Summary of the Capital Markets Advisory Committee discussions

The IASB's user advisory group, the Capital Markets Advisory Committee (CMAC), held its last meeting of 2014 on 16 October.

The meeting took place in the IASB offices in London. Recordings of the meeting discussions, the agenda and related papers are available on the **meeting page**.

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

The topics for discussion were:

- **Rate-regulated Activities – *Reporting the Financial Effects of Rate Regulation***
- **Measuring quoted investments at fair value**
- **Post-implementation Review of IFRS 8 *Operating segments***
- **Research projects and investor involvement**
- **Business combinations under common control-information needs of investors**
- **Disclosure Initiative—Principles of Disclosure projects**
    - **issues relating to cash flow statements and related disclosures**
    - **non-IFRS information in financial statements.**

Contact us

General information:
info@ifrs.org

Website:
www.ifrs.org

Email alerts
To manage your alerts **click here**.

CMAC members discussed rate-regulated activities and measuring quoted investments at fair value in separate break-out groups before coming together to discuss the feedback from the groups.

Rate-regulated Activities – *Reporting the Financial Effects of Rate Regulation*

In many countries, governments regulate pricing and supply in key industries (ie gas, water or electricity supply). We refer to this as 'rate regulation'. Rate regulation can have a significant impact on the timing and amount of an entity's revenue, and on the certainty of related cash flows. IFRS does not provide any specific accounting guidance for these industries. On 17 September 2014 the IASB published a Discussion Paper (DP) on reporting the financial effects of rate regulation.

The DP outlines the main features of defined rate regulation. Focusing on these features, the staff asked for CMAC members' feedback on:

- what information about the financial effects of defined rate regulation is most relevant to users of IFRS financial statements in making investing and lending decisions; and
- how that information could best be presented in an entity's annual report.

The CMAC members who participated in the break-out session for rate regulation noted the importance of information being provided, either in the notes or in the financial statements, to enable investors and lenders to understand the specifics of the regulatory environment. This includes information about the regulatory carrying amount of assets used in the rate-regulated business and the target rate of return set by the regulator on that asset base.

Some in the group thought that regulatory assets could be created if the local environment was strongly regulated, although some do not consider the regulation to be a binding promise and so those members consider that no asset is created.

All CMAC members in the break-out group expressed concern about how any regulatory asset would be measured and the level of judgement involved.

Rate regulation—next steps

The DP is open for comment until 15 January 2015. During the comment period, the IASB will continue to speak to investors and analysts to discuss what information about the financial effects of a particular type of rate regulation would be most relevant to investors, and how best to present that information in the financial statements.

Measuring quoted investments at fair value

The IASB staff explained the background of the Exposure Draft *Measuring Quoted Investments in Subsidiaries, Joint Ventures and Associates at Fair Value* ('the ED') and the IASB's rationale for reaching its tentative decisions. The ED clarifies that an entity should measure the fair value of quoted investments as the product of the quoted price for the individual financial instruments that make up the investments held by the entity and the quantity of financial instruments ('P × Q'), rather than adjusting the quoted value (for example, a control premium), or using a valuation technique. The IASB reached this conclusion because it believes that the resulting measurements are more relevant, objective and verifiable when they are based on unadjusted Level 1 inputs.

The staff then asked the CMAC for feedback on which measurement method provides investors with the most useful information for quoted investments:

- a measurement based on unadjusted Level 1 inputs as proposed; or
- a measurement based on adjusted Level 1 inputs or a valuation technique.

All of the CMAC members in the break-out session indicated their preference for a measurement based on unadjusted Level 1 inputs. This reflects their view that such measurements are more understandable and verifiable and less reliant on judgement. Only in specific instances (for example, when there has been a significant decrease in the volume or level of activity for the financial instruments, and their quoted price therefore does not represent fair value) do they envisage adjustments to Level 1 inputs.

The CMAC members observed that in some instances the acquisition price paid by an investor for a controlling interest includes a premium or discount. The fair value measurement of such a controlling interest, if measured on the basis of unadjusted Level 1 inputs, could lead to so-called Day 1 losses or gains. All of the CMAC members in the break-out session considered that the recognition of such losses or gains subsequent to the acquisition is appropriate, because they reflect the investor's risk of doing business. The CMAC members noted that appropriate disclosures about those losses or gains would also be useful.

