STAFF PAPER

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Prepared for the Capital Markets Advisory Committee Meeting

Paper topic	**Follow up on issues discussed at the November 2018 CMAC meeting**		
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Purpose of this paper

1. This paper provides a brief, high-level update to the Capital Markets Advisory Committee (CMAC)[1] on how the staff or the International Accounting Standards Board (the Board) considered the advice received during the CMAC meeting held in November 2018. It is for information purposes only.

[1] Information about the CMAC's past meetings can be found at http://www.ifrs.org/About-us/IASB/Advisory-bodies/CMAC/past-meetings/Pages/past-meetings.aspx.

Update on advice received at the November 2018 CMAC meeting

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Primary Financial Statements	The purpose of this session was to seek feedback on the main project proposals, namely: a. defined subtotals in the statement(s) of financial performance; b. management performance measures; and c. disaggregation. CMAC members were asked to assess the effect of the proposals on financial reporting—in particular whether these proposals will: a. lead to better economic decision-making by investors; b. improve the comparability of financial information between different reporting periods for an individual entity; or between different entities in a particular reporting period; and c. improve a user's ability to assess the future cash flows of an entity, or ability to assess management's stewardship of the entity's economic resources. In preparation for the session, CMAC members completed a written assessment of the proposals, the results of which were discussed during the session. During the session the staff also provided an overview of the Board's recent tentative decisions on the project. ***Defined subtotals in the statement(s) of financial performance*** Many CMAC members stated all the proposals on subtotals meet each of the objectives in paragraph 0. However, a few CMAC members said some proposals would have a negative effect on financial reporting, specifically the proposed separate presentation of integral and non-integral associates and joint ventures and the proposed subtotal 'operating profit and share of profit or loss of integral associates and joint ventures. One CMAC member expressed the following concerns:	At a future Board meeting the Board will discuss whether to publish an Exposure Draft or a Discussion Paper. The Board will consider all feedback received about the likely effects of the proposals in making that decision. CMAC members' feedback on the MPM proposals will be reported to the Board at a future Board meeting. The suggestion to require separate presentation of integral and non-integral associates and joint ventures in the statement of financial position is discussed in paragraphs 21–26 of the March 2019 Agenda Paper 21A. The suggestion to require presentation of amortisation and depreciation in the statement(s) of financial performance is discussed in paragraphs 27–31 of the March 2019 Agenda Paper 21A.

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	a. significant judgment may be required in applying the definitions of 'income/expenses from investments', 'integral' and 'non-integral'. If the definitions are applied inappropriately, core activities might be classified as 'investing'. b. entities will avoid classifying assets as 'investments' or classifying associates and joint ventures as 'non-integral', because investors may question why an entity is holding an investment that is not an integral part of its operations. One CMAC member suggested that integral and non-integral associates and joint ventures should be separately presented in the statement of financial position, because this would facilitate the calculation of returns ratios. A few CMAC members suggested possible requirements related to EBITDA: a. the Board should define EBITDA, as it is one of the most commonly used subtotals in investors' analysis; and b. the Board should require separate presentation of depreciation and amortisation expenses in the statement(s) of financial performance, to enable users to calculate EBITDA easily. ***Management performance measures*** Many CMAC members stated the proposals on management performance measures will meet each of the objectives in paragraph 0. Some members expressed strong support for the proposals because they would increase the transparency of, and discipline applied to such measures. One CMAC member cautioned that the proposed requirement to provide an explanation of why a management performance measure is useful and how it has been calculated may result in boilerplate disclosures. This member encouraged the Board to clarify that an entity is expected to disclose an accounting policy that describes in detail the types of items that the entity adjusts for in the calculation of its management performance measure(s).	

