

## Summary of Capital Markets Advisory Committee Meeting

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This is a summary of the topics discussed at the Capital Markets Advisory Committee meeting on 24 October 2012, prepared by the staff of the IFRS Foundation. For more detailed information about the meeting, please visit <http://www.ifrs.org/The-organisation/Advisory-bodies/CMAC/Pages/CMAC.aspx>

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### Introduction

1. The Capital Markets Advisory Committee (CMAC) held a meeting in London on 24 October 2012. Eight IASB members and some staff were in attendance. Stephen Cooper, IASB member, welcomed CMAC members and introduced Martin Edelmann, IASB member, who attended the meeting for the first time since his appointment to the IASB in July 2012.

### Work plan update

2. Alan Teixeira, the IASB's Senior Director of Technical Activities, gave an update on the IASB work plan. Dr Teixeira explained that the 2011 agenda consultation had been concluded and described the three standards-level projects the IASB intends to undertake: a project on rate regulated activities and a narrow scope project on IAS 41 and a small project on separate financial statements. He also said that work has begun on the Conceptual Framework and would begin on some research projects in the next 12 to 18 months. A CMAC member asked whether the research projects would result in a new IFRS, and Dr Teixeira clarified that a research project does not necessarily have to result in the issue of a final standard. He said that the point of doing research was to determine whether there is an issue the IASB can resolve, and in some cases the research work would end with a conclusion that no amendment or new Standard is necessary at that time. CMAC members suggested that research projects in the areas of inconsistent application or inconsistent enforcement would be useful. Dr Teixeira noted that the IASB is in the process of intensifying its relationships with regulators (including the International Organization of Securities Commissions (IOSCO) and the European Securities and Markets Authority

(ESMA)), as well as national standard setters and other parties involved in the enforcement process.

3. Dr Teixeira also noted that in the second quarter of 2013 the IASB intends to publish a discussion paper on the Conceptual Framework. The discussion paper will cover elements of financial statements, measurement, reporting entity, presentation and disclosure. Dr Teixeira affirmed a CMAC member's question on whether all parts would be developed and published at the same time.
4. A CMAC member asked whether the Standards resulting from the current projects (ie leases, revenue recognition, insurance and financial instruments) would have the same effective date. Stephen Cooper responded that the main current projects are unlikely to have the same effective date, because the projects are in different stages of finalisation (eg Revenue Recognition is close to publication of a final standard, whereas Leases is being re-exposed).
5. A CMAC member stated that getting the Standards right is more important than meeting a deadline.

### **Eumedion position paper**

6. CMAC member and Eumedion representative Martijn Bos presented an overview of Eumedion's position paper asking for additional disclosure when an entity fully consolidates a partially-owned subsidiary. Mr Bos stated that the non-controlling interest (NCI) line item in an entity's financial statements does not enable users of financial statements to understand whether particular items of income and expense are attributable to parent company shareholders and which assets and liabilities (in particular, cash and debt) are owned by the parent company. He emphasised the importance of this information for analysing a group's leverage, liquidity and value.
7. CMAC members overall agreed that further information on the composition of the NCI line item is needed. The general view was that current disclosures do not enable users of financial statements to understand the amount and timing of cash flows relating to subsidiaries with NCI. CMAC members stated that the lack of information about cash and debt in respect of NCI leads analysts to use

conservative assumptions that may not be accurate when calculating ratios for entities with partially-owned subsidiaries.

