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 2017 on 16 March.

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.

Topics for discussion included:

1. Primary Financial Statements;
2. Rate-regulated Activities;
3. Clarifications to IFRS 8 arising from the post-implementation review;
4. IFRS 3 *Business Combinations*: Definition of a business; and
5. Disclosure Initiative—outreach planning for the *Disclosure Initiative—Principles of Disclosure* Discussion Paper & case studies.

Primary Financial Statements

The purpose of the session was to consult CMAC members on their use of financial statement information, specifically on their use of entities' financial statements, data aggregators' standardised information and entity-provided performance measures (sometimes referred to as alternative performance measures).

CMAC members were asked to describe separately their information needs for large-sample screening and their information needs for small-sample deep-dive analysis. A majority of CMAC members use large-sample screening as a first-step filter, but spend most of their time on small-sample deep-dive analysis. One member typically focuses on small-sample analysis, but occasionally complements it with large-sample screening to provide context for industry trends.

CMAC members' comments are summarised below by type of analysis and by type of information.

Large-sample screening

Comparability and disaggregation in entities' financial statements for large-sample screening

1. Some members said that disaggregation and line items required by IFRS Standards in the primary financial statements (rather than in the notes) are important for large-sample screening because the primary financial statements should provide an easily accessible high-level overview of an entity's performance. For example, a few members suggested that the Board should require a separate line item for depreciation and for amortisation in the statement(s) of financial performance. However, one member disagreed and said that the location of information in the primary financial statements or in the notes has become irrelevant because of improvements in digital reporting.
2. One member stated that in large-sample screening one is interested in averages, so the error margin tolerated in the data is larger than for small-sample analysis. This member also said that a company that does not present its information in a standardised format cannot expect to be fairly valued and will be penalised by markets.
3. Some members said that, when setting requirements for line items and disaggregation in the primary financial statements and the notes, the Board should consider how investors use information for valuation. Investors want information that feeds into their models and ratio analyses.
4. One member said that accounting policy options in IFRS Standards, such as the presentation option for the net interest on net defined benefit liabilities, reduce comparability in large-sample screening.
5. Some members also pointed to the lack of comparability and inadequate disaggregation in segment reporting. For example, a line item for total assets is often missing from segment information, which is important for calculating the return on invested capital (ROIC) by segment.

Use of data aggregators' standardised information for large-sample screening

1. Many members do not have the time to collect data from a large number of financial statements, so they rely on data aggregators' standardised information for large-sample screening.
2. Some members only use data aggregators' 'raw data' as a starting point for their own analysis, rather than using data aggregators' summary metrics.
3. One member said that investors using rules-based investing strategies rely on input from data aggregators to run their models. The amount of invested capital covered by rules-based investing is growing.
4. Members have concerns about data aggregators' information, either because of the way data aggregators standardise or adjust financial statements, or because of errors. Members tolerate some errors or alternatively have methods for testing the quality of data aggregators' information. Some CMAC members are more comfortable with the data if they are able to trace the data aggregators' adjustments back to the entity's financial statements. One member also stated that the quality of data aggregators varies.

Small-sample (deep-dive) analysis

Comparability and disaggregation in entities' financial statements for small-sample analysis

1. One member argued that comparability is not important for small-sample analysis; another member disagreed, arguing that even when conducting small-sample analysis, investors need comparable financial information because they are comparing investment opportunities.
2. A few members provided examples of comparability issues they encounter when conducting small-sample analysis, such as diversity in classification of items above or below gross profit in the statement(s) of financial performance, eg warranty costs. These members acknowledged that better disaggregation would help them in some cases, but they preferred standard-setters to provide more guidance on classification to improve the comparability of line items and subtotals.
3. One member who uses only small-sample analysis said that accounting policy options in IFRS Standards allow companies to present information that is difficult to compare, especially when companies do not disclose their accounting policies clearly, adding that changes in accounting policies and estimates are often not clearly disclosed either.
4. Some members reported examples of disaggregation issues, such as a lack of disaggregation of receivables in the statement of financial position, ie trade receivables, tax receivables and other receivables are often presented in a single line item. Additionally, the allocation of restructuring costs to the different line items in the statement(s) of financial performance is often not clear.
5. One member added that a consistent classification of items across all the primary financial statements is important for calculating returns, such as ROIC.

