Summary of the Capital Markets Advisory Committee discussions

The International Accounting Standards Board's® (the Board) independent investor advisory group, the Capital Markets Advisory Committee (CMAC), held its first meeting of 2016 on 25 February.

The meeting took place at the Board's 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, please **click here**.

The topics for discussion were:

- IFRS® Advisory Council—Role and recent activities
- Disclosure Initiative Update—Final amendments to IAS 7 *Statement of Cash Flows*
- Different effective dates—IFRS 9 *Financial Instruments* and the new insurance contracts Standard
- Structured Electronic Reporting—What do investors need?
- Education Session—The new impairment requirements in IFRS 9
- Primary Financial Statements—An information gathering session on users' views of operating profit
- IFRS 16 *Leases*—Update on the new Standard

IFRS Advisory Council—Role and recent activities

In this session the IFRS Advisory Council (Council) Chairman presented the strategic function of the Council and its recent activities, noting the important role of investor members on the Council.

CMAC members further discussed the Council's role and considered how its recent advice was helpful to the IFRS Foundation®. Examples included implementation support and views on the future of financial reporting.

Disclosure Initiative Update —Final amendments to IAS 7 *Statement of Cash Flows*

The staff explained the final amendments to IAS 7 *Statement of Cash Flows* which were issued in January 2016. When effective, the amendments will require an entity to provide disclosure about changes in liabilities arising from financing activities including both changes arising from cash flows and non-cash changes. The staff also reminded the members of the views previously provided by the CMAC on this project.

CMAC members commended the Board for introducing the amendments to IAS 7. However, CMAC members encouraged the Board to continue developing disclosure about liquidity, including improving information about cash and cash equivalents.

Different effective dates— IFRS 9 *Financial Instruments* and the new insurance contracts Standard

The staff explained the proposals in the Exposure Draft *Applying IFRS 9* Financial Instruments *with IFRS 4* Insurance Contracts *(Proposed amendments to IFRS 4)*. This Exposure Draft proposes two optional approaches to address concerns raised by some interested parties, in particular insurers, about the different effective dates of IFRS 9 and the new insurance contracts Standard. The approaches are referred to as the overlay approach and a temporary exemption from applying IFRS 9. The proposed approaches aim to address concerns that:

- users of financial statements may find it difficult to understand the additional accounting mismatches and temporary volatility that could arise in profit or loss if IFRS 9 is applied before the new insurance contracts Standard; and
- two sets of major accounting changes in a short period of time could result in significant cost and effort for both preparers and users of financial statements.

CMAC members provided the following comments regarding the above concerns:

- One CMAC member observed that the CMAC members represent analysts / investors with more generalist coverage than insurance industry specialists. In his view, their contribution should be considered in this respect.
- They noted that the concerns raised are similar to the implementation concerns that tend to arise from a variety of constituents whenever any new Standard is issued. Furthermore, continual accounting changes are inevitable and if the Board were to delay implementation of some Standards in order to align them with implementation of other Standards for a particular population of entities, then improved financial reporting over time would be difficult to achieve. In addition, CMAC members noted that users of financial statements are accustomed to accommodating changes in accounting, which are also introduced by individual preparers because of changes in accounting policies.
- Volatility itself is not the source of concern as long as users of financial statements are able to understand the sources of volatility. In addition, they acknowledged that many investors do not focus their analysis solely on the profit or loss statement but also on other metrics.
- The cost concerns raised by preparers and costs associated to users were discussed in detail. CMAC members were generally surprised by the magnitude of the concerns on costs raised by preparers related to the different effective dates of the Standards, because those costs are not in line with what they would expect. They thought that:
    - the sooner preparers start thinking about the implementation of the two Standards, the better preparers will be able to mitigate their cost concerns.
    - most of the information needed to implement IFRS 9 requirements (including expected credit losses) should currently be available for management purposes.
    - the changes to the systems that would be needed to apply IFRS 9 would eventually need to be implemented anyway. Some noted the information produced by applying IFRS 9 in 2018 would be useful even if entities may reclassify some assets as a result of applying the forthcoming insurance contracts Standard.
    - the concerns might not be equally significant for all entities that issue insurance contracts. For example, the life insurance sector would potentially be more affected compared to the property and casualty sector, because of the difference in importance of investing activity between those sectors.
- On the cost concern for users of financial statements related to the different effective dates; CMAC members thought that the bigger source of concern is the potential loss of important and relevant information and lack of comparability, especially if some entities are temporarily exempted from applying IFRS 9.

