

SUMMARY REPORT OF THE JOINT OUTREACH INVESTOR EVENT

COULD PROFIT OR LOSS (P&L) BECOME MORE USEFUL?

IASB EXPOSURE DRAFT CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING

MILAN

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This summary report has been prepared for the convenience of European constituents by the EFRAG Secretariat and has not been subject to review or discussion by either the EFRAG Board or the EFRAG Technical Expert Group. It has been reviewed by the EFFAS and AIAF Secretariats and by IASB staff and has been jointly approved for publication by representatives of EFRAG, EFFAS and AIAF who attended the joint outreach event.

Introduction

This summary report has been prepared for the convenience of European constituents to summarise the joint outreach event held by EFRAG, EFFAS (The European Federation of Financial Analysts Societies), AIAF (Associazione Italiana degli Analisti e Consulenti Finanziari) and the IASB, in Milan on 22 October 2015.

The outreach event was one of a series organised across Europe following the publication of the IASB Exposure Draft *Conceptual Framework for Financial Reporting* ("the ED"). The purpose of the outreach event was to:

- stimulate the debate on the Conceptual Framework in Europe;
- obtain input from users and to understand their main concerns and wishes, in particular from those that may not intend to submit a comment letter to the IASB or EFRAG; and
- receive input for EFRAG's and EFFAS's comment letters and for the IASB.

At the conference, Luca D'Onofrio, Member of the AIAF Board, opened the event by welcoming participants and presenting AIAF. Saskia Slomp presented the role of EFRAG, the importance of users for its activities and EFRAG's document for public consultation on the IASB's proposals on the Conceptual Framework. Fred Nieto presented the user involvement in the IASB and IASB's activities focusing on users. Anne McGeachin provided a short presentation of the IASB's proposals on the revised Conceptual Framework and subsequently those proposals were debated by the participants and a panel consisting of representatives from users of financial statements, academics, the IASB and EFRAG and moderated by Angelo Casò. Finally, the event closed with an educational session "What you need to know about the new IFRS 9", which is not covered in this summary report.

The speakers and the panel comprised **Angelo Casò**, OIC Executive Board President and EFRAG Board Member, **Luca D'Onofrio**, Member of the AIAF Board in charge of International Accounting Standards; **Dario Colombo**, AIAF Financial Analyst; **Pietro Gasparri**, AIAF Board Member; **Javier de Frutos**, EFFAS FAC Chairman; **Stefano Zambon**, Professor of International Accounting with University of Ferrara and AIAF Financial Analyst, **Andrea Toselli**, EFRAG TEG member and PWC Partner, **Anne McGeachin**, IASB Technical Principal, **Fred Nieto**, IASB Investor Education Manager, and **Saskia Slomp**, EFRAG Director.

Summary of observations

Panel members and participants at the event expressed the following views:

- the financial information obtained from the statement of profit or loss (P&L) is key and in many cases P&L is the starting point of investors' analysis. Nonetheless, investors and creditors need a complete set of financial statements to properly assess the entity's performance, the quality of net assets and quality of earnings;
- IFRS guidance on Other Comprehensive Income (OCI) is inconsistent, complex and difficult to understand. Hence, the IASB should define what financial performance is, clarify the meaning and importance of OCI and how the distinction between P&L and OCI should be made in practice;
- Investors frequently use non-GAAP performance measures, such as EBITDA, for valuation purposes (e.g. valuation multiples based on EBITDA) and as a measure of the cash that a company generates from its operations. Some panel members called for a single set of definitions of non-GAAP performance measures, such EBITDA and EBIT.
- panel members highlighted the importance of having, for comparability purposes, a "more consistent breakdown of the accounts" in the total comprehensive income ("income statement");
- panel members and participants referred to goodwill as a broad issue that affects both the statement of financial position ("balance sheet") and the income statement and considered that this was an area that needed to be revisited by the IASB;
- panel members welcomed the reintroduction of the notion of prudence but noted that the IASB's definition of prudence focused only on the exercise of caution when making judgements under conditions of uncertainty. The notion of prudence could be understood as a broader concept that could help users in assessing stewardship and in understanding whether management is taking more risks than shareholders are comfortable with; and
- EFRAG and the IASB should continue to seek views from users.

