February 2016

STAFF PAPER

Prepared for Capital Markets Advisory Committee Meeting

Paper topic	**Follow up on issues discussed at the November 2015 CMAC meeting**		
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Purpose of this paper

1. This paper provides a brief, high-level update to the Capital Markets Advisory Committee (CMAC)[1] on how the staff or the International Accounting Standards Board (the Board) considered the advice received during the CMAC meeting held in November 2015. It is for information purposes only.

[1] Information about the CMAC's past meetings can be found at http://www.ifrs.org/About-us/IASB/Advisory-bodies/CMAC/past-meetings/Pages/past-meetings.aspx.

Update on advice received at the November 2015 CMAC meeting

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2015 Agenda Consultation The Board is required to consult on its work plan and priorities every three years. The Agenda Consultation provides an opportunity for interested parties to have their say on how the Board prioritises and balances its work. During the meeting, the staff asked the CMAC members: • which research topics the Board should prioritise; and • whether the Board delivers changes to IFRS Standards at the right pace.	The resulting discussion highlighted the following points: • Many thought that goodwill was an area that the Board should designate as a priority. Some members thought that amortisation of goodwill should also be considered. Others thought that disclosures about goodwill impairment testing should be developed to provide more information about the assumptions made and the success of previous acquisitions. One CMAC member thought that impairment should be based on an assessment of whether pre-acquisition projections had been achieved. • Performance reporting was also considered an important topic by many. One CMAC member thought that clear requirements about performance	The staff will include the CMAC's comments in the agenda paper Agenda Consultation–Feedback from users which will be discussed at a future Board meeting, likely to be held in either March or April. Comments made with respect to individual projects will be included in the analysis that will be taken to the Board on a project-by-project basis in the second quarter of 2016.

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	reporting would also clarify the effect of fair value measurements in the financial statements. Several CMAC members suggested that non-GAAP measures, or alternative performance measures, should also be covered by the IASB when reviewing this topic. CMAC members also discussed whether any performance reporting proposals would need to be tailored to individual industries such as banking, investment or insurance. Overall, there was a strong view amongst CMAC members in support of the Board taking forward work on performance reporting. • Segment disclosures were recommended by many as an area that would benefit from additional guidance. Information about operating segments is key to assessing any business. The staff noted that the Board is proposing a narrow-scope amendment to	

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	address issues that were identified during its post-implementation review of IFRS 8 *Operating Segments*. • Many members thought that only changes to items that were on the face of the statement of profit or loss, balance sheet or cash flows significantly affected their analysis. Some CMAC members, however, thought that the IASB changed IFRS Standards too frequently. One CMAC member suggested that changes should be stockpiled and that all changes should be made once every three years. Another member suggested that the research agenda should be limited to two or three issues. Another noted the importance of narrow-scope amendments. Large projects consume time and resources–greater benefits might be achieved through smaller changes that remedy urgent issues. It was noted that a	

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	European Investor Group published each year a list of topics that should be addressed to improve financial reporting.	
Goodwill and Impairment The staff asked for CMAC members' views on goodwill amortisation and how they currently use the information provided by entities about goodwill and impairment, eg whether they currently make any adjustments to the information provided by companies. This discussion was driven by a request from the Board in October 2015 that the staff perform additional work to further identify what investors want to know about goodwill and impairment. This	• A common thread amongst all members was the need to understand management's key drivers in justifying the valuation of the acquisition and hence the recording of goodwill. • Some would like to see a requirement that companies disclose a breakdown of the current amount of goodwill as attributed to past acquisitions. • Some supported reintroducing amortisation of goodwill because it provides useful information about the number of years over which management expects to benefit from the investment. Some noted that acquired goodwill is consumed and replaced by internally generated goodwill over time and this is best reflected by an amortisation model.	In February 2016 the Board discussed updated versions of the October and November 2015 IASB agenda papers on: identifying and measuring intangible assets acquired in a business combination; subsequent accounting for goodwill; and improving the impairment requirements for goodwill and other noncurrent, non-financial assets. These papers incorporated the feedback provided by CMAC members. The Board will continue its discussions at future meetings and determine what further outreach is required.

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work is used to inform the Board's discussions on whether to consider reintroducing goodwill amortisation and ways to improve the impairment requirements.	• Others did not support reintroducing amortisation and supported an impairment-only approach for goodwill. Some considered goodwill to be a long-life asset that does not have a determinable finite life. They thought that amortisation would be merely an arbitrary allocation exercise (ie it would not provide useful information). Some members were concerned that amortisation could hide impairment losses, meaning that useful information would be lost, eg about an assessment that management had overpaid. • Some said that conceptually the impairment test was the right approach, even though in practice impairment losses are often recognised too late. They noted that this indicates the need for a more robust impairment test rather than a different approach, eg amortisation. Some thought that the	