The CMAC members provided the following overall comments on the proposed approaches:

- Many CMAC members thought that the Board should not provide any temporary approaches. This is because IFRS 9 provides improved information and therefore, all entities should implement IFRS 9 at the same time. In addition, they emphasised that today's accounting for insurance contracts may not provide a realistic view of company performance and any temporary approaches proposed by the Board would further decrease comparability.
- Many members were also concerned about allowing two optional approaches, because doing so will decrease comparability between entities. They noted that if the Board were to provide any approach, it should be only one, simple approach that would alleviate some concerns for a short period of time and not decrease comparability. Furthermore, that approach should be mandatory. In selecting a single approach members preferred the overlay approach because it would:
    - preserve comparability between all entities, because all entities would apply IFRS 9 in 2018; and
    - provide transparent information about the effects of applying IFRS 9 in the statement of comprehensive income by reclassifying some changes to other comprehensive income (OCI).
- In general, CMAC members strongly opposed having a temporary exemption from applying IFRS 9, mainly because IFRS 9 brings vast improvements over IAS 39 *Financial Instruments: Recognition and measurement* (IAS 39). Therefore, allowing a temporary exemption from applying IFRS 9 is not justified.

The CMAC members provided the following comments on the details of the proposed approaches:

- On the overlay approach:
    - CMAC members generally did not raise any concerns on the proposed scope of the overlay approach.
    - Some commented that only one presentation should be allowed, because options, in general, decrease comparability. They recommended presenting the effects of the overlay approach as a single line item in the statement of profit or loss to allow comparability with entities that will apply IFRS 9 without any delay and to clearly mark the adjustment that is reclassified to OCI.

- If the temporary exemption from applying IFRS 9 were provided, they unanimously supported the ED proposals that:
  - the predominance criterion should be applied at the reporting level; otherwise, financial assets in one set of financial statements will be accounted for using two accounting Standards, which will be complex to understand;
  - the exemption from applying IFRS 9 should have an expiry date. This is because the exemption from applying IFRS 9 is temporary and should be treated as such. However, there was also a concern that the Board might not be able to uphold the expiry date if preparers ask for an extension; and
  - entities should disclose more IFRS 9 information, especially about the expected credit losses. This is because CMAC members believed that such information is an important improvement over IAS 39, and should already be produced by most entities for management purposes.

- Some recognised that they were not experts in insurance accounting, and therefore had no strong views on these points.

Next steps

A summary of feedback received on the ED, including investor feedback, was presented at the March 2016 Board meeting. At that meeting the Board tentatively decided to move forward with the proposed overlay and temporary exemption approaches. The temporary exemption will only be allowed at the 'reporting entity level' (ie an entity would be prohibited from applying both IAS 39 and IFRS 9 in its financial statements) and for a limited period of time. The final amendments are targeted for September 2016.

Structured Electronic Reporting—What do investors need?

The purpose of this session was to discuss CMAC members' views about structured electronic reporting. In particular, CMAC members were asked:

- whether they use structured electronic data in their analysis; and
- how structured electronic reporting could be made more useful to investors and analysts.

CMAC members discussed the topic in two break-out groups. Group 1 focussed on the current and potential use of structured electronic reporting. Group 2 discussed whether structured electronic reporting can work for principle-based IFRS financial reporting (including any risks of using structured electronic data).

Report back from Group 1

Members of Group 1 reported that their use of structured electronic data is relatively limited, and that any such usage is mainly through data aggregators. They identified implementation costs (versus expected benefits), data reliability and specific technical issues as factors in explaining their limited use of structured electronic data. One member of Group 1 noted that investors are making more use of XBRL data in Japan. In the view of this member, this is due to the more structured disclosure regime in Japan, which makes the data more reliable.

Most members of Group 1 expressed the view that some degree of data input automation could be beneficial. However, they also emphasised that structured electronic reporting is not a substitute for data interpretation and analysis and that data context (including narrative explanations) would remain important. Other technical advances (including, but not limited to, artificial intelligence) would need to be considered, especially for data that is less structured.

Report back from Group 2

Members of Group 2 expressed the view that structured electronic reporting can work for principle-based reporting.

These CMAC members stated that the use of (and the need for) structured electronic reporting differs among investors, with some using it on an extensive basis whereas others mainly use it for benchmarking. One member of this group reported using US XBRL data extensively. Those members of the group that make extensive use of structured electronic data stated that its main advantage is the cost-effective extraction of highly detailed quantitative and qualitative data ('the footnote information') over a period of time.