8. A CMAC member suggested requiring expanded segment disclosures, which would provide users of financial statements with additional information about the ownership of subsidiaries. Another CMAC member noted that it would be difficult to identify an appropriate solution since users of financial statements have varying information needs in respect of NCI. Another CMAC member thought that providing line items on a proportionate share basis could be onerous for entities with a large number of subsidiaries.
9. Mr Bos stated that entities already provide net income on a proportionate share basis. He thought that it would not be onerous for an entity to provide other line items on a proportionate share basis as well. He speculated that the relevant disclosure requirement in IFRS 12 *Disclosure of Interests in Other Entities* may not produce sufficient information about the composition of NCI since important information about intragroup transactions is eliminated. Although he supports the overall disclosure objective in IFRS 12, which has not yet been applied in practice, Mr Bos noted that it is not known whether entities will provide sufficiently granular information when meeting that objective.
10. Mr Bos also stated that users of financial statements are currently adjusting for NCI using whatever information is available (sometimes in an ad hoc manner). He stated that disclosure of line items on a proportionate share basis would eliminate the need for this adjustment and therefore facilitate financial statement analysis. He presented various solutions to the issue, including a recommendation to amend IFRS 12 to require disclosure of line items on a proportionate share basis at the group level (perhaps as part of the IASB's Annual Improvements project). As an alternative, Mr Bos suggested amending IFRS 8 *Operating Segments* following its post-implementation review.
11. Patrina Buchanan, IASB staff, noted that IFRS 12 requires an entity to disclose information about operating activities and cash flows in respect of subsidiaries with material NCI. Furthermore, this disclosure requirement was included to balance the need to provide information about NCI to users of financial statements with the costs to preparers of providing this information.

12. CMAC members generally agreed that eliminating the need to adjust for NCI would be ideal. Overall, CMAC members agreed that disclosure of line items on a proportionate share basis would at least partially address this issue, although the ideal solution would be for preparers to provide consolidating financial statements. However, they understand that such a solution is not possible at this stage and would welcome other solutions such as that proposed by Eumedion.
13. Philippe Danjou, IASB member, suggested that CMAC members assess the implementation of IFRS 12 when it becomes effective in 2013 and share their observations with the Board and staff. Mr Danjou noted that it is too early to amend IFRS 12 because entities have not yet started applying it. He also stated that the post-implementation review of IFRS 8 would focus on various areas of potential improvement, which may not permit amendment of IFRS 8 for this particular issue.
14. Peter Clark, the IASB's Director of Research, noted that the issue of how to account for NCI is relevant to the IASB's work on the Conceptual Framework project.

## **Revenue recognition**

15. Glenn Brady, IASB staff, gave an update on the revenue recognition project. Mr Brady then asked CMAC members for their views of three potential ways of accounting for and presenting customer credit risk:
  - (a) The approach in the 2011 exposure draft in which impairment losses are presented next to the revenue line for those contracts without a significant financing component and where impairment losses are presented as expenses (with other loan losses) for those contracts with a significant financing component.
  - (b) All impairment losses arising from contracts with customers are presented together in one location (either in expenses or adjacent to the revenue line).
  - (c) Having a collectibility threshold for revenue recognition.

16. A CMAC member noted that it would be helpful for users of financial statements to separate impairment losses for prior periods from those for the current period. Mr Brady responded that preparers have indicated that it would not be possible to distinguish between the two because they do not monitor their receivables in that way.
17. There was consensus between CMAC members that revenue is separate from collectability and they would prefer that entities presented the gross amount of revenue separately from customer credit risk (impairment losses). They see such impairment losses as part of operating expenses and not as part of gross profit or revenue, and would prefer to see them as a separate, but clearly labelled, line item. A CMAC member said that presenting impairment losses next to revenue would be misleading because revenue relates to the current period and the credit risk line item could include the credit risk related to customer transactions in prior periods. One CMAC member preferred the approach in the 2011 exposure draft (see [paragraph 15\(a\)](#) above).

### **Rate-regulated activities**

18. Michael Stewart, the IASB's Director of Implementation Activities, asked for CMAC members' views on the following:
  - (a) their information needs about entities with rate-regulated activities;
  - (b) how those needs are met currently; and
  - (c) what changes are needed to the financial statements of entities with rate-regulated activities.
19. Jane Pike, IASB staff, informed CMAC members that this project would be relevant for any industry in which a regulatory body limits the price a supplier can charge its customers (and therefore is not limited to utility companies). She noted that most jurisdictions apply a rate regulation regime that falls somewhere between a cost-based regime and an incentive-based regime. Ms Pike also noted the diversity in practice in the accounting for rate-regulated activities. Specifically, regulatory assets and liabilities are not reported in IFRS financial statements, while generally accepted accounting principles in Canada, India and

the US do require entities to recognise and measure regulatory assets and liabilities.

