fair and acknowledge the contributions made by all of these institutions.

Of course, Mr Jin also recognised that there is room for improvement. He acknowledged that the long gestation period of many infrastructure projects, combined with local policies, often makes it hard for private investors to get involved. Consequently, although its design has benefited from the experience of the existing development banks, the AIIB wants to 'do different things and do things differently'. The new President believes that by combining the strong features of (and leveraging his own experience with) MDBs and private sector companies, a new operating modality is expected to better serve the client members and all the other shareholders.

This will facilitate and enable co-operation with private investors, which can help mitigate many of the current risks. The AIIB and private sector investors could work out co-financing arrangements that meet their respective needs. Co-operation and working together is certainly the key. This is what the AIIB is all about.

### 21st century governance

Good governance and an effective principles-based corporate culture are high on the agenda for the AIIB's first President—the AIIB's intention has been described as 'to embody 21st century governance'. But what does this mean in practice?

The answer lies with accountability and responsibility. The AIIB is built on the belief that both accountability and responsibility should be clearly delineated. The AIIB's non-resident Board structure clearly defines responsibilities and accountabilities, allowing the Board to set the strategy and establish policy while the management is responsible for daily operations. In this structure, both Board and management are accountable for their decisions and actions. This emphasis on accountability extends throughout the organisation—employees at the AIIB are on three-year contracts, which are not renewed if their performance drops.

## A common accounting language

The AIIB uses the US dollar as its currency and English as its 'mother tongue'. IFRS Standards are its accounting language and Mr Jin would like to see IFRS Standards used more widely: 'I thought it was a wonderful idea for China to move forward on adoption of IFRS Standards because it works in China's interest. Chinese companies are operating throughout the world and you can't do that with domestic standards.'

Some of the participants at the event wondered if China's willingness to move towards IFRS Standards could eventually persuade the US to do the same. Time will tell, was the reply. Circumstances may not be right at present, but that is not to say that they will never be right. Time will also tell if the AIIB can be what it wants to be and deliver what it promises; but, as Mr Jin says, with the continuing strong support of its shareholders, the AIIB will put forth all efforts to realise these goals.

## More about Jin Liqun

The Board of Governors of the AIIB convened its inaugural meeting on 16 January 2016, declaring the AIIB open for business and electing Mr Jin Liqun as President for a five-year term.

Mr Jin has served as AIIB's President-designate since 1 September 2015. Prior to his selection as President-designate, Mr Jin served as Secretary-General of the Multilateral Interim Secretariat (MIS), the entity tasked with preparing the legal, policy and administrative frameworks and with undertaking other preparatory work required for the establishment of the AIIB.

Immediately prior to assuming the role of Secretary-General of the MIS, Mr. Jin was Chairman of China International Capital Corporation Limited, China's first joint-venture investment bank. From 2008 to 2013, he served as Chairman of the Supervisory Board, China Investment Corporation (CIC). From 2009 to 2012, Mr Jin served first as Deputy Chairman, and subsequently as Chairman of the International Forum of Sovereign Wealth Funds.

From 2003 to 2008, Mr Jin was Vice President, and then Ranking Vice President, of the Asian Development Bank (ADB), in charge of programs for South, Central and West Asia, and private sector operations.

Mr Jin joined the Ministry of Finance in 1980, where he served as Director General and Assistant Minister, and became Vice Minister in 1998. He was also a Member of the State Monetary Policy Committee. Earlier in his career, Mr Jin served as Alternative Executive Director for China at the World Bank and at the Global Environment Facility as well as Alternative Governor for China at the ADB.

Mr Jin holds an M. A. degree in English Literature from Beijing Institute of Foreign Languages (now Beijing Foreign Studies University). He was also a Hubert Humphrey Fellow in the Economics Graduate Program at Boston University from 1987 to 1988. He is a national of the People's Republic of China.

## Spotlight: Leases

We are delighted to tell investors that the Board has recently finalised its project to improve lease accounting with the publication of IFRS 16 *Leases*. IFRS 16, which is effective from 1 January 2019, will replace the current requirements in IAS 17 *Leases*.

IFRS 16 aims to make financial reporting for leases more relevant and understandable for investors. The new Standard eliminates the classification of leases as either operating or finance for lessees and, instead, introduces a single lessee accounting model. This model reflects that leases result in a company obtaining the right to use an asset at the start of the lease and, because most lease payments are made over time, also obtaining financing. As a result, the new Standard requires lessees to account for all of their leases in a manner similar to how finance leases were treated when applying IAS 17.

While most investors will not feel the urge to rush out and read the new Standard cover to cover, we think they might be interested to read other related Board publications that contain helpful information, such as the Investor Perspectives article ['A New Lease of Life'] or the [Effects Analysis.]

Below we highlight a few of the 'big ticket' changes that investors will see once IFRS 16 is applied. We discussed these in greater detail in the publications mentioned above.