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	current impairment test provided useful information for the calculation of return on invested capital, about whether management had overpaid and if the acquisition was a good business decision, and about the value of the organisation and expected future cash flows. • Some members expressed concerns about the difficulties of comparing organically grown companies with acquisitive companies. However members generally agreed that it would be difficult to resolve these concerns without a radical change, eg either capitalising more internally generated companies or writing off goodwill immediately.	
Trustees' Review of Structure and Effectiveness of the IFRS Foundation The IFRS Foundation's Executive Director provided an overview on the	On the relevance of IFRS Standards within wider corporate reporting developments, the resulting discussion highlighted the following points:	The comment period on the Trustees' RFV closed on 30 November 2015. The feedback from this CMAC meeting, together with the feedback from

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background and context for the Trustees' latest review of the structure and effectiveness of the Foundation, on which a Request for Views (RFV) was published in July 2015. Feedback from CMAC members was sought on two particular aspects raised in the RFV that related to ensuring that the relevance of IFRS Standards was maintained, taking into account developments in: (a) wider corporate reporting and (b) technology.	• Most expressed the view that the Board should stick to its core business of developing Standards for financial reporting, where there was still much to do. 'IFRS' is a strong global brand and the Board should maintain its attention on keeping the strength of that brand. Taking leadership for areas beyond financial reporting would run the risk of the Board losing its main focus. • Some acknowledged that it was important to maintain a dialogue with the International Integrated Reporting Council (IIRC) and other bodies operating in the corporate reporting arena, but not at the expense of the Board being diverted from its core work. • However, a few saw some merit in the Board devoting some limited resources in this area, in particular in relation to non-GAAP measures.	comment letters and other outreach activities, was presented to the Trustees at their January 2016 meeting. • On relevance of IFRS Standards, the Trustees have decided that the Board's current role in wider corporate reporting should be retained and that the Board's remit should not be extended to the public sector. • The Trustees asked the staff to conduct further analysis on the issues and consequences of any proposed extension of the Board's remit to cover Standards for the private, not-for-profit sector. • The Trustees reaffirmed the

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	On the relevance of IFRS Standards within wider technological developments, the resulting discussion highlighted the following points: • Most expressed the view that technology was of increasing importance, and while the Foundation and the Board should not themselves look to develop technological solutions, they should look to stimulate the development of technological tools by third parties that would assist investors and analysts by giving them rapid access to reliable data. • CMAC members expressed a variety of views in relation to the IFRS Taxonomy™. Some saw it as an appealing product, but noted that there had been very little take-up of its use, which was an issue that needed to be explored. One member took a more positive view, stating that an effective IFRS Taxonomy was a useful tool in helping to achieve	Foundation's strategy for the IFRS Taxonomy and agree that the staff should take forward further work on the proposal that the Foundation should establish a network of experts to provide advice on technological developments and its potential impact on IFRS Standards. • No decisions were made on consistent application or governance issues. The staff plan to present a more detailed analysis of the feedback and the issues arising at the next Trustees' meeting in May 2016. This will include taking into account any implications in the light of the Board's Agenda Consultation and

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	consistent application of IFRS Standards. Another CMAC member felt that an important potential role for the IFRS Taxonomy would be in connecting the IFRS numbers in the financial statements to non-GAAP measures. CMAC members commented on a number of other issues raised in the Trustees' RFV, including: • CMAC members were content with the three-tier governance structure and were strongly of the view that the independence of the Board needed to be maintained in order to avoid politicisation and to protect the brand. • Some acknowledged that the work of the Education Initiative could be enhanced to assist consistent application of IFRS Standards, but they did not want to see this enhancement coming at the expense of the current work being undertaken on investor	whether any further due process is necessary.

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	education. • Some acknowledged the importance of Post-Implementation Reviews (PIRs) as a tool for ensuring consistent application, but felt that the way in which PIRs had been conducted to date (in particular the PIR for IFRS 8 *Operating Segments*) could have been better.	
Conceptual Framework: Measurement The purpose of the session was to gain feedback on the proposals in the Exposure Draft *Conceptual Framework for Financial Reporting* on measurement. CMAC members were asked: • if they agreed with the description of the information given by each of the measurement bases described in the	The CMAC members had various feedback and questions on the description of the information given by each of the measurement bases. These included: • Whether information provided by value in use and fair value was similar. (The staff indicated that yes- and that the difference between the two measurement bases was that fair value was based on market participant assumptions and value in use was based on entity-specific assumptions.) • Whether the description of historical cost	The deadline for comments on the *Conceptual Framework* Exposure Draft closed on 25 November 2015. The Staff plan to provide a summary of feedback received on the Exposure Draft (including a summary of feedback from investors) at the Board's March 2016 meeting. At its April 2016 meeting, the Board will discuss its strategy for

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Exposure Draft; • which measurement basis they thought gave the most useful information for some examples of assets and liabilities, and why; and • whether their reasons were consistent with the factors to consider when selecting a measurement basis identified in the Exposure Draft.	information in the statement of financial position was entirely accurate. If the recoverable amount of an asset had increased, that would not be reflected in historical cost. (The staff noted that the intention was to make any impairment an integral part of historical cost.) • That IAS 2 *Inventories* requires inventory to be measured at the lower of cost and market value, not the lower of cost and recoverable amount, and asked why that measure had not been used in the Exposure Draft. (The staff noted that the *Conceptual Framework* used the term 'recoverable cost' to mean the recoverable part of cost without specifying how recoverability would be assessed, which would be a Standards-level decision.) • Why the paper described remeasurements of fair value as being caused by changes in estimates of	finalising the project.