Use of data aggregators' standardised information for small-sample analysis

One member said that they do not use data aggregators' information for small-sample analysis. Another member said that they prefer to manually extract the data from annual reports, because the data is more reliable and they can see the figures in context.

Use of entity-provided performance measures for small-sample analysis

One member uses entity-provided performance measures in small-sample analysis, but adjusts the measures applying their own judgement for determining whether items are non-recurring.

Next steps

The Board will discuss the Primary Financial Statements project throughout 2017; updates can be found here.   Feedback from CMAC discussions will inform Board papers.

Rate-regulated Activities

The session focused on whether CMAC members find it useful for companies to recognise regulatory assets and liabilities for understanding the financial position, performance and expected cash flows of an entity subject to defined-rate regulation. Agenda Paper 4 provides three examples of how a regulatory asset or liability could be recognised using an accounting model the Board is developing:

1. CMAC members expressed mixed views on the usefulness of recognising regulatory assets and liabilities:
    a. some CMAC members, particularly those who track investments in rate-regulated industries, said companies should recognise regulatory assets and liabilities in the primary financial statements. These members suggested that failing to do so could be misleading when the collection of cash from customers through the regulated rate in the current period includes amounts relating to expenses to be incurred in future periods, or vice versa; and
    b. other CMAC members suggested companies should disclose information about regulatory assets and liabilities in notes without recognising them in the primary financial statements. These members were concerned about the judgements required for many rate regulation issues, including the uncertainty of recovering regulatory assets, measurement uncertainty and possible problems in constraining the scope of the model.
2. Some CMAC members mentioned that many items in the primary financial statements require that preparers use judgement in deciding what to recognise and how to measure the items recognised. Those members said it is better to apply that judgement in the primary financial statements and provide accompanying disclosures in the notes describing the judgements and estimates used.
3. Many CMAC members acknowledged the importance of understanding rate regulation—how any adjustment to the regulated rate reflects past versus future events and the level of uncertainty about the effectiveness of rate regulation, particularly for recovering any regulatory assets.

Next steps

The Board will consider the CMAC discussion and advice as it develops the proposed accounting model.

Proposed amendments to IFRS 8 Operating Segments

CMAC members heard a summary of proposals that the Board will publish for comment at the end of March 2017. The discussion focused on three of the nine proposed amendments.

1. The proposed requirement to explain differences in segments identified in the financial statements and identified in other parts of the annual reporting package. CMAC members had mixed views on the potential effectiveness of the proposed requirement:
    a. one member thought that the proposed amendments would be effective. He also expressed surprise that such differences occur.
    b. another member, who has seen such differences, did not think that the disclosure would prevent differences arising, but might provide a hurdle that discourages an entity identifying different segments.
    c. another member was concerned that the proposed requirement might lead entities to reduce the amount of information provided in investor briefings, which would be detrimental to investors.
    d. two CMAC members questioned the whether the proposals could be used for audits, given the reference to the ‘annual reporting package’ and ‘published at approximately the same time’.
    e. another CMAC member compared the issue of differences in identified company segments to companies publishing non-GAAP amounts. Two CMAC members said it is important for the entity to explain the relationship between different identification of segments.
2. Proposed clarification of aggregation criteria and addition of further examples of economic characteristics CMAC members provided the following comments:
    a. several CMAC members thought that the criteria that an entity must meet for aggregation were helpful, and that the changes proposed are helpful.

b. a number of CMAC members noted, however, that the aggregation criteria do not prevent management from choosing how it organises the business and how it reports the results to the chief operating decision maker (CODM) For example, management could decide to organise three unrelated and dissimilar products within one segment and report this to the CODM— in this circumstance nothing in the Standard requires disaggregation of such a segment. IFRS 8 already includes some aggregation criteria that should prevent such aggregation.

c. a couple of CMAC members raised the point that the Standard does not prevent management making changes to the segments identified if management changes the way the business is organised and reported to the CODM – such changes make investors' analysis more difficult because of the changes to trends, even though there is a requirement to restate comparatives.

d. one member observed that some small companies aim to report only one segment, even though more than one segment is reported to the CODM – that member explained that they thought this reflected problems with compliance with the Standard, rather than a problem with the Standard itself.

e. a Board member explained that IFRS 15 will require more disaggregation of revenues by product, irrespective of how products are organised within segments.

