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Introduction

1. The Capital Markets Advisory Committee (CMAC) and Global Preparers Forum (GPF) held a joint meeting in London on 15–16 June 2016.

2. In this meeting, CMAC and GPF members discussed:

   (a) the IASB and the IFRS® Interpretations Committee Update (paragraphs 3–5);

   (b) materiality (paragraphs 6–12);

   (c) statement of cash flows (paragraphs 13–32);

   (d) the Primary Financial Statements research project (paragraphs 33–47); and

   (e) the Financial Instruments with Characteristics of Equity research project (paragraphs 48–58).

   CMAC and GPF members discussed items (b) to (e) in break-out groups before coming together to discuss the feedback on each item.

The IASB and the IFRS Interpretations Committee Update (Agenda Paper 1)

3. This session highlighted the main features of Agenda Paper 1.

4. One GPF member asked how the International Accounting Standards Board (the Board) intends to support consistent application of IFRS Standards. The staff explained the Board's approach, emphasising that the Board could only *support* consistent application of the Standards because it has no authority to mandate how the Standards are applied. The Board's approach includes producing high-quality Standards, providing implementation support for newly-issued Standards, and also

Information about the Capital Markets Advisory Committee (CMAC) is available at http://www.ifrs.org/The-organisation/Advisory-bodies/CMAC/Pages/CMAC.aspx

Information about the Global Preparers Forum (GPF) is available at http://www.ifrs.org/The-organisation/Advisory-bodies/Pages/Global-preparers-forum.aspx working with others that have an important role to play in fostering consistent application (for example, the audit firms and regulators).

5. Another GPF member congratulated the staff and the Board for the depth of analysis of feedback received on the agenda consultation, but expressed regret that the draft work plan does not address the following two topics:

   (a) problems that can arise from the interaction between IAS 29 *Financial Reporting in Hyperinflationary Economies* and IAS 21 *The Effects of Changes in Foreign Exchange Rates* when exchange rates are not quoted in a free market, but rather are set by the government.

   (b) deferred tax on intercompany transfer of assets.

Materiality (Agenda Paper 2)

6. The purpose of this session was to obtain advice from CMAC and GPF members on a proposed ‘four-step approach’ for making materiality judgements when preparing a financial report.

7. This four-step approach would consist of:

   (a) Step 1—identifying the primary users and their information needs;

   (b) Step 2—making a materiality judgement, considering quantitative factors as well as qualitative entity-specific and environmental factors;

   (c) Step 3—organising material information within the financial report; and

   (d) Step 4—stepping back and reviewing the financial report as a whole.

8. Generally, CMAC and GPF members found the four-step approach helpful.

9. Specific comments were made about the proposed steps:

   (a) users and preparers had diverging views about the starting point for Step 1 :

      (i) Some CMAC members suggested that Step 1 should consider the full range of users’ needs, although one CMAC member argued that assessing users’ needs had to reflect what users could reasonably expect financial statements to provide.

(ii) However, some GPF members were of the opinion that the starting point should be the requirements of the Standards themselves and that users' needs should be evaluated within the context of the financial statements.

(b) Two GPF members suggested removing the reference to related-party transactions as a factor to consider when applying Step 2. These GPF members commented that such a reference could be misinterpreted as saying that related-party transactions would always be considered material. However, one CMAC member expressed a different view, commenting that when assessing the materiality of a related party transaction, the monetary amount could be irrelevant in some circumstances.

(c) One GPF member and one CMAC member stated that Step 3 seems out of place. The remaining Steps are about establishing what is considered 'material', whereas Step 3 involves deciding how to present material items. Accordingly, Step 3 might be removed or replaced by a step which would refer to assessing the appropriate level of granularity with which to present the information.

10. One GPF member provided an example of a situation where, in that member's view, the four-step approach would not help to exclude immaterial information. In that example, a manufacturing company hedges 40% of its future revenue in a foreign currency. IFRS 7 *Financial Instruments: Disclosures* requires the entity to disclose the hedged portion of the foreign currency risk, but not the unhedged portion. In that member's view, information about the hedged portion would be immaterial.