**Table 1: IFRS 16 - Key changes to expect**

| Quick rules of thumb[1] | |
|---|---|
| ↑ Gearing (debt/equity) | Debt increases due to lease obligation. |
| ↑ EBITDA | Lease expense appears after EBITDA. |
| ↑ EBIT | Interest component of lease expense appears after EBIT. |
| ↔ Profit before tax | Little change expected, will vary by company. |
| ↔ Net Profit | Little change expected, will vary by company. |
| ↑ Operating Cash flow | A portion of lease expense cash flow will be classified as financing cash flow. |
| ↑ Higher / ↓ Lower / ↔ Depends | |

### Balance sheets will get bigger

By bringing lease assets and liabilities onto the balance sheet, companies with material off balance sheet leases will report higher assets and financial liabilities than they currently do.

[1] See Glossary in the Effects Analysis for short definitions of terms.

### The income statement will offer more detail

The new model will align the income statement expense treatment for all leases by replacing today's straight-line operating lease expense with a depreciation charge for the lease asset and an interest expense on the lease liability. In Table 1, we highlight a few of the income statement sub-totals that will be affected.

### Which sectors do we expect to be most affected?

IFRS 16 is expected to affect the amounts reported by almost half of listed companies across the globe. However, the use of off balance sheet leases is concentrated within some industry sectors such as airlines, retailers, transport and travel & leisure.

### Financial ratio analysis will be affected

The changes to presentation of lease expense will be noticeable to investors when analysing ratios such as profit margins (eg EBITDA margin). This is because, unlike under IAS 17, EBITDA calculated under IFRS 16 does not include expenses related to leases. Other effects are discussed further in the Effects Analysis.

### Freeing up investors to analyse information instead of adjusting data

At a high level, having substantially all leases appear on the balance sheet should mean that investors will have better information to calculate return on capital employed and leverage ratios. The new accounting will result in more information about leases both on the balance sheet and in improved note disclosures. It will also provide a more accurate reflection of the economics of leases in the financial statements.

### Improved disclosures about leases

Because the information presented today is considered by many to be inadequate, improving the quality of disclosures was necessary. Among the new disclosures investors can look forward to are details about lease expense and lease assets by class of asset. IFRS 16 also requires disclosure of a maturity analysis of lease liabilities similar to that for all financial liabilities.

### What about convergence with US GAAP?

The Board and the FASB have reached the same conclusions in many areas of lease accounting. However, they reached different conclusions on lessee expense recognition for some leases. The key takeaway for investors will be that the reporting of expenses and cash flows will be different between IFRS Standards and US GAAP.

### Lessor accounting unchanged

While lessee accounting will change, IFRS 16 does not change substantially how a lessor accounts for leases.

### How can I stay in the loop?

The IASB hosts podcasts and conferences during which companies share their thoughts on transition, providing investors with insights ahead of the change.

## We need your views

The Board 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 for which we are currently seeking investor views.

### ***Principles of Disclosure***

To help companies determine the basic structure and content of a complete set of financial statements, the Board is conducting research to improve existing guidance in this area. We need your views on specific topics, including the placement of information in and outside of financial statements, disclosure of significant accounting policies, and whether requiring disclosures in a specific format makes a difference for investors. We would also like to understand whether the scope and issues addressed in this project respond to investors' concerns about disclosures. A Discussion Paper on this topic is targeted for Q2 2016.

### ***Financial instruments with characteristics of equity***

Some financial instruments have characteristics of both liabilities and equity (eg put options on a company's own shares). The Board is investigating potential improvements to how such instruments should be classified, as well as to the presentation and disclosure requirements for such instruments, irrespective of whether they are classified as liabilities or equity. We would like to understand how the classification of these instruments would affect your assessments of a company's financial position and performance. We would also like to understand what features of these instruments are relevant for investors, what information about those features would be useful, and why. This project is currently in the research stage.

### ***Equity method of accounting***

Requests for input will depend on how the Board decides to develop this project when it has assessed the feedback from the Request for Views: *2015 Agenda Consultation*. If the Board proceeds with such a project, an important step will be to understand what information you use when reviewing investments that are accounted for using the equity method of accounting.

### ***Update: Proposed Amendments to IFRS 4*** **Insurance Contracts**

In December 2015 the Board published an Exposure Draft of proposed amendments to IFRS 4, on which we sought and received investor feedback. A summary of this feedback was presented at the March 2016 Board meeting, where the Board voted on the final direction of the project. Click here for more information. Thank you to those investors and analysts who have provided input on this project.

### ***Update: 2015 Agenda Consultation***

You may recall that our October 2015 *Investor Update* discussed the Board's Request for Views: *2015 Agenda Consultation*, which closed on 31 December 2015. The project team received a significant amount of investor input on this consultation. In addition to 9 investor outreach meetings, we received 12 comment letters from investors/investor representative organisations. And out of 169 respondents to the online survey[1], 86 were investors.