3. Change in segmentation: earlier information in interim reports. CMAC members provided the following comments:

   a. several CMAC members welcomed the proposals; and

   b. members suggested some companies would take advantage of the impracticability clause in the amendments to avoid giving the restated information.

Next steps
The staff will report the feedback received from CMAC members at a future IASB meeting.

IFRS 3 Business Combinations: Definition of a business

The staff explained the screening test proposed in the Exposure Draft Definition of a Business and Accounting for Previously Held Interests (the ED) and presented an example to illustrate the accounting consequences of the proposed screening test. The staff asked CMAC members whether they find the proposed screening test useful for the example presented.

1. Some members expressed the following concerns on the proposed screening test:

   a. according to the screening test the transaction described in the example (ie the acquisition of a fully-leased shopping mall) is not a business combination. However, it should be considered a business combination, because the asset acquired has its own customers (ie it generates revenues);

   b. the screening test may be difficult to apply in practice, because it may require the entity to measure at fair value the acquired workforce.

   c. the acquisition of the workforce indicates that the transaction described in the example is a business combination.

2. Some members questioned whether a deferred tax liability should be recognised in the example presented. They observed that the real issue is whether this deferred tax liability makes sense from a users' perspective and whether and how it should be evaluated.

3. Some members expressed the view that having a distinction between an asset purchase and a business combination creates confusion; goodwill/synergies are the key difference. How a specific asset or liability is acquired should not drive its basis of recognition.

Next steps
The staff will report the feedback received from CMAC members at a future IASB meeting.

Disclosure Initiative

Principles of Disclosure Discussion Paper

The purpose of this session was to provide CMAC members updated information on the forthcoming Discussion Paper *Disclosure Initiative—Principles of Disclosure* (the Discussion Paper), including planned outreach activities. CMAC members were asked to identify which of the areas covered in the Discussion Paper they are most interested in or affected by.

1. CMAC members expressed an interest in the following topics:
   a. principles of effective communication—in particular organising information in a way that highlights important matters;
   b. the role of the primary financial statements and of the notes;
   c. use of performance measures;
   d. disclosure of accounting policies; and
   e. centralised disclosure objectives.
2. CMAC members provided several examples illustrating that there is not enough relevant information in financial statements, which the forthcoming Discussion Paper recognises as an important part of the 'disclosure problem'. A Board member commented that the forthcoming Financial Instruments with Characteristics of Equity Discussion Paper would include proposals that would require entities to provide some of the information CMAC members say financial statements now lack.

Examples of Better Communication in Financial Reporting

CMAC members were informed about the plan to publish a report to illustrate how some entities have improved how they communicate information in their financial statements. CMAC members discussed how they thought improved communication would help investors.

1. Some CMAC members said investors price information risk and therefore, better communication in financial statements would result in a lower risk premium for preparers. However, one member commented that preparers face a trade-off between providing information that would reduce an entity's cost of capital and incurring proprietary costs.
2. A few CMAC members questioned whether a report illustrating companies' experiences falls within the Board's remit. A Board member replied that, in the 2013 Discussion Forum on disclosures, the Board was asked to take the lead in encouraging behavioural changes to improve communication of information in financial statements. This report is one way in which the Board is responding to that request.

Next steps

The Board will consider the feedback received during this CMAC session in planning the outreach activities for the Discussion Paper. The Discussion Paper was published after this CMAC session on 30 March 2017 and it can be accessed here. The deadline for comments on the Discussion Paper is 2 October 2017.

Education Session—Insurance Contracts

The CMAC heard an overview of IFRS 17 *Insurance Contracts*, which the Board plans to issue in May. The session provided CMAC members a summary of the differences that investors are likely to observe when entities shift from using the existing IFRS 4 *Insurance Contracts* to IFRS 17. The CMAC also heard the expected effects on insurance entities and the key implications for investors resulting from changes introduced by IFRS 17.

Next steps

The Board issued IFRS 17 on 18 May 2017, and will support the implementation of IFRS 17 by publishing education and explanatory materials for both preparers and users of financial statements.

Next CMAC meeting

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