11. CMAC and GPF members were also asked to consider the application of materiality to two examples: a tax reconciliation note and disclosures about the risks of climate change. This prompted some to comment on whether, and if so how, risk factors and forward-looking information are reflected in the financial statements. A GPF member commented that disclosures about risk factors probably belong outside the financial statements, for example in the management commentary. This GPF member feared that the draft IFRS Practice Statement

Application of Materiality to Financial Statements could lead to such disclosures being included in financial statements inappropriately.

Next steps

12. The Board will consider the CMAC/GPF's discussion and advice as it develops the final Practice Statement. The Board expects to publish the final Practice Statement in early 2017.

Statement of Cash Flows (Agenda Paper 3)

13. This session sought the views of CMAC and GPF members on suggested improvements to the statement of cash flows included in a draft Discussion Paper (DP) prepared by the staff of the UK Financial Reporting Council (FRC). The suggestions made in the paper are not official positions of either the FRC or the IASB. The draft DP suggests changes to IAS 7 *Statement of Cash Flows* in the following areas:

    (a) the objective of the statement of cash flows;

    (b) the classification of cash flows;

    (c) cash equivalents and the management of liquid resources;

    (d) reconciliation of operating activities; and

    (e) direct or indirect method.

    The members were asked to comment on (b), (c) and (d) during the breakout session. Some members also commented on (e).

The classification of cash flows

14. The draft DP suggests the following modifications to the classification of cash flows:

    (a) Cash flows from operating activities, which currently act as a default category, should be positively defined or described. Items that do not relate to operating activities should be reported separately.

(b) Cash outflows to acquire property, plant and equipment should be reported as a cash outflow from operating activities, rather than within investing activities as currently required. As such outflows are likely to change significantly from period to period, a sub-total of cash generated from operating activities before capital expenditure should be disclosed. Entities should be encouraged to disclose the extent to which expenditure on property, plant and equipment represents 'replacement' and 'expansion'—as is currently the case under IAS 7.

(c) Cash flows related to financing liabilities (including the payment of interest) should be reported in financing activities. Cash received from customers (including any amount treated as interest income in the statement of profit or loss) should be reported within cash flows from operating activities.

(d) Cash flows relating to tax should be reported in a separate section of the statement of cash flows.

15. A number of CMAC members stated that they are indifferent to where an item is presented in the statement of cash flows, as long as material items are presented as separate line items.

Positively defining cash flows from operating activities

16. There was some support for a positive definition of cash flows from operating activities. However, one GPF member commented that defining cash flows from operating activities is a challenge when operating profit is not defined by IFRS Standards. IASB staff noted that the Primary Financial Statements research project will examine whether to define operating profit.

17. Members also discussed whether 'operating activities' should be consistently defined for the statement of cash flows and the statement of profit or loss and other comprehensive income, but they did not express conclusions.

Presenting cash outflows for acquiring property, plant and equipment (capex) as cash flows from operating activities

18. CMAC and GPF members generally did not support this suggestion and questioned the need for change. The majority of users and preparers were not aware of any major issues arising from the current presentation requirements.

19. The following concerns were expressed about the suggestion:

    (a) A CMAC member argued that the suggested change would introduce volatility to the cash flows from operating activities, and this might confuse stakeholders.

    (b) Some CMAC members questioned whether it would be appropriate to present cash flows related to assets acquired in a business combination differently from other asset acquisitions.

    (c) A GPF member noted that it is unclear whether cash outflows for the acquisition of intangible assets would be presented as cash flows from operating activities. The FRC staff clarified that cash outflows for the acquisition of intangible asset would be classified as operating activities.

    (d) Another GPF member argued that, in that member's industry, capex is funded through debt and share capital. It would therefore be misleading to present capex within cash flows from operating activities.

    (e) Some CMAC members commented that the current structure of the statement of cash flows shows how a company raises funds through financing activities, invests these funds and then generates day-to-day operating cash flows. In their view, the suggested change would disrupt this logical flow of the cash flow statement.

20. CMAC members stated that, in theory, they supported the idea of reporting expenditure on replacement of property, plant and equipment separately from expenditure on enhancements or expansion. However, both CMAC members and GPF members expressed the view that it is impracticable to distinguish replacement expenditure from expenditure for enhancement or expansion.

21. A limited number of members supported the suggestion to present capex within cash flows from operating activities :

(a) One CMAC member argued that, as a definition of operating profit would probably include depreciation and amortisation expense, capex should be included in cash flows from operating activities.