Measuring quoted investment at fair value – next steps

The ED is open for comment until 16 January 2015. The IASB will subsequently discuss an analysis of the comment letters received.

Post-implementation Review of IFRS 8 *Operating Segments*

In 2013 the IASB issued its report and Feedback Statement on its first Post-implementation Review of IFRS 8 *Operating Segments*. In that report the IASB identified some specific areas for further investigation and potential amendments to the Standard. The staff described the messages received on those issues and possible solutions that had been suggested by outreach participants. The staff asked the CMAC members for their views on how effective any proposed amendments would be and what importance investors would attach to each of the proposals.

The main topics discussed were:

Identification and aggregation of operating segments

Some CMAC members expressed concern about identifying segments in accordance with the management perspective, as required by IFRS 8. In their view, the management perspective can result in frequent changes to segmentation as a result of internal reorganisation and aggregation of segments at too high a level. Investors would like to see segments that are the equivalent of stand-alone businesses. Others thought that the management perspective provided useful information and that aggregation at too high a level was an enforcement or an audit issue instead of a fault in the Standard.

Preservation of trend data on reorganisation

The CMAC members considered the time period for which data should be restated on the reorganisation of operating segments. Restating five years was considered to be too much; three years was considered more reasonable. The CMAC thought that the restatement of quarterly reported information was also important.

Allocation of reconciling items and central charges to operating segments

The CMAC members thought that central charges should be allocated to individual segments when that allocation is sensible. It may be difficult to allocate some charges on a systematic basis and the CMAC suggested that when that is the case, the entity should explain why allocation would be difficult. One CMAC member suggested that allocation could be covered by the notion of 'comply or explain'. Others thought it was useful to know how much 'corporate fat' in the form of unallocated central charges was borne by the business.

Reported line items

The CMAC members generally thought that insufficient segmental information was reported for balance sheet items. In particular, some felt that there was insufficient information from which to calculate return on capital employed by segment.

Post-implementation review of IFRS 8 Operating Segments—*next steps*

The IASB will consider the results of the staff's investigations into the issues identified in the Feedback Statement at a future meeting.

Research projects and investor involvement

The IASB staff discussed how to involve investors in the research projects conducted by the IASB under the new Research Programme. The staff provided details on how the programme intends to shorten the lead time needed to develop improvements to financial reporting. Specifically, it is intended to clarify problems early on before developing solutions, and feed manageable projects to the Exposure Draft stage on a timely basis. The staff sought specific feedback on issues relating to gathering input from investors, such as: when are the best times to engage with investors, what is the most effective form of input and assessing the representativeness of investor views. Staff presented the current list of priorities for the Research Programme.

The CMAC members generally supported this new programme. They noted that obtaining investor input early in the process would be useful, and supported a shift in philosophy towards a more evidence supported decision making process. Some cautioned about the issue of 'self-selection' bias in obtaining investors to provide views for the research projects, and that the IASB should be aware of this to ensure that a range of views is collected from the investor community at large, to be consistent with their other investor outreach activities to investors today.

Some CMAC members observed that the list of priorities (in terms of timing) for the Research Programme appeared to be more narrow within the overall scope than what some investor surveys have indicated should be priorities (for example, performance reporting topic surveyed by the CFA Society of UK). It was acknowledged by an IASB member that the labelling of priorities may sometimes be unclear (for example, even though it appears in the medium-term time scale, performance reporting is a priority project).

Research projects and investor involvement – next steps

There are 14 different projects in the IASB's Research Programme, all at various stages. The staff are currently identifying which topics would be of interest to investors during the research phase. We will be conducting outreach with investors on these projects in due course.

Business combinations under common control – information needs of investors

The accounting for business combinations today excludes business combinations of entities under common control ('BCUCC') from its scope. In general, BCUCC is defined as 'business combination[s] in which all of the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination…'. These are different from other business combinations because:

- they are directed by the controlling party rather than at arm's length (so the transaction price might not represent fair value); and
- the reason for such transactions could be different from the reason for entering into business combinations that are not under common control.

Respondents to the 2011 Agenda Consultation expressed concerns about the absence of specific guidance on accounting for BCUCC under IFRS and about diversity in practice. As a result, the IASB identified BCUCC as a priority research project.