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	A few CMAC members reiterated the importance of requiring entities to provide sufficient explanation, if there is a change in how the management performance measures have been calculated during the year, to help users understand the reasons for and effect of the change. One CMAC member said that management performance measures should only be presented in the notes, where they are accompanied by explanatory disclosures. ***Disaggregation*** Most CMAC members stated the disclosure of unusual and infrequent items would meet each of the objectives in paragraph 0, except for a few members who were unsure whether the disclosure would improve comparability between entities. Most members also stated the proposals for disaggregation of expenses by nature or function and the proposed principles of disaggregation would meet the objectives in paragraph 0. However, one member stated that they disagree with the proposals on disaggregation because entities that present an analysis of expenses by function would be prevented from presenting depreciation and amortisation expenses in the statement(s) of financial performance. One CMAC member suggested that the Board should consider: a. requiring disclosure of unusual or infrequent items by segment; and b. extending to interim financial reporting the proposed requirement to provide additional information on the nature of expenses in the notes when an entity presents its primary analysis of expenses by function. ***Other comments*** One CMAC member expressed the view that it may not always be clear who are the intended users of IFRS financial statements and that the Board should consider further clarifying that the intended users are existing and potential investors, lenders and other creditors.	
Financial Instruments with Characteristics of Equity	The purpose of this session was to seek feedback from CMAC members on whether the presentation and disclosures proposed in the Discussion Paper DP/2018/1 (DP) would be useful, in particular:	The feedback received from CMAC members formed part of the staff's high-level comment letter analysis presented at the March 2019 Board meeting (Agenda Paper 5). The Board will

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	a) additional disclosures, including priority of issued financial liabilities and equity instruments on liquidation, the maximum potential dilution of ordinary shares, and terms and conditions that affect the timing and amount of cash flows of the financial instruments issued by the entity; b) expanded statement of changes in equity, which will show how total comprehensive income of an entity is attributed between different classes of equity instruments; and c) presentation in other comprehensive income (OCI) of income and expenses from particular types of financial liabilities i.e. those that have the amount feature that is not independent of the entity's available economic resources. ***Disclosures*** *General* CMAC members were asked whether the disclosure proposals in the DP would result in useful information and whether they consider any of the individual proposed disclosures to be particularly more useful than the other proposed disclosures. Two members enquired about the scope of this project and its interaction with employee share-based compensation. It was clarified that only financial instruments issued by entities are in the scope of this DP. It was acknowledged that, with this consultation the Board is not planning to change the existing requirements of IFRS 2 *Share-based Payment*, consideration should be given to the linkages between financial instruments covered by this DP and share-based	continue its re-deliberations and decide on project direction in 2019.

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	payments within the scope of IFRS 2. For example, when considering the disclosure of maximum dilution of ordinary shares. *Maximum dilution of ordinary shares* A majority of CMAC members consider this disclosure as critical and a few noted they currently try to estimate it when information available allows them to do so. Some members suggested maximum dilution disclosure should be supplemented with basic scenario or sensitivity analysis e.g. if share price increases x%, maximum dilution would be Y etc. In contrast, other members expressed interest in having sufficient information about the inputs, which could enable them to run their own analysis. This could be more dynamic than relying on the output of scenarios based on management's assumptions. *Priority of issued financial liabilities and equity instruments on liquidation* Some CMAC members consider this proposed disclosure to be potentially useful but acknowledge that there are many challenges to implementing it in practice. For example, ranking information about financial liabilities and equity instruments depend on group structures that may continuously change, moreover, when users examine this disclosure they may consider the information from several different perspectives such as: legal, structural subordination or time perspective. Some members expressed concerns that these challenges	

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	may lead to limited or only high-level information being provided, which in turn, might reduce the usefulness and reliability of the disclosure. One member said that providing this information only for the parent would not be useful given that currently it is usually the information about subsidiaries that is lacking. Certain CMAC members said that if entities provide information on maximum dilution of ordinary shares and terms and conditions that affect the timing and amount of cash flows of the entity, they would themselves be able to compile some useful information that would inform them on the priority of issued financial liabilities and equity instruments on liquidation. *Terms and conditions that affect the timing and amount of cash flows of the entity* CMAC members said that this disclosure is necessary with some members ranking it as the proposed disclosure that provides the most useful information. However, they suggested that for information to be useful, there should be a balance between providing information that is sufficiently granular to allow them to appropriately use it versus disclosure overload. One member noted that for Banks similar information is currently required by Basel III Pillar 3 *Disclosure Requirements* and that, in his view, if this disclosure is required by IFRS Standards, it would improve the consistency of the level of information provided by companies across different jurisdictions. However, this CMAC member suggested that for Banks an exemption	