(b) One GPF member supported the suggestion as, in that member's view, it would result in 'free cash flow' being presented in the statement of cash flows. However, GPF and CMAC members noted that that there are different definitions for 'free cash flow', depending on the purpose that the measure is used for. In addition, it was noted that users can calculate the measure themselves, if the required inputs are provided.

Presentation of cash flows related to financing liabilities, cash received from customers and presentation of cash flows related to tax

22. The views of CMAC and GPF members on these suggestions were mixed. CMAC members argued that the focus should be on:

(a) eliminating choice for preparers; and

(b) ensuring that cash flows arising from interest received, interest paid and tax are presented separately in the cash flow statement. Currently, investors have trouble finding this information despite the existing disclosure requirements.

Cash equivalents and the management of liquid resources

23. The draft DP suggests that the statement of cash flows should report flows of cash, rather than flows of cash and cash equivalents, and that a separate section of the statement of cash flows should report cash flows relating to the management of liquid resources. Liquid resources should be limited to assets that are readily convertible into cash, but should otherwise not be restrictively defined.

24. The majority of CMAC and GPF members did not support this suggestion. One GPF member argued that, instead of using a narrow definition for cash, the definition should be broadened, to take into account new methods of payment that

might become more prevalent, such as cryptocurrencies. The FRC staff acknowledged that this had not been taken into consideration.

25. CMAC members also noted that some items are currently included in cash and cash equivalents but are not liquid because they are subject to restrictions. They encouraged the Board to look at this issue, because the current presentation might be misleading.

Reconciliation of operating activities

26. The draft DP suggests introducing a requirement to reconcile a sub-total in the statement of profit or loss that represents operating income or loss to cash flow from operating activities. Generally, members supported this suggestion, as it would allow users to better understand a business' cash flow conversion and working capital variations.

27. Members had mixed views about the starting point of this reconciliation. Ideally, members agreed, the starting point should be operating profit. However, this sub-total is neither defined nor required at the moment. Some CMAC and GPF members therefore argued that earnings before interest and tax (EBIT) or net profit might provide a better starting point.

28. Although CMAC members welcomed the suggestion, they expressed their preference for a line-by-line reconciliation of the statement of financial position, the statement of profit or loss and other comprehensive income and the statement of cash flows.

29. Some GPF members argued that the suggested reconciliation would not be useful for certain industries, which typically only have small differences between their accruals-based figures and cash-based figures.

Direct or indirect method

30. One CMAC member felt that the draft DP seemed to imply that the direct method was no longer the preferred method. The FRC replied that the draft DP does not suggest that companies currently using the direct method should be required to

change to the indirect method. Some GPF members noted that the direct method was impractical when using certain financial systems.

31. A CMAC member expressed a preference for the indirect method as it allows users to (partially) reconcile the statement of financial position, the statement of profit or loss and other comprehensive income and the statement of cash flows. However, that member would prefer a complete line-by-line reconciliation between these statements.

Next steps

32. The FRC plan to revise the draft DP with a view to publication before the end of 2016.

The Primary Financial Statements project (Agenda Paper 4)

33. The purpose of this session was to help the Board to determine the scope of its Primary Financial Statements project by obtaining CMAC members' and GPF members' views on the structure and content of the statement of profit or loss and other comprehensive income (OCI) and the statement of financial position.

34. One CMAC member asked Board members to clarify the relationship between the Primary Financial Statement project and the previous Financial Statement Presentation project that was suspended in 2010. A Board member stated that the work performed in the 2010 Financial Statement Presentation project will serve as an input to the current Primary Financial Statement project. However, the Board intends in the current Primary Financial Statements Project to think afresh about the structure and content of the primary financial statements, because stakeholders did not necessarily support all the proposals in the project that was suspended in 2010.

Structure and content of the statement of profit or loss and OCI

Line items and subtotals

35. CMAC members and GPF members expressed concerns about the lack of comparability between different companies' statements of profit or loss and OCI.

They think that this is partly due to the limited guidance in IAS 1 *Presentation of Financial Statements* on the structure and content of those statements. CMAC members and GPF members expressed the view that the Board should address this lack of guidance, rather than leave it to market forces.

