Summary of the Capital Markets Advisory Committee discussions

The IASB's user advisory group, the Capital Markets Advisory Committee (CMAC), held its first meeting of 2015 on 27 February.

The meeting took place in the IASB 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**.

The topics for discussion were:

- **EFRAG Discussion Paper: Separate Financial Statements**
- **IAS 29 *Financial Reporting in Hyperinflationary Economies***
- **Income taxes**
- **Disclosure Initiative Project**
  - **Update and questions**
  - **Proposed amendments to IAS 7: 'debt reconciliation'**
  - **Information needs resulting from changes in accounting policies and estimates.**

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EFRAG Discussion Paper: Separate Financial Statements

Although the use of separate financial statements under IFRS is well advanced in Europe, those who prepare and use them have expressed concerns about the relevance of some of the IFRS requirements, or the lack thereof, in relation to separate financial statements. To address these concerns, EFRAG and its partners published in 2014 a Discussion Paper (DP) on separate financial statements. The DP considers how separate financial statements are used in Europe, analyses the challenges that arise in practice and proposes improvements to the existing guidance.

The CMAC members considered that banks and trade creditors were the primary users of separate financial statements. The CMAC members further explained that these users would often need information about the resources of, and the claims against, the legal entity when making credit decisions. Many CMAC members also agreed that equity investors were usually focused on consolidated financial statements when making investment decisions, although separate financial statements were at times used to supplement the information found in consolidated financial statements. In particular, use is made of information about cash available for use, distributable dividends, debt arrangements (for example, subordinated debt) and intra-group commitments (for example, guarantees or other support arrangements.

Some CMAC members noted that the value of separate financial statements and the reason for differences in accounting treatment between separate and consolidated financial statements were related to the fact that these financial statements reflected different views: the view of the legal (parent) company and the view of the economic group. Nevertheless, these CMAC members considered that it was useful to have separate and consolidated financial statements prepared under the same basis (IFRS) and to have improved disclosures about, for example, guarantees and distribution of dividends to shareholders in both separate and consolidated financial statements.

IAS 29 *Financial Reporting in Hyperinflationary Economies*

IAS 29 *Financial Reporting in Hyperinflationary Economies* overrides all other Standards when an entity is operating in a hyperinflationary economy. Among the indicators included in IAS 29 that a country is suffering from hyperinflation is an inflation rate of 100 per cent over a three-year period. The IASB has been asked to consider a request to change the definition of hyperinflation so that 8 per cent per annum over a three year period (ie cumulatively 26 per cent) would indicate hyperinflation.

The strong and consistent message from CMAC members was that the IASB should not lower the indicative threshold. Among the comments expressed were:

- lowering the threshold would put a lot of pressure on the credibility of the particular price index used, given that most countries will have experienced this level of inflation, or something close to it, in the last 20 years.
- IAS 29 is a very blunt instrument, which is trying to fundamentally correct a major economic event in a country. Lowering the threshold without considering the Standard more carefully would be dangerous.
- analysts cope with price changes and that is one of their roles.
- adjusting prices as if the price changes had not occurred is like adjusting for a very high fever and pretending it is normal. The adjustments can make it hard to really understand the true financial health of the company and hide economic reality.

There was also a general discussion about the effects of inflation, particularly in countries with exchange controls, which caused counterintuitive results. Again, CMAC members thought that IAS 29 should only be used when it was obvious that a country was going through a major economic readjustment and the currency is, effectively, irrelevant—the test must be very high.

In summary, there was no support for lowering the indicative threshold.

Next steps

We are taking this project to the IASB meeting in April with the aim of obtaining a decision on whether to proceed with the project or remove it from the agenda.

Income taxes

Today's accounting for income tax has been criticised for not providing information that is useful to users of financial statements and for the complexity in its application. In order to identify the areas of weakness and obtain input from investors about the extent to which the Standard should be improved, a pre-meeting survey to CMAC members was conducted in January and the result was summarised and used as the basis for discussion during the meeting.

