Summary of the Capital Markets Advisory Committee discussions

The IASB's user advisory group, the Capital Markets Advisory Committee (CMAC), held their final public meeting of 2013 on Thursday 17 October.

The meeting took place in the IASB offices in London. A recording of the meeting, the agenda and related papers are available on the **meeting page**. Detailed minutes from the meeting will be posted on the CMAC webpage at a future date.

For more information about CMAC, **click here**.

The topics for discussion on 17 October were:

- **Conceptual Framework**
  - **Profit or loss/other comprehensive Income**
  - **Liabilities/equity**
  - **Prudence/stewardship/reliability**
- **Disclosure Initiative**
- **Leases**
- **IFRS 3 *Business Combinations*: Post-implementation Review**
- **Appointment of new members (closed session)**

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Conceptual Framework

Profit or loss/other comprehensive Income

The IASB staff explained the IASB's proposed approach to profit or loss (P&L) and other comprehensive income (OCI). The staff explained how the use of OCI might be restricted to one or more of the following types of items:

- when the IASB decides to give a two-dimensional view of an asset or liability by using one measurement in the statement of financial position and a different measurement to determine the amounts reported in profit or loss ('bridging items');
- when changes in measurement result in incomplete information about a set of linked transactions ('mismatched remeasurements'); and/or
- when a measurement of a long-term asset or liability is expected to reverse/change significantly ('transitory items').

The staff then asked the CMAC how they view/use the information in OCI versus the information in the statement of profit or loss.

While there was no consensus from CMAC members on the use of OCI or the proposed categories, many agreed that the value of OCI is that it breaks out the elements that many analysts would also take out when modelling a company's financial performance. For example, it can provide current value information on the balance sheet and in total comprehensive income without reducing the usefulness of the statement of profit or loss from a valuation perspective.

Liabilities/equity

The IASB staff discussed why the distinction between a liability and equity for accounting purposes may result in the provision of insufficient information to users about pending equity transactions. They explained that the IASB has proposed two solutions: a narrow view of equity or a strict view of liabilities. The staff also explained the proposed enhancements to the information presented in the statement of changes in equity.

The CMAC members discussed the objectives of the classification of a liability and of equity, with a particular emphasis on obligations to issue equity instruments. Members agreed that more information is needed to enable them to understand the potential dilutive effects of such instruments under different scenarios. They discussed possible ways of communicating this information through the primary financial statements and disclosures, and whether the proposed changes to the equity statement would actually provide them with the information they need. There was no formal conclusion on which approach was preferred.

Prudence/stewardship/reliability

The IASB staff briefly discussed the reasons why the IASB decided:

- to remove from the Conceptual Framework the brief discussion of ‘prudence’;
- to remove the word ‘stewardship’, while retaining a brief discussion of that notion; and
- to replace the qualitative characteristic of ‘reliability’ with the qualitative characteristic of ‘faithful representation’. The staff noted that the previous version of the Conceptual Framework stated that information was reliable when it was free from material error and bias and could be depended upon by users to represent faithfully that which it either purported to represent or could reasonably be expected to represent.

The IASB also summarised the concerns that have been raised by some users as a result of these changes.

The CMAC members then discussed whether it made sense for the IASB to bring back the word ‘prudence’, and if so, some ways that the IASB could consider doing so. It was noted that the word ‘prudence’ means different things to different people. If the IASB decides to reintroduce a more explicit notion of prudence/conservatism/caution, it is important that it is clear what the notion is intended to mean: for example, would it mean exercising a degree of caution in making judgements under conditions of uncertainty, or would it be more of a smoothing device? The IASB should be careful about reinstating a word that may be seen as meaning something else.

There was also some general acknowledgement about the reasons for removing the word ‘stewardship’ and that this was possibly a less complicated area to address than the concerns around the word ‘prudence’.

Conceptual Framework—next steps

The IASB staff encouraged members to consider writing comment letters in response to the Conceptual Framework Discussion Paper. The IASB staff will continue its outreach on the Conceptual Framework project and will include views expressed by members of CMAC in the feedback they provide to the IASB.

Disclosure Initiative

The IASB staff discussed the feedback that has been received in the past from users about the need for disclosures around ‘net debt’, and whether this should or could be considered as a narrow amendment to IAS 1 *Presentation of Financial Statements*. The staff were particularly interested in whether CMAC members thought some sort of a net debt disclosure should be required and, if so, whether the CMAC members preferred specific types of information (ie a definition of net debt versus a description of net debt) and why.

The CMAC members generally agreed that ‘net debt’ is an important issue that the IASB should be considering. They indicated that net debt information, including a reconciliation between the beginning and the end of the year, is important for investors and analysts. It helps them to understand many items about a company’s operations, including:

- cash that is ultimately available at the parent company;
- limits on actual cash available;
- movements in debt items throughout the year; and
- a company’s liquidity risk/risk regarding continuity.

It also helps users to understand how complex a company's finance structure is, and compare different companies' financing decisions. However, CMAC members did not agree on what items should make up 'net debt'. It was also recognised that user needs concerning information about cash versus debt are not always the same and that the IASB staff needed to keep this in mind. This highlighted a general view that more research was needed by the IASB on this topic.

CMAC members agreed that net debt should not be considered as part of the Amendments to IAS 1 project; however there were some concerns about timing if net debt becomes part of a broader long- or medium-term project.

Disclosure Initiative—next steps

The IASB staff will be bringing the subject to the IASB at its October meeting for further discussion on how to proceed. The feedback received from the CMAC will also be considered as part of the discussions with the IASB.