36. CMAC members and GPF members encouraged the Board to require in the statement of profit or loss and OCI some minimum line items and minimum subtotals, such as operating profit, earnings before interest and tax (EBIT), cost of goods sold and gross profit. One CMAC member expressed a strong preference for the presentation by nature. CMAC members indicated that they need comparable subtotals because such subtotals provide a common starting point when comparing companies and are useful during discussions with management.

37. CMAC members and GPF members agreed that the Board should provide principle-based descriptions or objectives for any required line items or subtotals rather than detailed rules, to allow preparers some flexibility to tell their own story. They also thought that preparers should be required to disclose the composition of each line item and subtotal in detail in the notes.

38. Some CMAC members and GPF members suggested that, although the Board has avoided providing industry-specific guidance in the past, it should consider developing industry-specific structure and content for the statement of profit or loss and OCI. A CMAC member commented that, if the Board adopted this approach, the industries should be defined broadly (eg corporates, banks and insurance companies).

39. Some CMAC and GPF members encouraged the Board to look at jurisdictional guidance for the structure and contents of the statement of profit or loss and OCI. They considered that such guidance is useful because it helps achieve comparability within the jurisdictions.

40. Some CMAC members commented that a more standardised structure and content for the statement of profit or loss and OCI might benefit the IFRS Taxonomy®. However, one GPF member cautioned that the structure and content of the primary financial statements should not be driven by the needs of the IFRS Taxonomy.

41. Some GPF members expressed the view that the Board should not mandate the presentation of expenses by nature, because the presentation of expenses by function can be more effective in particular settings.

Alternative performance measures

42. CMAC members expressed the view that alternative performance measures are useful to investors, and should not be prohibited. However, these CMAC members thought that the quality and transparency of such measures should be improved. For example, preparers should clearly disclose how each measure is calculated and should define measures consistently over time.

43. GPF members did not support setting a strict rule that some items (eg restructuring costs) should always be presented as ‘recurring’. They argued that whether an item is ‘recurring’ depends on the specific context and the industry in which a company operates. In addition, some GPF members expressed the view that the usefulness of the non-GAAP measures is often diminished by the presentation outside of the financial statement as required by some regulators. Under the rules of some regulators a reporting inside the financial statements could be enabled by the IASB as these regulators allow non-GAAP measures within the financial statements where expressly permitted by the accounting standard setter responsible for the GAAP used.

Structure and content of the statement of financial position

44. Members expressed less significant concerns on the statement of financial position:

    (a) One CMAC member stated that the lack of a definition for debt is problematic because information about debt is heavily used by investors in their analysis (eg in estimating Enterprise Value or in considering covenants). This member considered that a common definition of debt would be needed when defining interest and EBIT.

    (b) CMAC members and GPF members commented that the statement of financial position requires more disaggregation than currently required.

Interaction between items reported in different primary financial statements

45. GPF members emphasised that they did not support the strictly cohesive approach that was proposed in the suspended Financial Statement Presentation project, because they considered this approach to be impracticable. A Board member commented that there is no intention to resurrect all the suggestions proposed in that project.

46. CMAC members supported the idea that the structures of the various primary financial statements should be aligned to some extent. For example, they suggested that 'operating assets and liabilities', 'cash flows from operating activities' and 'operating profit' could be aligned across the primary financial statements.

Next steps

47. The staff will consider the feedback received as it undertakes further research as part of the Primary Financial Statements project.

Financial Instruments with Characteristics of Equity research project (Agenda Paper 5)

48. Overall, CMAC and GPF members were supportive of the direction of this project and, in particular, the majority supported the proposal to consider the pay-off (or amount) feature of an instrument, and whether it requires the transfer of economic resources prior to liquidation, for both classification and presentation.

49. Some CMAC members continued to advocate defining equity so that it includes only the most residual class of shares. This is because, to value the ordinary shares, they currently find it difficult to pick out those equity instruments that are not ordinary shares. In contrast, some GPF members continue to support a definition of a liability that focuses only on obligations to transfer economic resources. Similarly, several GPF members called for the introduction of a category of quasi-equity for hybrid instruments.

50. Many CMAC members commented that disclosure of the capital structure of an entity is important, as it would disclose where the claims held by them rank in the

distribution ('waterfall') of the entity's returns. Different claimholders, such as ordinary shareholders and senior creditors, may have different views as to what constitutes 'equity', depending on where they rank in the 'waterfall'.