During the meeting, the staff asked the CMAC members:

- what tax information is used for analysis today and how this information is incorporated into valuation models;
- whether today's accounting for income tax provides the information needed, and in which areas do the CMAC members recognise a need for improvement; and
- to what extent should the Standard be improved, whether limited amendments to improve disclosures or a new Standard to tackle difficult issues such as the discounting of deferred tax?

The main messages from the CMAC members are as follows:

- the use of tax information and its usefulness:
    - investors use tax information, including deferred tax information, to help them to project future tax cash flow.
    - the tax information investors use are, for example, information on tax rates, tax loss carryforwards and other items that may affect future tax payments. Some investors see a deferred tax asset representing tax loss carryforwards, and a deferred tax liability, which is a mixture of liability (ie non-recurring items), equity (ie recurring items) and something else (for example, deferred tax on revaluation).
    - some users think that the disclosure of information about tax is useful information but currently there is a lack of transparency, with some seeing it as a 'black box'.
    - some users think deferred tax is a mechanism to smooth out earnings and hide volatility, whereas those investors would prefer to see the

volatility.

- investors are looking for more information about effective tax rates and differences in taxation that relate to jurisdictional factors. They would like more information such as:
    - geographical or segment information on the breakdown of the composition of effective tax rate and tax expense, as well as key tax information such as application of special tax schemes (for example, patent box), planning to use tax losses etc.
    - some users want the management's projections while other users prefer to get raw data, based on which they will project future tax themselves,
- mixed views on the discounting of deferred tax balances:
    - those who support discounting believed that deferred tax balances are affected by the time value of money like any other assets or liabilities.
    - those who oppose discounting suggested that it is difficult to determine which discount rate should be used and discounting will make deferred tax balances even more difficult to understand.

Next steps

The staff plan to reach out to the wider investor community to seek more input from users and incorporate their views, together with views expressed by CMAC members, into the research paper.

Disclosure Initiative

Project update

The IASB staff provided an overview and update on the activities that collectively comprise the Disclosure Initiative. Feedback from CMAC members was sought on the Disclosure Initiative overall and in particular on the Principles of Disclosure project.

The CMAC members were asked whether the topics addressed in the Principles of Disclosure project respond to investors' concerns about disclosures and whether there are any topics of importance missing from the current project. The CMAC members were also asked what topics were of most interest to them.

The resulting discussion highlighted the following points:

- most CMAC members agreed with the topics addressed in the Principles of Disclosure project, including topics of importance to investors.
- the concept of materiality was of particular interest to investors. A few CMAC members stated that the IASB should lead the materiality discussion, with close interaction with the International Auditing and Assurance Standards Board.
- some CMAC members were of the view that the linkage between the primary financial statements should be discussed within the Disclosure Initiative.
- a few CMAC members expressed a preference for discussing the disclosure of less speculative forward looking information.

Proposals to improve debt disclosures

The IASB staff provided background on the Exposure Draft *Disclosure Initiative* (Proposed amendments to IAS 7) (the 'ED'). Feedback was sought from CMAC members on whether the proposed reconciliation would provide investors with sufficient information to perform their analysis of an entity's debt. CMAC members were also asked whether this requirement to provide a reconciliation of debt will encourage entities to disclose supplementary information about how they manage debt.

The resulting discussion highlighted the following points:

- overall agreement that the proposed amendments would provide useful information. Some CMAC members suggested other areas related to debt for which disclosures could be improved, such as debt held by the parent entity and that held by subsidiaries.
- CMAC members were not sure whether the proposed reconciliation would give rise

to entities providing more information about debt, but they agreed that the proposal would provide more discipline and transparency around current disclosure practice on this topic.

- some CMAC members were interested in the possible effect that the proposed reconciliation might have on current debt rating practices that treat particular items as debt, but that are not currently included in financing activities, such as pensions.

In addition, the CMAC members were also asked for their feedback on the proposed requirement to disclose information about restrictions that would affect an entity's decision to use cash and cash equivalents. In particular, they were asked whether the proposals would provide useful information that helps them to better understand the liquidity of an entity and for their views on the definition of cash and cash equivalents in IFRS.