We would also like to thank those of you who took the time to provide your input on this project. Your feedback is important to us.

*Key messages*

At the March 2016 meeting the Board discussed the high level strategic messages received on this consultation. Key investor messages include:

- when prioritising projects, the most important, or sole factor, should be the importance to investors;
- the Board should focus more on targeted improvements ('quick wins'), implementation activities and Post-implementation Reviews, rather than Standards-level projects. The exception is projects of particular relevance to investors such as the Disclosure Initiative and Primary Financial Statements; and
- the pace of change has been too slow. Projects of importance to users, such as performance reporting, have not progressed quickly enough.

In addition, investors generally put greater emphasis on wider corporate reporting issues (eg consideration of environmental, social and governance issues) and reporting for non-listed entities (eg the Capital Markets Union[2]), than did other respondents. We also noted that Primary Financial Statements is a recurring topic for most investors regardless of type (buy-side or sell-side), geographical region, or the channel through which they shared their views. Although not necessarily the top priority for all, Principles of Disclosure was the only other project that stood out across all channels as important to investors.

*Next steps*

At a future meeting the Board will discuss the prioritisation criteria that should be applied to individual projects, the comments received on individual projects and what effect those comments should have on prioritisation, and a proposed work plan.

[1] This was also discussed in the October 2015 *Investor Update*.
[2] http://ec.europa.eu/finance/consultations/2015/capital-markets-union/index_en.htm

# Stay up to date

## Announcements

**The Board responds to calls from investors for better disclosures** by issuing amendments to IAS 7 *Statement of Cash Flows* in January 2016. The amendments will require companies to provide information about changes in their financing liabilities (including non-cash changes), and come as a response to requests from investors for information that helps them better understand changes in a company's debt. The new requirements are effective for annual periods from 1 January 2017.

In January 2016 the Board **set up a procedure for receiving implementation issues on the *IFRS for SMEs*.** This is a result of a recent comprehensive review of the *IFRS for SMEs*—the Standard developed for entities that do not have public accountability and that prepare general purpose financial statements—in order to allow constituents to submit implementation issues on the *IFRS for SMEs*.

**The IFRS Foundation commented on the European Securities and Markets Authority's (ESMA's) consultation paper on the European Single Electronic Format.** The comments welcome ESMA's proposal to use the IFRS Taxonomy as issued by the IFRS Foundation for structured financial reporting in companies that report under IFRS Standards. The IFRS Foundation believes that the introduction of structured electronic reporting will make a positive contribution to the healthy functioning of capital markets in Europe.

## Board reappointments

- The Trustees of the IFRS Foundation **announced** the reappointment of Hans Hoogervorst as IASB Chairman for a second, five-year term from 1 July 2016. At the same time, the Trustees **announced** that Ian Mackintosh has decided not to seek a second term, and will step down as IASB Vice-Chairman when his first term expires on 30 June 2016.
- The Trustees of the IFRS Foundation also **announced** the reappointment of Takatsugu (Tak) Ochi for a second three-year term and the retirement of Pat Finnegan, both effective 30 June 2016.

## Speeches and events

**Hans Hoogervorst participated in an exchange of views with the European Parliament** on 11 January 2016. Mr Hoogervorst spoke about IFRS 16, IFRS 9 *Financial Instruments*, accounting for insurance contracts and the *Conceptual Framework*. His opening remarks are available here.

## Reading material for Investors

In January Board member Sue Lloyd published the Investor Perspective article 'A New Lease of Life', in which she discusses some of the key changes to financial statements that investors will see when companies apply the new lease accounting requirements.

## Summaries of investor feedback

Below are examples of how investor views were fed back to the Board on various projects. For more information please click here.

| Date | Summary of Investor Feedback Document |
|---|---|
| January 2016 | Fair value measurement—Unit of Account : Investor feedback<br><br>Present value measurement– discount rates research: Investor feedback |
| November 2015 | Report on IFRS 2 *Share-based Payment* research to date<br><br>Investor feedback on goodwill and impairment from the Post-implementation Review of IFRS 3 *Business Combinations* |
| September 2015 | Feedback from investors on the different effective dates of IFRS 9 *Financial Instruments* and the new insurance contracts Standard |
| June 2015 | Feedback from research project on treatment of changes in accounting policies<br><br>Feedback from proposed amendments to IAS 7 *Cash Flow Statements* |
| May 2015 | Feedback from surveys about treatment of accounting estimates |
| March 2015 | Investor feedback on the fair value measurement of quoted investments in subsidiaries, joint ventures and associates |
| February 2015 | Investor feedback on accounting for dynamic risk management |
| March 2014 | *Conceptual Framework:* summary of investor feedback |

### Register for investor alerts

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