Primary Financial Statements project:

Consumption of financial information by users

Capital Markets Advisory Committee meeting
March 2017

Agenda paper 2

Purpose of the session

- To discuss approaches to fundamental analysis and their implications for users' needs for:
    - standardised and comparable financial statement information; and
    - disaggregated financial statement information.

- We would like to hear your experiences on the consumption of financial information when:
    - using entities' financial statements (comparability/disaggregation);
    - using entity-provided performance measures (aka APMs); and
    - using data aggregators' standardised information.

Agenda

Update on project
Fundamental analysis & users' data consumption
Users' data consumption – specific cases
1. Use of entities' financial statements – comparability
2. Use of entities' financial statements – disaggregation
3. Use of entity-provided performance measures (aka APMs)
4. Use of data aggregators' standardised information

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Update on project—Stage of project

- Primary Financial Statements project is an early-stage research project.

December 2016

Target publication date—early 2018

The Board tentatively decided to focus on targeted improvements to:

- statement(s) of financial performance; and

- statement of cash flows.

The Board will decide whether it will issue:

- Discussion Paper; or

- Exposure Draft

as the first due process output of the project.

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Primary Financial Statements

Statement(s) of financial performance

Statement of cash flows

Statement of financial position

Statement of changes in equity

- ✓ requiring additional subtotal(s); EBIT and/or a measure of operating performance
- ✓ providing guidance on the performance measures that exclude non-recurring items etc
- ✓ better ways to communicate OCI

- ✓ eliminating options for the classification of interest and dividends
- ✓ aligning the operating section between the statements of cash flows and financial performance
- ✓ requiring a consistent starting point for the reconciliation

- × only limited changes in this project—ie possible development of templates & greater disaggregation for all primary financial statements
- ✓ other changes are being discussed in the Financial Instruments with Characteristics of Equity project

- ✓ developing templates for primary financial statements
- ✓ achieving greater disaggregation

Fundamental analysis & users' data consumption

Large-sample screening

Small-sample deep-dive analysis

'The biggest part of fundamental analysis involves delving into the financial statements.' *Introduction to Fundamental Analysis, Investopedia*

Spend less time on one entity

Greater need for comparability/ standardisation

- We consider both needs
- Some users may do both

Able to spend more time on one entity

Greater need for disaggregated information

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1. Use of entities' financial statements—comparability

- Comparability of financial statements affects users' analyses and decisions.

Large-sample screening

Small-sample analysis

What are your concerns about comparability when conducting large-sample screening?

'…screening focuses on tangible variables such as market capitalization, revenue, volatility and profit margins, as well as performance ratios such as the P/E ratio or debt-to-equity ratio.'

--Excerpt from http://www.investopedia.com/articles/01/112101.asp.

What are your concerns about the comparability when conducting small-sample analysis?

'…the results suggest that comparability is positively associated with forecast accuracy and negatively associated with forecast dispersion. These results provide evidence consistent with our hypotheses that comparability lowers the cost of acquiring information, and increases the overall quantity and quality of information available to analysts about the firm.'

--Excerpt, De Franco, Kothari, & Verdi, 20 April 2011, Journal of Accounting Research, '*The Benefits of Financial Statement Comparability*'.

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2. Use of entities' financial statements—disaggregation

- Sometimes users do not find sufficiently granular information in financial statements.

| Large-sample screening | | Small-sample analysis |

What information should be more disaggregated for large-sample screening and why?

'The problems users face are clear

…Items with very different economic characteristics are aggregated more often than we would like, either under the heading of "other" or by netting off items which would more helpfully be shown gross, impeding our analysis.'

--Excerpt, The Corporate Reporting Users' Forum, May 2009 comment letter to the Board regarding its Financial Statement Presentation project Discussion Paper.

What should be more disaggregated for small-sample analysis and why?

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3. Use of entity-provided performance measures (aka APMs)

- Most users adjust the performance measures provided directly by entities.

Large-sample screening

Small-sample analysis

Do you use entity-provided performance measures in large-sample screening?

Do you encounter any specific issues when using such performance measures?

'Our survey results show that 60% of respondents make further adjustments to reported NGFMs.'

--Excerpt, CFA Institute blog, Papa, 14 December 2014, https://blogs.cfainstitute.org/marketintegrity/2016/12/14/solving-the-conundrum-presented-by-non-gaap-financial-measures/. Note: NGFMs refer to both US GAAP and IFRS-based measures.