Most CMAC members agreed with the direction of the proposed disclosure requirements about restrictions on cash and cash equivalents. However, there were some concerns about whether the requirements would capture current problems in understanding liquidity. Hence, CMAC members suggested that the proposals should clearly require entities to disclose information about:

- the ultimate parent entity's ability to access the consolidated group's cash and cash equivalents balances, by taking into consideration factors such as up-streaming time and conversion costs;
- the nature of cash restrictions, for example, when:
    - construction companies hold large cash advances from clients; or
    - cash and cash equivalent balances are held by subsidiaries whose non-controlling interests directly affect the ultimate parent's ability to access those balances.

Some CMAC members also suggested widening the scope of the amendments to require information about an entity's cash and cash equivalents balance by region or by group entity (for example, by using a table). They also suggested that information about an entity's debt split by region or group entity would be useful. The IASB staff also asked for CMAC members' views on the inclusion of the *Proposed IFRS Taxonomy Update* in the ED and what other actions should be taken to increase investor involvement within the IFRS Taxonomy development.

CMAC members largely supported the *Proposed IFRS Taxonomy Update* accompanying the proposed amendments, but advised that the lack of a proper jurisdictional mandate requiring entities to file their IFRS financial statements in XBRL is preventing data aggregators and investors from using the results of the IFRS Taxonomy. Until such mandates are in place, it will be difficult to engage investors in the development of the IFRS Taxonomy.

Principles of Disclosure (Reporting Accounting Changes)

The staff of the Italian accounting standard-setter (OIC) is assisting the review of the requirements of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* under the IASB's Disclosure Initiative. The purpose of the review is to identify possible improvements. As part of this review, the OIC launched a survey for investors in December 2014. During the meeting, CMAC members were given an overview of the results of this survey.

In order to understand the changes in accounting policies and accounting estimates, CMAC members were asked what information they need an entity to disclose.

The resulting discussion highlighted the following points:

- some CMAC members stated that the impracticability threshold for voluntary changes in accounting policies by entities should be very high.
- with respect to mandatory changes of accounting policies (ie due to new IFRS guidance), most CMAC members preferred restatements of comparative periods. However, they agreed that the IASB should use its discretion to allow an exemption to restate comparative periods whenever it determines that retrospective application is impracticable for preparers.
- most CMAC members stated that information provided by the limited retrospective

application method and the catch-up adjustment (with enhanced disclosures) method should provide sufficient information in cases in which an entity (ie a preparer) finds it impracticable to restate all comparative information.

- one CMAC member suggested that changes in accounting policies should be reflected in a consistent way in both interim and annual financial statements.
- another CMAC member suggested that by giving entities more time for making mandatory accounting changes, the IASB could keep the full retrospective application requirement. This would achieve greater comparability between entities.
- one CMAC member made a comment that it would be preferable—to the extent possible—to have the same application method for changes in accounting policies across Standards and entities.
- most CMAC members opposed the possibility of an alternative method proposed by the OIC staff, which distinguished between 'measurement' and 'other' accounting. In their view, the distinction between changes in accounting estimates and changes in accounting policies was generally understood by investors. They also believed that requiring only prospective application for all measurement changes would prevent entities from reporting useful information. However, some CMAC members acknowledged that the retrospective application of a change in measurement can be onerous and may require the use of hindsight.
- some CMAC members were of the view that the quality of disclosures around changes in accounting estimates should be improved.

Next steps

The OIC staff will discuss the specific results of the preparers' survey on reporting accounting changes at the March 2015 Global Preparer Forum (GPF) meeting. The results of both the investors' and preparers' surveys will be discussed with the IASB in Q2 of 2015.

The IASB's deliberations on the content of a *Principles of Disclosure* Discussion Paper are expected to be completed in Q2 of 2015. In addition, the IASB staff plan to discuss the feedback received in response to the ED at the June 2015 IASB meeting.

Next CMAC meeting

The next CMAC meeting will be held jointly with the GPF and will take place on **11 and 12 June**. The agenda topics for the meeting will be discussed in the upcoming month.