Leases

The IASB staff described the feedback received on the lessee accounting proposals included in the Exposure Draft published in May 2013. The staff indicated that, although there is broad support from the user community, preparers and others are concerned about the costs and complexity of the proposals.

The CMAC discussed the merits of the Leases proposals and unanimously agreed that recognising assets and liabilities for all leases of more than 12 months on a lessee's balance sheet is an improvement to financial reporting. Because CMAC members unanimously agree on this topic, the CMAC decided to send a formal recommendation on lessee accounting to the IASB. **Click here** to access the letter.

The IASB staff also discussed the lessor accounting model. The CMAC generally supports the changes proposed to the lessor accounting model. The CMAC noted, however, that recognising a lease receivable and a residual asset for leases of long-lived assets might not always be appropriate (in particular, when the lessor could release the asset for a similar rental charge and/or when the value of the residual asset is very volatile).

Leases—next steps

The IASB staff will be summarising the feedback received on the Leases project for the IASB, who will begin redeliberations in the fourth quarter of 2013.

Post-implementation Review (PiR) of IFRS 3 *Business Combinations*

The IASB staff explained the purpose of the PiR. Using a slide pack and illustrative examples of IFRS 3 requirements, including the required disclosures, the staff asked the CMAC for feedback on the usefulness of the information that IFRS 3 provides.

The CMAC discussed investors' needs when looking at business combinations and with respect to today's requirements under IFRS 3. The main messages resulting from the discussions were:

Disclosures

- The disclosures required in IFRS 3 today are too generic. Often they do not provide enough detail to assist investors in assessing the primary reasons for the business combination and perhaps for then challenging management on whether they have overpaid for a company. More information is needed about the acquirer's strategy, as well as for items such as acquisition costs, synergies expected and consideration paid.
- Investors need more detailed, disaggregated pro forma income statements and cash flow information about acquisitions and disposals in order to properly analyse the effects that these transactions have on an entity's accounts. Prior year pro

forma information is also important because it allows investors to recompose the latest 12 months' information to value the entity and judge its performance (ie calculate the return on invested capital). Pro forma information helps investors determine how efficient and effective management has been in its use of the entity's resources (ie whether the acquired entity's performance is consistent with the expectations that were originally used by management when deciding on the acquisition price).

Goodwill and intangibles

- Some members think that identifying and separating the value of intangible assets from the value of the goodwill is unnecessary. In addition, separating intangible assets such as customer lists may be difficult to audit and may require too much use of judgement. There was also a discussion about acquired versus internally generated intangibles and how to treat subsequent amortisation in the valuation models (some back it out while others distinguish between wasting and non-wasting intangibles).
- There were different views on whether amortising goodwill could be better than impairment.
    - The majority supported more timely impairment testing, and enhanced disclosures to increase transparency. Some believe that while impairment is often delayed, amortisation is not the right answer because it will hide bad investment decisions and subsequent decreases in value of the purchase. In the end the market will make the correction even if the impairment is not recognised in the appropriate period. These members would add back any amortisation costs because they would otherwise distort their calculation of return on invested capital.
    - However, one member supported bringing back the amortisation of goodwill. This member believes that management is too optimistic and will therefore pay more for a company but may not take the impairment at the appropriate time.

Other concerns

- There were concerns about using the closing price for the measurement of shares used for consideration because the closing share price already includes reactions to the acquisition.
- Acquisition-related costs should be included in the purchase price instead of in the P&L.
- Some CMAC members indicated concern about accounting for earn-outs in the P&L. Currently an acquisition that is performing above expectations results in higher costs (earn-outs), whereas some believe recording additional goodwill as a result of the higher performance would provide a more accurate picture to an investor.
- The exercise of valuing all assets and liabilities at fair value at the acquisition date and subsequently on a different measurement basis is not helpful. The step-up of assets causes a measurement mix. As a result, depreciation in the following quarters is higher, and the higher depreciation figures affect the analysis. A few CMAC members also mentioned the step-up that may occur when valuing inventory and the effect on their ability to assess underlying performance after the acquisition date.
- Some CMAC members believe it would be useful to restore the former requirement to disclose the carrying amounts of the assets acquired, and liabilities assumed, of the acquiree immediately before the business combination.
- More information is needed at the segment or cash-generating unit level so that investors can track the performance of the acquired entity.

PiR of IFRS 3* Business Combinations—*next steps

The IASB will publish a Request for Information (RfI) in early 2014. The RfI will ask for feedback on the issues that the first phase of the review of IFRS 3 has identified (for example, the usefulness of the information provided and/or practical implementation matters). The IASB will conduct further outreach with users of financial statements during the first half of 2014.

Appointment of new members—closed session

Several CMAC members' terms will end in 2013. Therefore, in its closed session the CMAC discussed the applications for new membership in 2014.

As a result of its discussions the CMAC agreed to extend the membership of Jane Fuller for another year and to appoint the following new members:

- Paulo Cezar Aragão: Partner—Barbosa, Mussnich & Aragão Advogados
- Norbert Barth: Equity Research, Chemicals—Baader Bank AG
- Tanya Branwhite: Executive Director–Strategy, Research—Macquarie Securities Group
- Peter Joos: Equity Research–Executive Director, Global Head of Valuation and Accounting—Morgan Stanley
- Goro Kumagai: Senior Fellow, Strategic Research Department—Mizuho Securities
- Dan Mahoney: Director of Research—CFRA
- Mitch Reznick, CFA: Co-head, Hermes Credit—Hermes Fund Managers

The complete membership list can be found at **CMAC members**.