51. Most of the discussion focused on case studies that illustrated the approach (labelled as approach 'Gamma') currently being considered by the Board. The case studies illustrated the classification and presentation of:

    (a) shares redeemable at fair value; and

    (b) cumulative preference shares.

Shares redeemable at fair value

52. Almost all members agreed that shares redeemable at fair value should be classified as liabilities because of the requirement to transfer economic resources. Only one GPF member argued that those shares should be classified as equity.

53. Most of the discussion focused on the separate presentation of changes in the fair value of those shares. All members agreed that some form of separate presentation would be useful to understand the entity's performance. None of the GPF members suggested that it would be difficult to present separately those changes in fair value.

54. Members expressed mixed views on whether the separate presentation of the fair value changes of those redeemable shares should be within profit or loss, or using OCI:

    (a) Most CMAC and GPF members supported presentation in OCI for the following reasons:

        (i) Some CMAC members suggested that presentation in profit or loss could lead to counter-intuitive results if a gain is recognised for a decrease in the fair value of those shares caused by a decrease in the price of ordinary shares. This is because the decrease in the price of ordinary shares would typically reflect a decrease in the entity's performance, and it would be counter-intuitive to report a gain when that occurs.

        (ii) Some CMAC members suggested that the counterintuitive result in (i) would be exacerbated because not all of the entity's assets are recognised, and the recognised assets are not all measured at fair value. Hence, the gain recognised for a decrease in the fair value of those redeemable shares would not be fully offset by the losses recognised for the decrease in the entity's assets.

(iii) Some CMAC and GPF members agreed with presenting gains in OCI, disagreed with also presenting losses in OCI.

(b) Some CMAC and GPF members supported presentation in profit or loss for the following reasons:

(i) Some CMAC members expressed concerns that presentation through OCI disguises losses which in their view are part of an entity's performance, because cash would be paid on redemption of the shares.

(ii) Some GPF members said that if a financial instrument affects what is distributable to lower-ranking claimholders, then the associated fair value changes should be recognised in profit or loss.

(iii) One CMAC member and one GPF member expressed concerns about creating opportunities to structure instruments to permit the presentation of the effect of remeasurements in OCI.

(c) One GPF member suggested presentation outside both profit or loss and comprehensive income, directly in equity. That member did not view the changes in fair value as faithfully representing financial performance, because incomplete recognition and mixed measurement leads to the counterintuitive effects mentioned in (a) above.

Cumulative preference shares

55. Almost all CMAC members, and some GPF members, agreed that cumulative preference shares should be classified as liabilities:

(a) Many CMAC members, and some GPF members, observed that the return on the instrument is pre-specified, in the same way as the return a fixed-interest bond. Presenting that return (the cumulative preference dividends) as a finance cost in profit or loss would be consistent with the treatment of interest expense on such a bond.

(b) Many CMAC members also suggested that they would treat amounts related to cumulative preference shares as debt in leverage ratios and as interest in interest coverage ratios.

(c) One CMAC member suggested that the definition of equity should be limited to those financial instruments that participate in the potential upside of an entity's returns.

56. Some GPF members thought that cumulative preference shares should be classified as equity because of the entity's right to defer transferring cash until liquidation. However, one GPF member noted that, currently, very limited information is disclosed about cumulative preference shares and similar instruments when they are classified as equity and asked for more informative disclosure about such instruments even if they are classified as equity.

57. CMAC and GPF members discussed the separate presentation of cumulative preference shares if classified as liabilities.

(a) Many CMAC and GPF members suggested that separate presentation of the cumulative preference shares within liabilities would be useful to flag the fact that the entity cannot default on them.

(b) Some CMAC members said that cumulative preference shares have fixed priority payment terms, which essentially have the same leverage effect on the return on ordinary shares as other fixed return liabilities. This effect is already reflected in the numerator of earnings per share, through subtraction from profit or loss. They stated that it would be clearer to capture this effect by deducting it as finance cost in arriving at profit or loss, rather than as a deduction from profit or loss to arrive at the numerator of earnings per share.

Next steps

58. The staff will consider the feedback received as it undertakes further research as part of the Financial Instruments with Characteristics of Equity research project.

Next meeting

59. The next CMAC meeting will be held on 3 November 2016 and the next GPF meeting will be held on 29 November 2016.