Opening comments and presentations

Luca D'Onofrio opened the outreach event by welcoming the participants and panellists and thanking EFRAG, EFFAS and IASB for organising the Outreach Event together with AIAF.

The new EFRAG and its role: why users matter

Saskia Slomp spoke about EFRAG's role and its objective on ensuring that the European views on the development of financial reporting are properly and clearly articulated in the international standard-setting process. She also explained that EFRAG had recently changed its governance structure as a response to the calls for a more cohesive process on Europe's engagement with the IASB and increased involvement of National Standard Setters in that process, following the recommendations of Philippe Maystadt in 2013. Finally, she highlighted the importance of users' involvement in the global financial reporting standard setting process and EFRAG's efforts in reaching out to investors and the analyst community and possible way for interested users to be involved.

IASB and users involvement

Fred Nieto introduced the IASB's team that focuses on keeping investors up to date on the major accounting issues and engaging users in the IASB's outreach activities. He also provided an overview of the IASB's outreach activities focused on users and described the different types of publications issued by the IASB to improve investors' knowledge on IFRS, such as "Investors Perspectives", "Project Snapshot" and "Investor Update newsletter".

Presentation of the IASB Exposure Draft on Conceptual Framework

Anne McGeachin provided a high level overview of the IASB proposals on the Conceptual Framework and started by explaining that the IASB had decided, after considering the feedback received on its Discussion Paper, to reconsider some aspects of Chapters 1 and 2 of the *Conceptual Framework*. The IASB had decided to give more prominence to the concept of "stewardship" and to reintroduce explicit references to the notion of "prudence" and "substance over form".

Anne McGeachin noted that recognition was now more focused on relevance, faithful representation and cost/benefit considerations and that the IASB proposed a new section dedicated to derecognition, where it discussed the overarching aims of the accounting requirements for derecognition. The IASB is also proposing a number of changes to the existing definitions of elements of financial statements and advocating a mixed measurement model.

On presentation and disclosures, the Exposure Draft proposes that income and expenses in the statement of profit or loss (P&L) are the primary source of information about an entity's financial performance and hence there is a rebuttable presumption that all income and expenses will be included in that statement. Nonetheless, income or expenses would be reported in OCI if they relate to assets or liabilities measured at current values and if such classification would enhance the relevance of the

information in P&L. Finally, she explained that there was also a presumption that items included in OCI would be reclassified into P&L in some future period (recycled). Anne McGeachin noted that the ED might not provide definitive guidance on which items should be reported in OCI, but it was a step forward compared with the current Conceptual Framework.

Presentation of EFRAG's bulletin on profit or loss versus OCI

Saskia Slomp explained that EFRAG had decided to publish a bulletin on profit or loss versus OCI after concluding that the Conceptual Framework should include more guidance on when it would “enhance the relevance of profit or loss” to include changes in net assets in OCI rather than in profit or loss. EFRAG also concluded that it was important to have clear principles relating to the timing of recycling.

The EFRAG bulletin aims to help the IASB improve the final Conceptual Framework on this issue and explores ways of articulating guidance on the role of the business model in the selection of measurement bases. It also indicates that after determining the relevant measurement basis for primary performance, an entity should test whether this measurement basis is also relevant for the statement of financial position (for more information, please click [here](#)).

Panel Discussion

Angelo Casò opened the panel discussion and invited panel members to answer the following questions.

Main messages received

Financial information obtained from the statement of profit or loss (P&L) was key and often the starting point of their analysis.

Is P&L the starting point of your analysis? If not, what is it and where do you use P&L in your analysis?

Members of the panel considered that the financial information obtained from statement of profit or loss (P&L) was key and explained that in many cases P&L was the starting point of their analysis.

A member of the panel added that the answer to the question would largely depend on the type of investors whom you asked. Financial analysts were typically focused on the present value of future cash flows of an entity, hence more interested in income statement items that indicate the amount of cash the entity has generated. Other items of the income statement that did not correspond to cash earned (such as those related to measurement changes and others included in OCI), were a challenge for these type of investors. By contrast, debt investors and other creditors were more focused on the integrity of equity and sustainability of debt. Thus, their approach was different and more focused on the financial statements as a whole and not only on some elements.

