Meeting Notes—CMAC Meeting

The Capital Markets Advisory Committee (CMAC) held a virtual meeting on 11 March 2021 broadcast by the International Accounting Standards Board (Board).

Members discussed the following projects:

- Post-implementation Review of IFRS 9—Classification and Measurement (paragraphs [1–7])
- Post-implementation Review of IFRS 10, IFRS 11 and IFRS 12 (paragraphs [8–17])
- Rate-Regulated Activities (paragraphs [18–33])
- Business Combinations Under Common Control (paragraphs [34–43])

Post-implementation Review of IFRS 9—Classification and Measurement

1. In October 2020 the Board decided to begin the post-implementation review of the classification and measurement requirements in IFRS 9 *Financial Instruments*. The Board will consider the timing of the post-implementation reviews of the impairment and hedge accounting requirements in IFRS 9 at a later date.

2. CMAC members were asked to share their views on the application of the classification and measurement requirements in IFRS 9, and on matters that members think the Board should consider as part of the post-implementation review. CMAC members were asked to consider three questions:

    a. does IFRS 9 provide useful information about how an entity manages financial assets to realise cash flows (paragraphs 3−4)?

    b. is classification and measurement information comparable between different entities? Is there information you expected to see which is not being provided (paragraph 5)?

    c. did you find the information provided in the first set of financial statements prepared applying IFRS 9 useful to understand the changes in classification (paragraph 6)?

a. Does IFRS 9 provide useful information about how an entity manages financial assets to realise cash flows?

3. CMAC members said that, generally, the information provided by IFRS 9 about classification and measurement of financial instruments is useful. One member noted that the changes in the classification and measurement requirements introduced by IFRS 9 were not significant. Some members noted that the classification and measurement requirements in IFRS 9 are an improvement on IAS 39 *Financial Instruments: Recognition and Measurement.* They said that IFRS 9 enables investors to understand how an entity expects to utilise financial assets and how that expectation determines the measurement category within which those assets are classified.

4. CMAC members commented on the following specific topics:
    a. *Financial liabilities designated at fair value through profit or loss*—some members said that the requirement to present in other comprehensive income fair value changes arising from changes in own credit risk on such liabilities is a key improvement introduced by IFRS 9.
    b. *Equity instruments classified as fair value through other comprehensive income*—members expressed mixed views about:

i. the scope of equity instruments for which the election to present changes in the fair value in other comprehensive income could be made; and
ii. the prohibition from reclassifying amounts from other comprehensive income to profit or loss (recycling).

b. Is classification and measurement information comparable between different entities? Is there information you expected to see which is not being provided?

5. CMAC members noted that, generally, comparing the fair value measurement of complex financial instruments (for example, derivatives and repurchase agreements) is a challenge for users of financial statements. A Board member responded that comments on the transparency of fair value measurements would be useful input for the upcoming exposure draft of proposed amendments to the disclosure requirements in IFRS 13 *Fair Value Measurement*.

c. Did you find the information provided in the first set of financial statements prepared applying IFRS 9 useful to understand the changes in classification?

6. CMAC members said that the combination of graphical representations, tabular formats, and qualitative information provided by entities on transition to IFRS 9 were extremely useful in understanding how financial instruments were reclassified under IFRS 9.

Next steps

7. The Board will continue its outreach over the coming months to identify matters on which to consult publicly in the request for information the Board expects to publish in the second half of 2021.

Post-implementation Review of IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interests in Other Entities*

8. The purpose of this session was to:

   a. provide an overview of the Request for Information *Post-implementation Review of IFRS 10* Consolidated Financial Statements*, IFRS 11* Joint Arrangements *and IFRS 12* Disclosure of Interests in Other Entities; and

   b. request feedback on the matters in the Request for Information that relate to investors' information needs regarding interests in subsidiaries, joint ventures, associates and unconsolidated structured entities.