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	cash flows, interest rates and the amount or price of risk. Wouldn't this only apply to value in use, because fair values were amounts that were observable? (The staff noted that Level 3 fair values could be determined by estimating the cash flows, discounting those cash flows and making a risk adjustment. Furthermore, even if fair values were observable, changes in fair value could still be disaggregated into those elements.) The CMAC members then discussed the examples of assets and liabilities: • **Inventory (eg raw materials to be used in a manufacturing process, not commodity-broker traders):** Most thought that historical cost would give the most useful information, because the inventory would generate cash flows though use in the production process. Some stated that current	

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	value would become more relevant if the inventory were held for a long period, or in times of high inflation. Others stated that volatility arising from using current value simply created noise, and that better information was given by showing the gross margin based on inventory measured at historical cost. • **Building (own use):** CMAC members expressed different views. Some thought that historical cost gave the most useful information, because the building does not generate its own cash flows. Some thought that it would be useful to disclose the fair value, because the fair value could allow financing to be arranged, whereas others thought that fair value information would not be useful if it were not easy for the entity to move to a new location. It was suggested that if an entity moves	

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	often and there is a good supply of buildings, then an office building is similar to a financial asset and should be measured at fair value. • **Investment property:** All CMAC members supported the use of fair value for investment properties, because they can be monetised (ie converted into a stream of cash flows). One CMAC member wanted fair value in the statement of financial position, but historical cost in profit or loss, with other comprehensive income (OCI) being used for the difference. • **Equity securities (no active market):** Most CMAC members preferred fair value rather than historical cost, because the investment generates its own stream of cash flows. Some of those supporting fair value considered it might be most useful to recognise changes in fair value in OCI, because	

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	otherwise the effect of the investment in profit or loss might be disproportionate to its role in the entity's activities. • **Interest bearing financial liability (not traded) (eg a corporate bond):** Most supported the use of amortised cost, because they regarded changes in discount rates as creating accounting noise in profit or loss (or OCI). CMAC members generally stated that the effect of changes in own credit risk should not be included in a measure of liabilities, but it was noted that this was an issue that needed more discussion than time allowed. • **Decommissioning liability:** CMAC members supported using value in use. Some supported using current interest rates, whereas others supported using a locked-in discount rate because they did not think that the change in value arising from changes	

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	in discount rates was useful information. The IASB staff concluded by noting that the CMAC members' discussions had touched on all the factors identified in the Exposure Draft as needing to be considered when selecting a measurement basis. In particular, the way that the asset or liability contributes to future cash flows had been mentioned very frequently. One CMAC member thought that this factor should be ranked higher than some of the others, for example the characteristics of the asset or liability, noting that this would be different to the approach currently in IFRS 9 on the classification and measurement of financial assets.	
Disclosure Initiative Project: Materiality Practice Statement In October 2015 the Board published an Exposure Draft of an IFRS Practice	The main messages from the CMAC members are as follows: • There was general agreement with bringing the	The staff are currently carrying out outreach on the Draft Practice Statement. The comment period deadline is 26 February 2016. The staff

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Statement: *Application of Materiality to Financial Statements* (Draft Practice Statement). The objective was to assist management in applying the concept of materiality in preparing general purpose financial statements in accordance with IFRS Standards. The Draft Practice Statement is also expected to help other stakeholders, including investors, understand the approach that management follows when making judgements about materiality. In the November meeting the staff asked the CMAC members whether they had any comments on the content and form of the Draft Practice Statement and also whether they thought it would help an	guidance currently scattered throughout IFRS Standards together, which may foster dialogue between entities and their stakeholders in the financial reporting process. • There was a discussion over whether the document should more clearly distinguish between the authoritative requirements in IFRS Standards and the additional non-authoritative guidance and examples, for example by including the requirements in IFRS Standards separately in an Appendix. • The CMAC members discussed whether the guidance should be mandatory and whether a Practice Statement was an appropriate form for the guidance. For example, they considered whether instead it should be implementation guidance to IAS 1 *Presentation of Financial Statements*, educational	are considering the comments received on the Draft Practice Statement and will present their analysis to the Board in the next few months. The Board aims to issue the finalised Practice Statement in 2016.

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investor to understand the materiality judgements that management makes.	material or an IFRS Standard. Although some were in favour of mandatory guidance because of concerns that it might not otherwise be applied by entities, a majority were happy with the non-mandatory Practice Statement format. • Some noted that it addressed two key concerns of users: the inclusion of an excessive amount of immaterial information and also that material information can be obscured by immaterial information, particularly in narrative disclosures. Some also noted that disclosure overload is often a result of pressure from auditors and regulators and that guidance could not fully address this. • Some CMAC members said that they liked the fact that the Draft Practice Statement focussed on the primary users of the financial statements and the decisions they make. However, others noted that it	

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	is hard for management to assess what investors and analysts want unless they have a similar background. • Some CMAC members observed that if the Board does not produce guidance on materiality, it is likely that local enforcers would need to do so.	