20. Ms Pike then asked CMAC members to comment on the following questions:
- (a) Do you see regulatory assets and liabilities in IFRS financial statements?
  - (b) Do you make adjustments to compare the financial statements of entities that report regulatory assets and liabilities with those of entities that do not report these amounts?
  - (c) Do you have enough information to distinguish between different rate regulation regimes?
21. Although they said they are not experts in analysing entities with such activities, CMAC members generally agreed that rate regulated activities are economically similar to a master contract between a supplier and buyer. They noted that such contracts do not result in the recognition of assets or liabilities because they do not meet the criteria for recognition in the IFRS Conceptual Framework. However, a CMAC member noted that some regulatory assets and liabilities that are recognised currently in some jurisdictions may meet the threshold for recognition in the Conceptual Framework but others may not.
22. CMAC members stated that the recognition of regulatory assets and liabilities actually hinders an analyst's ability to understand the underlying financial performance (mainly because the measurement of regulatory assets and liabilities would require a large number of assumptions and would be subject to frequent changes in estimates; as a result they are unsure of the relevance that changes in the valuation would have period to period). They suggested that an entity should disclose the expected margin on next year's activities instead. They said that the following information about rate-regulated activities would be most useful:
- (a) which costs are recoverable;
  - (b) which costs are not recoverable;
  - (c) what rate the entity will charge in future periods; and
  - (d) the expected return in future periods.

23. They also expressed interest in disclosure of information about the regulatory framework to which the entity is subject and about the uncertainty in future pricing.
24. Mr Stewart informed CMAC members that in late 2013 the IASB intends to publish a discussion paper on the characteristics and features necessary for a rate regulated entity to recognise an asset or liability. He noted that feedback on the IASB's recent agenda consultation suggested a need for interim guidance on this topic. He then asked CMAC members for their views on the following topics:
- (a) "grandfathering" of currently recognised regulatory assets and liabilities;
  - (b) whether to specify an accounting treatment in the interim guidance; and
  - (c) whether the IASB should issue interim guidance if doing so would delay the timeline of the long-term project.
25. Overall, CMAC members did not favour grandfathering as many regulatory assets and liabilities that are recognised currently, as noted above, do not seem to meet the criteria for recognition in the Conceptual Framework.
26. CMAC members noted the possibility that the lack of interim guidance on rate-regulated activities may create a barrier for adoption of IFRSs in some jurisdictions given the size of the entities that such guidance would affect.
27. Mr Cooper noted that most analysts favour the accounting treatment that is applied in current practice in their jurisdiction. Because this has led to mixed messages from users of financial statements, Mr Cooper concluded the session by requesting CMAC members to place the IASB staff in contact with analysts that cover rate-regulated industries.

## **Leases**

28. Patrina Buchanan, IASB staff, presented some aspects of the staff's draft analysis of the effects of the lessee accounting proposals (an "effect analysis") and asked CMAC members for their views on how well the draft effect analysis