Nonetheless, the user panel members agreed that both investors and creditors needed a complete set of financial statements to properly assess the entity's performance, "quality of net assets" and "quality of earnings". They also noted that the balance sheet and income statement complemented each other. For example, companies to remain liquid and solvent (from a balance sheet point of view) needed to perform well (from a P&L point of view).

Non-GAAP metrics, such as EBITDA, EBIT, are important and there was a call for a single set of definitions.

Another member of the panel called for a single set of definitions of non-GAAP performance measures, such EBITDA and EBIT, and mentioned the AIAF EFFAS *Definition Guide* (click [here](#) to access the guide) which provided definitions of economic-financial data, including ratios.

The debate on Conceptual Framework should start by focusing on the objectives of financial reporting and users' information needs.

Finally, one panellist referred to the "value creation" perspective and expressed approval about the fact that the IASB's focus is being progressively shifting from balance sheet items to income statement items. However, this shift is not without consequences and raises

many new questions. For example, should accounting be based on business models? In his view, comparability has then to be reconsidered in its sense. Therefore, it was important to start the debate on Conceptual Framework by focusing on the meaning of financial performance (e.g. Hicks' definition), the objectives of financial reporting and the users' information needs.

Main messages received

All components of the income statement are needed, however it was important to have “a more consistent breakdown of the accounts” and normalized information.

Challenges related to the accounting for goodwill: an area that the IASB needs to revisit.

Are there items included in the statement of profit or loss that you eliminate? What are they?

The panel members replied that to be able to analyse in detail the performance of an entity and make their own adjustments (e.g. normalisation), investors needed all the components of the income statement. They also pin pointed the importance of having non-GAAP figures such as EBITDA, especially when the gains and losses in the income statement were classified “by function”. Investors frequently used EBITDA for valuation purposes (e.g. valuation multiples based on EBITDA) and as a measure of the cash that a company generates from its operations.

Additionally, panel members referred to the importance of:

- the information presented in the income statement being “more homogeneous”. That is, for comparability purposes it was important to have a “more consistent breakdown of the accounts”; and
- having normalized parameters. More specifically, investors want to measure the performance of a company under “normal conditions”. Hence, it would be interesting to have margins and net profit being adjusted for cyclical fluctuations and for items that are not expected to recur frequently or regularly.

One panel member referred to goodwill as a broad issue that affects both the balance sheet and the income statement. This panel member would write-off goodwill at initial recognition (i.e. at business acquisition date) and remove any subsequent impairments to goodwill from the income statement as these figures in some cases arose from a number of accounting procedures and do not always represent a real economic phenomena. In particular, this panel member referred to goodwill that arises from mergers between equals and that such recognition invariably results in subsequent impairments that are often untimely reported.

One participant highlighted the importance of having a high level of transparency and consistent application of the standards throughout Europe. In addition, the participant compared the supervisory regulatory requirements (e.g. financial industry) with the IFRS requirements and asked why some events and transactions were required, under IFRS, to be reported in the balance sheet and income statement (e.g. goodwill) while for regulatory purposes they were directly adjusted to equity. He encouraged the IASB to work with supervisory regulatory institutions and reach a common understanding to avoid differences. Finally, this participant called for a clarification of the purchased price allocation procedures in IFRS 3 *Business Combinations*.

Main messages received

Any future guidance on the use of OCI should not only be based on clear principles but also easy to apply and verify.

Do you use OCI? If not, why?

The panel members considered that the information reported in OCI was key for investors to have a complete picture of the company and that distinction between OCI and P&L was a relevant topic for investors. Some panelists explained that OCI was important to evaluate potential gains or losses associated to a business (e.g. pension funds).

Nonetheless, many referred to the conceptual and practical issues related to the use of OCI. More specifically, panel members expressed the view that:

- the IASB past decisions on which items should be reported in OCI had been taken on a case-by-case basis to address a number of practical issues that arose over time. Consequently, there is not a clear and robust principle driving the use of OCI;
- IFRS guidance on OCI is inconsistent, complex and difficult to understand. For example, some re-measurement gains and losses are reported in OCI while others are not; there is not enough consistency on the presentation of OCI in the income statement; and in some cases there is recycling to P&L when the underlying item is sold or realised while in other cases there is no recycling; and
- the number of items included in OCI has been increasing over time and this fact has been putting considerable stress on the definition of OCI and use of recycling.