9. Overall, CMAC members found that the disclosures required by IFRS 12 had improved financial reporting. Members provided feedback on the usefulness of disclosures for the following areas:

   a. Disclosure of significant judgements and assumptions

   b. Disclosure of subsidiaries

   c. Disclosure of joint ventures and associates

d. Disclosures of structured entities

a. Disclosure of significant judgements and assumptions

10. IFRS 12 requires an entity to disclose information about significant judgements and assumptions it has made in determining its relationship with its investees. On the subject of these disclosures:

    a. some CMAC members said it would be useful to receive information on why an entity has drawn a particular conclusion, for example, why an entity had decided it controls an investee in a situation when control is not obvious;

    b. one CMAC member said it would be useful to receive information on how an entity decides which joint arrangements and associates are material; and

    c. one CMAC member said it would be useful to receive information that explains changes in the relationship between an investor and an investee.

b. Disclosure of subsidiaries

11. IFRS 12 requires an entity to disclose information that enables users to understand the interest that non-controlling interests have in a group's activities and cash flows. On the subject of these disclosures:

    a. many CMAC members said the disclosures on material non-controlling interests are helpful in valuing non-controlling interests.

    b. one CMAC member said entities provide insufficient information for valuing non-controlling interests, particularly when the non-controlling interests are privately held. Some CMAC members said it would be helpful to obtain information on cash flows relating to the non-controlling interests. The member said this information is particularly important for loss-making subsidiaries.

    c. one CMAC member said it would be useful to receive information on the operating and non-operating assets of subsidiaries with material non-controlling interests. Another member said it is important to understand whether the profit of subsidiaries is operating-related profit or non-operating-related profit.

12. IFRS 12 requires an entity to disclose information that enables users to evaluate the nature and extent of significant restrictions on that entity's ability to access or use the assets, and settle the liabilities, of the group. Most CMAC members agreed that the disclosure of significant restrictions is helpful, and noted the improvements introduced by IFRS 12.

13. IFRS 12 requires an entity to disclose information that enables users to evaluate the consequences of losing control of a subsidiary during the reporting period. However, a CMAC member said such disclosures are not always provided.

c. Disclosure of joint ventures and associates

14. IFRS 12 requires an entity to disclose information that enables users to evaluate the nature, extent and financial effects of an entity's interests in joint arrangements and associates that are material to the reporting entity. On the subject of these disclosures:

    a. many CMAC members said the disclosure of summarised financial information on material joint ventures and associates is useful and sufficient information is provided. In contrast, two CMAC members said they did not always obtain sufficient information. One CMAC member said disaggregated information on the liabilities of joint ventures and associates would help explain the financial structures of such entities.

    b. many CMAC members said they received insufficient information about the cash flows of joint ventures and associates. One CMAC member said this information is used for free cash flow-based valuations. Another CMAC member said it is difficult to understand the quality of earnings due to lack of information on the cash flow of joint ventures and associates.

    c. one CMAC member said it would be helpful to obtain segment-level information on material joint ventures and associates.

15. IFRS 12 requires an entity to disclose financial information about the entity's investments in joint ventures and associates that are not individually material. A CMAC member said joint ventures and associates of some entities in the energy sector are individually immaterial but are material in aggregate.

d. Disclosure of structured entities

16. IFRS 12 requires an entity to disclose information that enables users of its financial statements to understand the nature and extent of its interests in unconsolidated structured entities and to evaluate the nature of, and changes in, the risks associated with its interests in unconsolidated structured entities. On the subject of these disclosures:

    a. two CMAC members agreed that the IFRS 12 disclosures on structured entities have improved the information provided and are useful.

    b. one CMAC member said these disclosures have caused entities to become more cautious about entering structured arrangements; and

    c. one CMAC member said information about the financial structure and cash flow of the structured entity is important. That member said it is important to understand whether an investor guarantees a structured entity's liabilities. One CMAC member said information on the duration of the liabilities of the unconsolidated structured entity would be useful for risk exposure analysis.

Next steps

17. The staff will consider members' comments together with feedback on the Request for Information and present a summary to the Board.

Rate-Regulated Activities

18. The purpose of this session was:

    a. to provide an overview of the proposals included in the Exposure Draft *Regulatory Assets and Regulatory Liabilities*.

    b. to gather preliminary feedback from CMAC members on the proposals and address any questions on the proposals.

19. The staff provided an overview of the proposals included in the Exposure Draft. Comments and questions from members are grouped in the following sections:

    a. General project information

    b. Scope

    c. Measurement

    d. Presentation and disclosure

a. General project information

20. A member asked how the differences in timing described in the Exposure Draft compare with the effects of pass-through contracts. The staff responded that pass-through contracts may give a company a direct right to cash flows, whereas differences in timing give rise to regulatory assets or regulatory liabilities. Regulatory assets or regulatory liabilities are not a direct right to cash flows—they are enforceable rights or obligations to add to or deduct amounts from future regulated rates. Such assets and liabilities would only generate cash flows when the company increases or decreases the rates it charges customers in the future.