The IASB staff updated the CMAC members on the status of the BCUCC research project and the IASB's tentative decisions on the scope of the project; notably, the decision to give priority to considering transactions that involve third parties such as prospective investors or existing non-controlling interests. This is also an area of particular concern for securities regulators. The purpose of this session was to understand the information needs of investors when a new group has been created as a consequence of a BCUCC.

The IASB staff presented two general BCUCC scenarios that involve third parties, and compared those with similar transactions that are not under common control. They then asked the CMAC members to describe and explain the information needs of investors for each comparative scenario.

Scenario 1 – initial public offering of a group entity

The staff presented a scenario in which a group restructuring was undertaken to prepare a group entity for an initial public offering (IPO) versus a scenario in which the group entity was ready for the IPO in its current form.

The staff asked the CMAC members:

- whether consolidated financial statements of the group being sold (in the IPO) should provide information about the newly created group as if it has always existed or from the date that it was created; and
- whether, in the latter case, the fair value of the assets and liabilities of the businesses acquired in the group restructuring would provide more useful information than the carry-over amounts and, if so, whether they should be recognised in the consolidated financial statements or disclosed in the notes.

The main messages from the CMAC were as follows:

- most CMAC members expressed a view that investors need consolidated financial statements of the newly created group to provide information as if the newly created group had always existed, ie as if the business has always been conducted in the form investors are invited to invest in. This is because such information will help investors to understand the trends and make future projections of the business.
- some CMAC members expressed a concern that assigning fair values in a transaction that is not at arm's length may be subject to abuse. Those members did not make a distinction between (i) the transaction price and whether it reflects the fair value of the acquired business and (ii) the fair values assigned to individual assets and liabilities in the acquired business in the acquisition accounting. Some members also expressed concerns about recognising goodwill and internally created intangible assets in a BCUCC.
- some CMAC members commented that if any part of the business of the newly created group entity was acquired in the past from an unrelated entity, the carrying values of that part of the group should be based on the values at which the acquisition of the business was accounted for in the past, including any remaining goodwill.

Scenario 2-BCUCC in which a non-controlling interest is involved

The staff presented a scenario in which a listed subsidiary acquires a business from another entity under common control, which is outside the scope of IFRS 3 *Business Combinations*, versus a scenario in which the listed subsidiary acquires a business from an unrelated entity, which is accounted for using the acquisition method in accordance with IFRS 3. The staff asked the CMAC members if the information needs of investors for a business combination are the same or different depending on whether the business was acquired from an entity under common control or from an unrelated entity. The main messages from CMAC were as follows:

- one CMAC member stated that the information needs of investors for business combinations are the same, whether the business was acquired from an entity under common control or from an unrelated entity, and that in both cases investors want historical information to understand the trends.
- some members noted that BCUCC are heavily regulated in some jurisdictions and as a result the values exchanged in those transactions would reflect market prices. Others stated that in other jurisdictions the values exchanged would not necessarily be at fair value and therefore using fair value accounting in those transactions could open the door to artificially creating or shifting values and manipulating future profits.

Business combinations under common control—next steps

The IASB is assessing this type of activity to see whether it is appropriate or feasible to accelerate the initiation of a related Standards-level project. As a result, staff will continue to conduct outreach with investors on this topic into Q1 2015.

Disclosure Initiative—Principles of Disclosure projects

Issues relating to cash flow statements and related disclosures

As part of the Disclosure Initiative project the staff of the UK's Financial Reporting Council (FRC) are reviewing the requirements of IAS 7 *Statement of Cash Flows* to identify possible improvements. The results of this review will contribute to the IASB's Principles of Disclosure research project, which forms part of its Disclosure Initiative. FRC staff presented their intermediate findings and the CMAC members discussed some of the issues arising from the FRC's review. In particular, they discussed the barriers encountered by investors in deriving useful information from the statement of cash flows.

The CMAC members were asked whether the main purpose of the statement of cash flows should be to provide information on cash inflows and outflows, in order to assess liquidity, instead of providing a measurement of performance. The CMAC members were also asked whether IFRS should require a reconciliation of cash generated from operating activities to profit or loss, as well as supplementary disclosure of non-cash transactions.