When referring to potential improvements, panelists in general considered that any future guidance on the use of OCI should be based on clear principles and, more importantly, should be easy to apply and verify. One member of the panel would welcome more disclosures on OCI and other questioned whether the business model approach could be the right approach.

A financial analyst commented that when analysing an entity's financial statements, his focus was mainly on net equity. This participant explained that from the statement of changes in shareholders' equity he would be able to find relevant information about net profit, OCI, dividends, etc.

Main messages received

Amounts in OCI are an important source of information for investment decisions. Nonetheless, the IASB needed to clarify the purpose of OCI.

Are there elements that you need but that you do not find in the P&L? Are there items shown in OCI that you include in your analysis?

One panellist presented a number of examples based on published companies annual reports and noted that in some cases the amounts in OCI were very large and changed significantly over time. In these cases, it was fundamental to understand the gains or losses that were reported in OCI and how they were moving over time. Panel members agreed that the amounts in OCI were an important source of information for investment decisions.

One panellist noted that this debate was directly related to a more fundamental question: *What is the purpose of OCI?* Is it related to unrealised gains or losses? Non-cash items? Something to be considered when distributing dividends? The answer to these fundamental questions would increase the relevance and usefulness of financial statements to users.

Main messages received

No call for a single measurement basis.

When assets are measured at fair value through P&L, how do you treat gains and losses associated with the changes in value during the period?

The panel members acknowledged the existence of different measurement bases in IFRS, such as historical cost and fair value, highlighted the fact that they provided different information to users and debated the pros and cons of the different measurement bases.

Although panel members in general did not call for a single measurement basis, one of the members explained his preference for the use of fair value, particularly when there were quoted market prices. One other member highlighted the importance of historical cost measures. Finally, one panel member challenged the need for having multiple measurement basis (e.g. cost and fair value) and for having gains and losses being recognised either in OCI or P&L. He questioned whether it would be more reasonable to use a single measurement basis for all assets, liabilities, income and expenses.

Still, some panel members considered that changes in fair value should go to PL and OCI based on, for example, whether the assets are available for sale.

Main messages received

The reintroduction of the notion of prudence was welcomed.

The notion of prudence should be understood as a broader concept that could help users assessing stewardship and understand whether management is taking more risks than what shareholders are comfortable with.

About prudence: should bad news be reflected earlier than good news that is expected but still uncertain?

The panel members discussed the definition of prudence, its importance and expressed the following views:

- prudence should not be an “accounting cookie jar” containing hidden reserves or excessive provisions. Prudence was the use of a degree of caution when making estimates under conditions of uncertainty;
- a certain level of prudence was important for the society at large and for companies to be able to survive financial crisis (e.g. banks);
- it was important for investors to have qualitative information that would help investors understanding whether management is being conservative or not; and
- the IASB’s definition of prudence focused only on the exercise of caution when making judgements under conditions of uncertainty. Nonetheless, the notion of prudence could be understood as a broader concept that could help users assessing stewardship and understand whether management is taking more risks than what shareholders are comfortable with.

One user participant agreed that prudence was important, however he was concerned that the process of recognition and measurement was limited, to some extent, as not all assets were being recognised in the financial statements (e.g. internally generated intangible assets). This issue was common in the financial sector.

What would you tweet to the IASB?

The panel discussion ended with member of the panel stating what they would tweet to the IASB. Panel members considered:

- it is important to clarify the objective of financial reporting and the concept pursued of financial performance;
- the IASB should define what financial performance is, clarify the meaning of OCI and how the distinction between P&L and OCI should be made in practice.
- the IASB should reconsider the accounting for intangible assets;
- the future Conceptual Framework had to be understandable and easy to work with;
- the standards should be more simple and straightforward. For clarity purposes, the IASB should also separate the key “principles” of the standards and their “application guidance”;
- called for a single set of definitions for comparability purposes;
- encouraged EFRAG and the IASB to continue to contact users; and
- the IASB should stress the relevance of OCI.

Angelo Casò thanked the panellists and participants for their valuable feedback and closed the panel discussion.