21. Another member asked why the Board is proposing that entities present this information in the primary financial statements instead of disclosing it in the notes. The staff responded that, currently, primary financial statements give investors information only about revenue that arises from a company's contracts with its customers. However, when differences in timing arise, companies' reported financial performance for a period does not reflect the compensation to which those companies are entitled for the goods or services they supplied in that same period. Recognising regulatory assets, regulatory liabilities, regulatory income, and regulatory expense would solve this problem.

22. A member asked whether the proposals in the Exposure Draft are converged with the requirements in US generally accepted accounting principles (US GAAP) and whether the Board considered convergence with US GAAP when developing the proposals. The staff responded that while there are differences between the proposals and US GAAP, the expectation is that outcomes would not differ significantly. The staff added that when developing the proposals, the Board prioritised requiring entities to provide more useful information to users over achieving convergence with US GAAP.

23. A member commented that the proposals represent an improvement that would lead to a better understanding of companies' financial performance and improved comparability across companies.

24. Another member asked why the Exposure Draft took so long to be published. The staff responded that progress on the project was reliant on the completion of the *Conceptual Framework for Financial Reporting* (*Conceptual Framework*) because the Board needed to decide whether a regulatory asset and a regulatory liability met the definition of an asset and a liability. The *Conceptual Framework* was completed in 2018.

b. Scope

25. A member asked whether construction companies involved in building infrastructure would be affected by the Exposure Draft. The staff response was that the effect of the proposals on such companies would depend on the facts and circumstances of their contractual arrangements. The member responded that information about other assets that are subject to a regulatory agreement would be useful to users, even if such assets fall outside the scope of the Exposure Draft.

c. Measurement

26. Some members expressed concerns about the recoverability of regulatory assets. They pointed out that the proposals on measurement require management to make judgements and that disclosure of those judgements in the notes would be useful. The staff noted that the proposals would require the disclosure of risks and uncertainties that affect the recovery or fulfilment of regulatory assets and regulatory liabilities.

27. A member asked how the proposed measurement requirements would take into account the risks to which future cash flows might be subject, including demand risk. The staff answered that the proposals would require an entity to estimate future cash flows considering any uncertainties to which they might be subject.

28. Another member commented that the proposed requirement to discount estimates of future cash flows would not only constitute a difference with US GAAP but would also add unnecessary complexity for users, even though the outcomes when applying the proposals were similar to those obtained when applying US GAAP. The staff responded that the proposal to use the regulatory interest rate as the discount rate simplifies discounting the estimated future cash flows to their present value. The staff also noted that the Board considered whether to introduce a practical expedient to provide relief from discounting. The Board concluded, however, that such a

practical expedient would add complexity by requiring companies to carry out an additional assessment, and that the related benefits might not outweigh the cost associated with the added complexity.

d. Presentation and disclosure

29. A member asked whether regulatory assets and regulatory liabilities are financing assets and financing liabilities or whether they are operating assets and operating liabilities. The staff responded that they are operating assets and operating liabilities because they arise from companies’ operating activities rather than from companies’ financial activities.

30. A member asked whether revenue under IFRS 15 *Revenue from Contracts with Customers* plus regulatory revenue minus regulatory expense could be considered as equivalent to the revenue of non-regulated companies. The staff responded that the subtotal of revenue plus regulatory income minus regulatory expense for a period would reflect the compensation to which a company is entitled for the goods or services it supplied in that same period and that this amount could be comparable to revenue of non-regulated companies. However, the staff pointed out that revenue under IFRS 15 may include revenue from both regulated and non-regulated activities. In that case, a subtotal comprising of revenue and regulatory income minus regulatory expense may not be meaningful.

31. A member agreed with the proposal to present regulatory income minus regulatory expense as a separate line item immediately below revenue. This member also agreed with presenting regulatory interest income or regulatory interest expense within the operating category. Another member said that requiring the presentation of regulatory interest income or regulatory interest expense within the regulatory income minus regulatory expense line item would be acceptable because the proposals required separate disclosure of those amounts in the notes.