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	would be necessary to limit the scope of the disclosure requirements only to solvency capital instruments, as otherwise, it could lead to high costs and complexity as well as disclosure overload. ***Presentation - expanded statement of changes in equity*** CMAC members welcomed the DP proposal given the limited information currently provided on the attribution within equity. One CMAC member indicated that improvement can be made with respect to information provided about the extent of attribution within equity to holders of non-controlling interests (NCI), which in his view is critical information that is currently lacking in the financial statements. To this end, the member suggested that attribution of revenues or operating income might provide more useful information. With regards to the attribution method that would provide the most useful information: a. CMAC members asked for further clarifications on the approaches to attribution proposed in the DP. b. Some members indicated that the full fair value approach would provide the most meaningful information, but expressed mixed views as to whether it would be best to present the attribution on the face of the financial statements or in the notes to the financial statements. However, members acknowledged that the full fair value approach can result in a negative value for the total comprehensive income attributed to ordinary	

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	shares[2], which in their view, could appear to many users as a counter-intuitive outcome and therefore, impair the relevance of information provided. c. One CMAC member suggested that information about attribution for derivative equity instruments should be included in the notes to the financial statements rather than in the statement of changes in equity. That is because, in his view, it is not appropriate to allocate an amount of current period income (ie net profit) to parties that have yet to exercise their share options and thus should not have a claim on any amount of the total comprehensive income of the entity earned during the reporting period. ***Presentation in OCI of income and expenses from financial liabilities that have equity-like returns*** CMAC members said income and expenses from financial liabilities that behave like the return on an equity instrument should be separately presented due to the different characteristics underlying the associated financial instrument. Members expressed mixed views as to whether these items of income and expense should be presented in other comprehensive income (as proposed in the DP) or as a separate line item in profit or loss. Some members who support the presentation in OCI said that such approach	

[2] This would apply in instances when fair value of derivative equity instruments exceeds the attributable total comprehensive income, and therefore, resulting with a negative value attributed to ordinary shares.

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	would also be consistent with presentation of the effects of changes in the liabilities' credit risk (own credit gains and losses) when applying IFRS 9. In response to the question as to whether members would prefer to have gains or losses recycled from OCI to profit or loss, some members responded that they would like to see gains or losses recycled in profit or loss upon settlement as otherwise it wouldn't contribute to transparency but others said they would prefer to remain in OCI to avoid volatility brought in profit or loss.	
Management Commentary	The purpose of this session was to seek feedback from CMAC members on: a. objective of management commentary; b. applying materiality in preparing management commentary; and c. principles for preparing management commentary. ***Objective of management commentary*** Some members explicitly supported the overall direction of the project to revise IFRS Practice Statement 1 *Management Commentary* (Practice Statement) and commented that this project is very important to investors. They also agreed that management commentary is within the scope of financial reporting and is targeted towards the primary users of financial reporting as described in the *Conceptual Framework for Financial Reporting* (*Conceptual Framework*). Overall, members supported the proposal to explicitly refer to the assessments of prospects for future net cash inflows and of management's stewardship of the economic resources. However, a few members raised the concern that the wording could be interpreted as a need for management to disclose its forecasts. The staff confirmed that this was not the intention and will	The feedback on the objective of management commentary was reported to the Board at its November 2018 meeting. The Board will consider the remaining feedback at future meetings. The feedback was also considered in preparing the materials for the Stream 2 and Stream 3 discussions with the Management Commentary Consultative Group.