The resulting discussion highlighted the following points:

- some CMAC members were of the view that the statement of cash flows provides a different perspective of the performance of an entity (ie presenting the efficiency in capital allocation and the quality of the net income). They also noted that although some performance ratios use cash flow information, the use of the income statement information to derive key ratios is more widespread.
- some CMAC members preferred the indirect method of presenting the statement of cash flows, and highlighted the importance of the reconciliation in presenting the relationship between profit or loss, cash flows and the balance sheet. A few members preferred the reconciliation starting with a number higher up the profit or loss statement, such as EBITDA. Other members preferred cash flow statement information presented using the direct method, along with the disclosure of a separate reconciliation between reported profit/loss and cash flows. Many CMAC members agreed that the statement of cash flows provides useful information about liquidity, but that there is room for improvement within the context of providing information that is required to compute free cash flows.

Individual members made the following comments:

- analysis of working capital within the statement of cash flows should be disclosed at a similar level of detail as the related items in the statement of financial position.
- the importance of distinguishing between cash held in a subsidiary in which a significant non-controlling interest exists from cash held in a subsidiary with no, or only a minor, non-controlling interest.
- a request for more clarity in the treatment of leases within the balance sheet and the statement of cash flows, for example, investing cash flow presentation.
- a request for additional guidance on disclosing significant non-cash items and cash flows relating to restructurings.
- a few members stated that cash flow information in interim financial statements is frequently inadequate.

Non-IFRS information in financial statements

This section of the Principles of Disclosure project aims to answer what type of information, if any, should be considered 'non-IFRS' financial information, whether an entity should be able to disclose non-IFRS information in a complete set of IFRS financial statements, and, if so, where the disclosures should be made.

The staff asked the CMAC:

- for their views on the inclusion or use of non-GAAP/non-IFRS financial information as part of financial statements; and
- for input on developing guidance and clarification about providing 'supplementary information' in IFRS financial statements.

CMAC members discussed presentation and disclosure of non-IFRS information in IFRS financial statements. IASB staff asked CMAC members for their opinions and views on how the IASB should approach this issue. Most CMAC members were in favour of moving forward with the proposals in the paper. Some of the members were supportive, provided that some adjustments were made to the proposals put forward.

The comments from CMAC members in the meeting included:

- mixed views on the term used for some non-IFRS information; 'contradictory information' was considered too negative, because some non-IFRS information can provide useful information:
    - some referred to work carried out by regulators around the world on non-GAAP information as being a good starting point.
    - some suggestions for guidance included in IFRS that explains terms such as EBITDA and operating profit.
    - some stated that reconciliations from alternative performance measures back to common IFRS numbers should be one of the most important aspects within the discussion.
- mixed views on the inclusion and placement of 'non-IFRS information in the financial statements:
    - one member advised caution when using the term 'misleading' in describing non-IFRS information, because it could be subjective.
    - some stated that the main problem with non-IFRS information is that it is not audited, and that only audited information should be disclosed in financial statements.
    - one member stated that non-IFRS information should not be included in the financial statements, because it would increase auditors' workload.
    - some stated that when additional information is provided, entities should explain why they think that information is important in permitting users to understand the context and also why they are providing it. In addition, every additional measure provided should be clear enough that users are able to identify its origin from the common GAAP/IFRS numbers.
    - there were mixed views regarding the usefulness of providing additional columns in the face of financial statements.

Disclosure Initiative – next steps

The staff will be discussing issues relating to cash flow statements and related disclosures at the October 2014 IASB meeting. In addition, the staff plan to discuss non-IFRS information at the December 2014 IASB meeting. The IASB's deliberations on the content of a Discussion Paper are expected to be completed in the first half of 2015.

Appointment of new members – closed session

The CMAC discussed the applications for new membership in 2015, to replace members who will be leaving at the end of 2014. As a result the CMAC appointed the following new members effective January 2015:

- Paul Lee: Head of Investment Affairs – National Association of Pension Funds;
- Glen Suarez: CIO, Deputy CEO – Knight Vinke Asset Management; and
- Marietta Miemietz: Co-founder and Director of Pharmaceutical Advisory Services – Primavenue Advisory Services.

The complete membership list for 2014 can be found at **CMAC members**.

Next CMAC meeting

The next CMAC meeting will take place on Friday 27 February 2015.

Back to top