Members of this group identified the following risks of using structured electronic data:

- a risk of it being misleading, for example a disclosure tagged with the same IFRS Taxonomy element does not necessarily imply comparability;
- a risk of it leading to undue standardisation in financial reporting ('template thinking');
- a risk of it not being easily reconcilable to the PDF filing; and
- a risk of it being overwhelming and being complicated and costly to use; the implementation has to work for investors, or else it will not be used.

A Board member asked CMAC members whether they thought that structured electronic reporting has implications for Standard-setting. The Board and the IASB staff often hear that effective communication involves giving a certain degree of freedom to entities regarding what to disclose and how to present information, but the Board needs to balance this freedom with the need for comparability. It is not clear whether structured electronic reporting can help to achieve this balance. CMAC members had a variety of views on this question.

- A few CMAC members stated that structured electronic reporting should follow standard-setting. It does not make information inherently more useful, but it can help analysis. For example, entities could provide a computer-readable link to an IFRS Taxonomy element, thereby making entity-specific detail more easily accessible. Another example is that entities could provide a computer-readable (complete) disaggregation of IFRS disclosures, thereby facilitating data standardisation by investors.
- One CMAC member warned against giving preparers too much freedom to choose how to present and disclose information. This member expressed the view that some level of standardisation in presenting and disclosing information should be required.
- One CMAC member stated that in order to protect the relevance of IFRS Standards, the Board should take on some responsibility for how IFRS disclosures will be represented electronically.
- One CMAC member warned about the risk of structured electronic reporting undermining the usefulness of information; in the view of this member financial reporting remains very much about the narrative and the story.

Next steps

The IASB staff will undertake further investor outreach on the benefits, risks and costs of structured electronic reporting and of technology in general.

Education Session—The new impairment requirements in IFRS 9

This session was an information session that included a Q&A discussion; it provided CMAC members with a brief background on the differences that investors are likely to observe regarding impairment when financial institutions make the transition from the current Standard (IAS 39) to the new Standard (IFRS 9). IASB staff and a Board member also provided an overview and update on investor education activities that have been carried out recently about the new impairment requirements in IFRS 9.

Next steps

The staff plan to conduct additional investor education sessions on IFRS 9 with the wider investment community.

Primary Financial Statements—An information gathering session on users' views on operating profit

The purpose of the session was to obtain the CMAC members' views on the use of the operating profit subtotal, as a part of the staff's initial research work on the Primary Financial Statements project.

During the meeting, the staff asked CMAC members whether they employ the operating profit subtotal in their analysis and whether the Board should develop a standard definition of this subtotal.

The resulting discussion highlighted the following points:

- Many CMAC members mentioned that they use the operating profit subtotal. However, they observed that this subtotal is not consistently defined.
- Many CMAC members suggested that it would be very difficult for the Board to define operating profit because it is likely to vary from entity to entity. Some members expressed the view that deriving an appropriate operating profit subtotal for an entity requires considerable judgement and is a key part of an analyst's job. Consequently, a standardised operating profit figure would be unlikely to be useful.
- However, others suggested that a standardised operating profit subtotal might be useful for less sophisticated investors or for company communications with the press. Some CMAC members suggested that guidance on what could and what could not be included in arriving at operating profit or 'Earnings Before Interest and Taxes' (EBIT) might be useful.
- Many CMAC members thought that a standardised EBIT subtotal could be useful as a starting point for their analysis.
- A few CMAC members questioned the need for operating profit or EBIT subtotals if a standardised taxonomy is used for electronic reporting.
- CMAC members also commented on whether particular items should be included in the calculation of EBIT:
    - Many thought that the interest cost of a defined benefit pension scheme should be presented as a finance cost.
    - Some CMAC members thought that any share of profit of associates should be presented below the EBIT subtotal:
        - One CMAC member observed that inclusion of share of profit of associates in EBIT distorts the EBIT margin.
        - Another CMAC member thought that the inclusion of share of profit of associates in EBIT distorts future cash flow projections, because cash is received from associates through dividends.

Next steps

The staff will consider the feedback received as it undertakes further research work on the Primary Financial Statements project.

IFRS 16 *Leases*—Update on the new Standard

The IASB staff provided an overview of the new *Leases* Standard, with a particular focus on the areas that had previously been discussed with CMAC members and the related feedback received by the CMAC throughout the leases project. The session was an information session; it provided CMAC members with a summary of the differences that investors are likely to observe when entities make the transition from the current Standard (IAS 17 *Leases*) to the new Standard (IFRS 16). The IASB staff also summarised how feedback received from CMAC members has been incorporated into IFRS 16.

Next CMAC meeting

The next CMAC meeting will be held jointly with the Global Preparers Forum (GPF) and will take place in London on 15 and 16 June. The agenda topics will be posted on the IFRS website prior to the meeting.