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	develop wording to clarify this and that management commentary is about providing information to allow the primary users to make their forecasts. A member expressed concern about the reference to ‘whole life cash flows’ because it might imply that an entity has a finite life which is known to management. The member suggested using ‘enduring cash flows’ instead, to address the continuity of cash flows. Some members agreed that although the emphasis on prospects for the long-term is important, the statement that management commentary should include historical information to explain past performance was also needed. Members agreed that they needed information explaining what went well and what went wrong and why, because that information would be useful when they make their forecasts. Information on management’s future plans and desired outcomes needed to be supported by factual information on *how* the entity would achieve them. Some members commented that referring to the business model in the statement of the objective of management commentary is helpful. In addition, a few members commented that referring to wider purposes that an entity might have, such as creating employment, was not so useful; instead, they want information on how the entity makes money. One member suggested adding in the guidance supporting the objective a reference to management’s assumptions in relation to the prospects for future cash flows. Besides information on risks, this would include information on the entity’s dependencies and contingencies which would affect the entity’s ability to continue operating. One member suggested that the Practice Statement should include explicit reference to ‘returns’, which in that member’s view is not sufficiently captured by the wording on future cash flows and stewardship. Others suggested that management’s strategy on capital structure and its dividend policy should be referred to in the guidance supporting the objective, or elsewhere in the Practice Statement.	

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	One member commented that including in the discussion of the objective of management commentary concepts such as neutrality and understandability would help to improve practice, even though these concepts are already included in the *Conceptual Framework.* One member suggested that management commentary should present information on external trends, including the operating and competitive environment of the entity. Information on external trends needs to explain the entity-specific consequences of those external trends and their relation to, and effect on, the entity's business model. ***Applying materiality in preparing management commentary*** There was general support for a two-stage approach identifying 'matters' first and then the 'material information' on those matters. However, one member thought that the definition of material in *the Conceptual Framework* was sufficient and addressed what would be material for management commentary. That member noted that materiality is sometimes used as an excuse to not disclose information, and that the definition of material needs to remain principles-based. Another member commented that the Practice Statement should note that what is material changes over time, and that as circumstances change, a matter that was immaterial may suddenly become material. One member suggested it may be helpful to discuss with the International Auditing and Assurance Standards Board (IAASB) the auditor's perspective on materiality. The staff noted that one member of the Management Commentary Consultative Group is a representative of the IAASB. ***Principles for preparing management commentary***	

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	One member was of the view that management may not always be able to provide neutral information because reporting on negative matters could create a self-fulfilling prophecy. However, other members noted that neutrality was an important principle and that emphasising it was important because in their view narrative reporting often has a positive bias. One member commented that management may think that a requirement for comparability with industry peers would detract from their ability to explain the entity's 'story'. The member suggested that more guidance may be needed in this area. Another member suggested that a principle on consistency, which explains that information within a management commentary needs to be internally consistent, should be included in the Practice Statement. One member asked whether the project would include a review of existing disclosure requirements to see whether some belong in management commentary rather than the financial statements. The staff explained that there was no plan to undertake such a review.	
Goodwill and Impairment	The purpose of this session was to seek CMAC members' feedback on the new disclosure objectives that the Board decided in July 2018 to explore, and on whether disclosures made with the aim of meeting these objectives can satisfy the needs of users. Specifically, CMAC members discussed the following: a. additional disclosures at acquisition date; b. why do users need information on the subsequent performance of the acquired business? c. additional disclosures about subsequent performance; and d. use of the carrying amount of goodwill in analysis ***Additional disclosures at acquisition date***	The feedback from CMAC members has been used to develop the staff's suggestions for improving disclosures further. The revised suggestions, along with the feedback gathered from CMAC members, will be included in a staff paper on disclosures to be presented to the Board at a future Board meeting, currently planned for April 2018.

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	CMAC members generally agreed that more information is needed to enable them to make a more informed assessment of investment decisions made by management. Members suggested a wide range of disclosures that could help to make information more useful for decisions. Among these suggestions, two types of disclosures gained wide support around the table: a. additional pro-forma pre-acquisition information to enhance the comparability of financial information; and b. additional information on the synergies expected from the acquisition to enable users better understand the impact of the acquisition. *Pro-forma information* Several members stated that additional pro-forma information on pre-acquisition financial performance would allow users to see how the consolidated financial statements would have looked if the acquisition had taken place at the beginning of the financial period. Members expressed various views on what information should be provided about financial performance. One member mentioned net earnings (i.e. profit or loss), while another member would like to see all the new subtotals introduced by the Primary Financial Statements project. A few members commented that in addition to information on financial performance, they would also like to see additional pro-forma information relating to the acquirer's financial position and cashflow. One member highlighted that, under current disclosures, users would need to wait close to 3 years after a mid-year acquisition before fully comparable year-on-year financial information is required to be available. Another member mentioned that the standards currently only require disclosure of pro-forma revenue and profit and stated that this is insufficient to enable users to analyse the acquisition in detail.	