32. A member commented that the proposed requirement to disclose the maturity profile of the regulatory assets and regulatory liabilities was clearer, more practical and easier to understand than other proposed disclosure requirements such as the proposal to disclose the discount rate used in measuring regulatory assets and regulatory liabilities.

Next step

33. The Board will consider feedback from CMAC members when it redeliberates the proposals in the Exposure Draft.

Business Combinations Under Common Control

34. The purpose of this session was to provide CMAC members with an overview of the Discussion Paper *Business Combinations under Common Control* published in November 2020 and to seek CMAC members’ views on:
    a. which accounting method(s) would provide useful information in common scenarios; and
    b. how to design a book-value method.

a. Which accounting method(s) would provide useful information in common scenarios?

35. The staff introduced the Board's preliminary views and illustrated how they would apply if:

    c. the receiving company is a listed company with a majority shareholder;
    d. the receiving company is preparing for an initial public offering; and
    e. the receiving company has debt investors but no non-controlling shareholders.

36. In general, CMAC members who commented on the topic agreed with the proposed approach. In particular, they supported the use of the acquisition method when non-controlling shareholders are affected. Some CMAC members asked whether disclosure of fair value information could also be useful for debt investors (for example, in calculating leverage ratios or in relation to debt covenants), especially if the receiving company's debt is not guaranteed by its parent. Other CMAC members supported the Board's views and observed that:

    f. the information most important to debt investors and credit analysts is information about cash flows;
    g. modelling performed by debt investors and credit analysts is based on book values; and
    h. assets' carrying amounts would not be overstated because IFRS Standards required assets to be tested for impairment.

37. One CMAC member commented that it is not desirable to base the selection of the accounting treatment *solely* on whether the receiving entity's shares are listed on a public market. However, that member supported the Board's view that in making this selection, a preparer should consider whether the transaction affects non-controlling shareholders.

38. A few CMAC members asked how the information currently provided to users would change if the proposed approach is confirmed and implemented. The staff explained that, currently, there is no consistency in practice—the accounting for business combinations under common control is not set out in IFRS Standards and is a matter of accounting policy. The aim of the project is to increase comparability and to provide better information to users of financial statements.

39. Two CMAC members asked whether the accounting treatment would depend on whether the transaction price is the same as would have been paid at arms' length. One CMAC member asked whether the Board had considered other approaches (such as a quantitative threshold) in determining when the acquisition method should be applied to transactions that affect non-controlling shareholders. The staff explained why the Board decided against pursuing those approaches.

b. How to design a book-value method

40. CMAC members discussed which pre-combination information should be provided when using a book-value method. Those who commented on the topic agreed that pre-combination information in the receiving company's primary financial statements should not be restated to include information for the transferred companies.

41. Some CMAC members noted that IFRS 3 *Business Combinations* requires disclosure of 'pro forma' pre-combination information about all combining companies, prepared as if those companies had always been combined. Many CMAC members suggested that such disclosures would also be useful when a book-value method is applied. With regard to such pro forma information:

    i. a few members suggested that such proforma information should be provided with sufficient detail;
    j. one member said that even an aggregate disclosure for all business combinations under common control that occurred during the reporting period would be useful;

k. one member said it would be helpful if entities provided information on how pro forma information is prepared and explained any significant judgements and estimates involved;

l. another member said that reconciliations to primary financial statements should be provided where they are necessary to help users understand the amounts presented; and

m. one member emphasised that information about liabilities, for example, pension liabilities, is important.

42. CMAC members also discussed disclosures when a book-value method is used. Those who commented on the proposed disclosures agreed with the Board's approach of considering requirements in IFRS 3 as a starting point for developing disclosure requirements for when a book-value method is applied. These members also agreed with the proposed disclosure requirements except they highlighted the need for pro forma pre-combination information. One member said they would welcome additional disclosures, for example, disclosure of the fair values of the assets and liabilities received, but agreed with the Board's proposed approach on cost–benefit grounds.

Next steps

43. The staff will report input from CMAC members to the Board at a future meeting and will consider that input in analysing feedback on the Discussion Paper *Business Combinations under Common Control*.

Next meetings

The next CMAC meeting will be held joint with GPF on 10th & 11th June 2021.