- depicted the effect the leases proposals would have on users of financial statements.
29. CMAC members said that it is difficult to assess people's behaviour before new standards are implemented and in their view the effect analysis should not attempt to do so. They thought that the effect analysis should focus on:
- (a) identifying what investors and analysts are struggling with today when analysing financial statements; and
  - (b) describing how the IASB thinks the proposals would solve those issues. In their view, an important aspect of the effect analysis is to show how the proposals would make the day-to-day job of analysts and investors more efficient in analysing financial statements. For example, one CMAC member noted that there would be benefits (and cost savings) for users arising from the reduced uncertainty resulting from companies making estimates of operating lease liabilities, rather than analysts needing to do so.
30. A CMAC member said the draft effect analysis is descriptive, and suggested that the quality of the effect analysis could be enriched by adding some real-life illustrations using more quantitative examples. Some CMAC members indicated that the table of effects on ratios would be particularly useful, although they thought that the table of ratios should be clear that analysts and investors do not always use the financial information as reported because they often will make adjustments. Some amendments to the table were suggested.
31. A CMAC member noted that the effect analysis should explain that leases are financial liabilities that are treated as secured debt. Another CMAC member said that the effect analysis should note the benefit of having all assets used in the business recognised in a lessee's balance sheet.
32. CMAC members generally agreed that the effect analysis should address the possible effects on a lessee's cost of capital. One CMAC member noted that if a lessee's cost of capital increased as a result of the proposals (and the increased transparency of that entity's debt), it would be because the entity had been able to "hide" assets used in its business under current requirements by not recognising them on its balance sheet.



33. Ms Buchanan stated that the IASB plans to publish the effect analysis together with its revised Leases Exposure Draft in the first quarter of 2013.

### **IFRS 8 post-Implementation review**

34. Mr Stewart informed CMAC members that the IASB had published a request for comment on the application, enforcement and use of information resulting from IFRS 8.
35. April Pitman, IASB staff, said that before this standard was issued, IAS 14 *Segment Reporting* required an entity to report information by geographic region and product line. In contrast, IFRS 8 requires an entity to determine its segments by “looking through the eyes of management”. She indicated that the intent of IFRS 8 is to align the presentation of segment information across the entity’s internal commentaries, the actual financial statements and investor presentations. She asked CMAC members to comment on whether IFRS 8 has resulted in a consistent segmentation basis across all forms of reporting and, if so, if this change in reporting has been helpful to users of financial statements.
36. The general view amongst CMAC members was that combining products and geographic regions within a segment does not result in useful information. Some CMAC members think that IFRS 8 provides entities with too much flexibility in the determination of a segment, and most CMAC members expressed a preference for the dual product and geographical matrix segment disclosures that IAS 14 previously required. Overall, CMAC members agreed that IFRS 8 should require an appropriate level of granularity in the determination of an operating segment.
37. In particular, CMAC members noted the following problems with segment reporting in IFRS 8:
- (a) presentation of segment information across internal commentaries, the actual financial statements and investor presentations is not always aligned;
  - (b) some entities change their operating segments from period to period without any apparent reason, reducing comparability over time;

- (c) it is difficult to determine who is the “chief operating decision maker”; and
  - (d) comparability across entities is reduced.
38. Some CMAC members noted that these problems in current practice may be issues with application and enforcement rather than issues with IFRS 8. Those members thought that because the purpose of a post-implementation review is to identify issues with the standard itself, issues with enforcement of the standard should be brought to the attention of (and is the responsibility of) auditors and regulators.
39. CMAC members thought that segment reporting should provide the following:
- (a) forward-looking information about segments;
  - (b) knowledge of what and how management is managing the business; and
  - (c) differentiation between segments with distinct value drivers.
40. In conclusion, CMAC members commented that segment information would only be useful if it were comparable across entities.

## **Financial Instruments: Impairment**

41. Manuel Kapsis, IASB staff, described the IASB’s recent efforts to get input from interested parties on the impairment project. He also described the discussions at the October 2012 IASB meeting, which was held the week before the CMAC meeting. At the IASB meeting, the staff presented a summary of the feedback received during the outreach activities, both from users of financial statements and from others (eg regulators, auditors, preparers). Overall, the users of financial statements said that they wanted the IASB to develop an impairment model that reflects the underlying economics of an entity’s financial instruments, including the effect of credit risk. Mr Kapsis noted that some investors and analysts did not think that the three-bucket model would fully accomplish this given the potential “cliff effect” from moving from a 12-month expected loss horizon to a lifetime expected loss horizon. Having said that, users of financial statements said they generally preferred the three-bucket model to the lifetime

day one loss model because the three-bucket model enables users of financial statements to distinguish between assets that have deteriorated in terms of credit quality and those that have not. A CMAC member suggested that disclosure of lifetime expected credit losses should be required even if the IASB finalises a three-bucket deterioration model.