'We are concerned by the evolution of nontraditional add-backs to earnings…
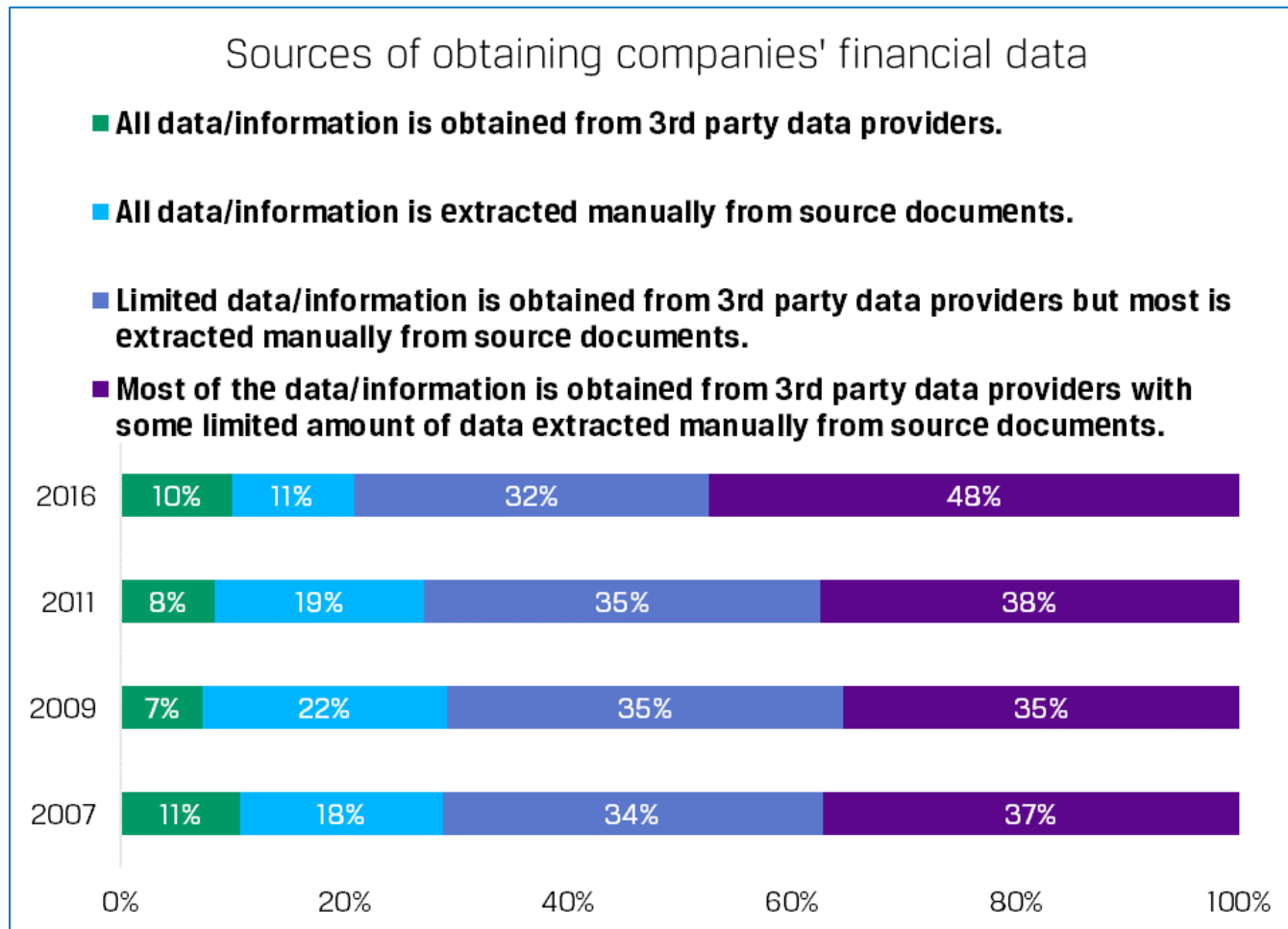
--Excerpts, Morgan Stanley US Equity Strategy, 20 April 2016, *'The GAAP Gap – Does It Matter?'*

If you use entity-provided performance measures, do you make your own adjustments?

What additional (disaggregated) information do you need to make these adjustments?

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- Users rely on 3rd party data aggregators' databases.

Sources of obtaining companies' financial data

- ■ All data/information is obtained from 3rd party data providers.

- ■ All data/information is extracted manually from source documents.

- ■ Limited data/information is obtained from 3rd party data providers but most is extracted manually from source documents.

- ■ Most of the data/information is obtained from 3rd party data providers with some limited amount of data extracted manually from source documents.

Year				
2016	10%	11%	32%	48%
2011	8%	19%	35%	38%
2009	7%	22%	35%	35%
2007	11%	18%	34%	37%

0%   20%   40%   60%   80%   100%

--CFA Institute blog, Mohini Singh,15 December 2016,
https://blogs.cfainstitute.org/marketintegrity/2016/12/05/do-you-know-what-xbrl-is-a-majority-of-survey-respondents-do-not-know/.

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4. Use of data aggregators' information (continued)

Large-sample screening

Small-sample analysis

Which types of standardised or comparable information provided by data aggregators are particularly useful for large-sample screening?

'We publish **Standardised**, rather than the company specific, financial statements to meet the needs of subscribers who wish to swiftly compare fundamentals between different companies. Standardised data is ideal in making like-for-like comparisons across industries and markets - and perfect for screening.

Stockopedia is a DIY investor site, powered by Thomson Reuters data, http://help.stockopedia.com.

Stockopedia

Do you use data aggregators' standardised (or disaggregated) information for small-sample analysis? If so, why and how?

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Large-sample screening

1. What are your specific concerns about the comparability of financial statements by different entities when conducting large-sample screening?

2. Which aspects of financial statements information should be more disaggregated for large-sample screening and why?

3. Do you use entity-provided performance measures in large-sample screening? Do you encounter any specific issues when using these measures?

4. Which types of standardised or comparable information provided by data aggregators are particularly useful for large-sample screening?

Questions—
For users who conduct small-sample analysis

Small-sample analysis

1. What are your specific concerns about the comparability of financial statements by different entities when conducting small-sample analysis?

2. Which aspect of financial statements information should be more disaggregated for small-sample analysis and why?

3. If you use entity-provided performance measures, do you make your own adjustments? What additional (disaggregated) information do you need to make these adjustments?

4. Do you use data aggregators' standardised (or disaggregated) information for small-sample analysis? If so, why and how?

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