42. Mr Kapsis stated that users of financial statements had expressed concern over the judgement that management would exercise in determining which assets had deteriorated in the three-bucket model. That is because only when the credit quality of an asset has deteriorated “significantly” would the asset move from the initial bucket (with a 12-month expected loss horizon) to another bucket (with a lifetime expected loss horizon). Users of financial statements and others asked for clarification of the criteria for recognition of lifetime expected losses. Specifically, they wanted to know what is meant by:

- (a) a “more than insignificant deterioration” in credit quality; and
- (b) the likelihood of loss is “at least reasonably possible”.

43. CMAC members agreed that the criteria for recognition of lifetime expected losses should be simplified and strengthened. CMAC members expressed concern that the criteria as currently proposed could enable entities to purposefully avoid recognising lifetime losses.

44. CMAC members also supported distinguishing between assets that have deteriorated and those that have not. However, CMAC members were concerned about the “arbitrary” nature of the 12-month perspective, and Mr Kapsis noted that the Board decided to use a 12-month expected loss measure because it provides an offset to contractual interest rates and enables entities to make use of information that they already use for prudential purposes.

45. Mr Kapsis noted that the IASB had decided against the lifetime day one loss model in part because it would not take into account the interest income that an entity expects to earn over the life of an asset.

46. A CMAC member noted the similarity between the impairment model that the FASB is currently developing and the approach proposed in the IASB’s 2009 exposure draft. CMAC members requested that the IASB evaluate the FASB’s model once it is fully developed to see if further steps can be taken toward

having a converged impairment model. CMAC members also noted their conceptual preference for the time proportional approach in the IASB's 2011 supplementary document.

## **Enhancing investors' IFRS knowledge**

47. Mike Wells, the IASB's Director of the Education Initiative, described the IFRS Foundation's early stage plans for contributing to the education of investors and analysts on accounting matters. Mr Wells asked CMAC members for their views on how the staff could apply their resources to enhance the IFRS knowledge of investors and analysts.
48. Some CMAC members were concerned about the viability of the self-funding of the Education Initiative's investor education programme, because some companies (eg the 'Big 4' accounting firms) already provide accounting educational material for free. Nevertheless, a CMAC member said educational material produced by the IASB could pay off in the long run in terms of improving the branding of the IASB, generating revenue and getting more access to outreach possibilities.
49. A CMAC member explained there is a lack of educational material that is understandable for users of financial statements. Consequently, educational material produced by the IASB should focus on the challenges that users have in understanding IFRSs and should try to translate the standard-setter's language into something understandable to users. It was also noted that such a format could be beneficial to other stakeholders. A CMAC member noted that the snapshot documents that accompany exposure drafts and the Executive Briefings document are useful and easy to understand. He therefore suggested that the staff spend time tailoring existing materials to be more useful for investors and analysts. A CMAC member added that it would also be important for any such material to illustrate the accounting changes using real life examples.
50. Another CMAC member commented that the investor community can be very diverse in terms of their understanding and use of accounting, and therefore the focus of the material should initially be on the more experienced users to try to

get the messaging right. Similarly other CMAC members highlighted the industry focus of particular analysts and investors.

### **CMAC membership**

51. Following the close of the public CMAC meeting, a non-public session was held to discuss CMAC membership. Hilary Eastman, IASB staff, noted that the terms of three members expire in 2012 and the terms of six members expire in 2013. One of the CMAC members who was scheduled to retire in 2012 has agreed to attend his term and another is considering doing so. CMAC members also discussed potential candidates for CMAC membership and agreed to add three new members who will begin their terms in 2013.
52. Ms Eastman asked CMAC members to refer any additional candidates to her.