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	One member stated that a newly acquired business is essentially the converse of a discontinued operation to which IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* applies. According to the member, proforma information on the acquired business for the comparative period provides a baseline that allows the subsequent performance of the group to be better understood. *Expected synergies* Many members stated that having additional information on the nature, timing and amount of expected synergies would allow users to better understand the transaction, forecast the entity's financial performance and monitor stewardship. One member stated that disclosure on the nature of the synergies (revenue vs cost) is needed to enable users understand how reliable the information is. In his view, estimates of economic benefits from cost synergies are generally more reliable than estimates of those from revenue synergies. Another member stated that quantitative disclosures on expected synergies are more reliable if they are in audited financial statements. *Other comments* One member commented that users would need qualitative information on the post-acquisition integration strategy to enable them to monitor the progress of integration and assess the success of the acquisition. In addition, a few members stated that they would like to see additional disclosure on pension and debt obligations taken on by the acquirer in the acquisition. One of them further stated that he would like to know the amount of recourse debt assumed in a business acquisition. A few members also highlighted that the acquired businesses generally have a risk profile different from that of the entity's existing operations. Additional information on the subsequent	

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	performance of the acquired business is therefore needed to enable users to better understand the acquisition. ***Why do users need information on the subsequent performance of the acquired business?*** Feedback from CMAC members indicated that information on the subsequent performance of the acquired business is generally needed for 2 purposes: a. to monitor the stewardship of management in making acquisition decisions; and b. to enable users to value the combined business more accurately moving forward. Many members agreed that disclosure on subsequent performance is needed for stewardship monitoring purpose. One member highlighted specifically that this information can be used to assess whether the entity is the best owner of the acquired asset or would be better off disposing the asset instead. ***Additional disclosures about subsequent performance*** CMAC members generally agreed that more detailed disclosures on the subsequent performance of the acquired businesses are needed. However, there is no specific information that would be needed for all acquisitions. One member stated that any information that helps users assess the post-acquisition returns would be useful. The exact information needed to make that assessment may vary from deal to deal. A few members also stressed that quantitative disclosures are preferred to boilerplate qualitative information. Although members generally agreed that additional disclosures on the subsequent performance of the acquired businesses or combined business would be useful, there were different views on how long and how frequently such information should be provided:	

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	a. one member suggested such post-acquisition information is needed for only one financial period post-acquisition to enable users to establish a baseline for comparison. b. one member stated that the information would be needed for as long as expected synergy arising from the original deal remains unconsumed. A few members agreed with the staff's suggestion that disclosures relating to the subsequent performance of acquired businesses should be based on benchmarks used internally by management. A few members acknowledged that information on the subsequent performance of acquired businesses or combined business in routine acquisitions may not be traceable due to post-acquisition integration of businesses, and that management may not monitor each acquisition separately. However, they would expect that management would at least monitor separately the performance of major acquisitions. Users would need additional disclosures about subsequent performance for these major acquisitions. One member commented that management should also be required to disclose how the subsequent performance of business acquisitions is monitored. If an entity does not monitor its subsequent performance, it should disclose that fact, and investors will be able to act accordingly. The member stated that requiring such disclosure would create an incentive for management to monitor business acquisitions more closely, promoting better corporate governance. A few members commented that information contained in segment reporting alone is insufficient in addressing the information needs of users relating to the subsequent performance of acquired businesses for the following reasons: a. segment information disclosed in financial statements is generally provided at a level higher than that of individual acquisitions. Information contained in segment reporting would not capture acquisition-specific information; and	

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	b. IFRS 8 currently does not require the disclosure of some specific information for each segment, such as segment operating cashflow, capital expenditure, assets and liabilities. ***Use of the carrying amount of goodwill in analysis*** Two members who specialise in analysing financial services entities commented that they do not use goodwill in their analysis. They would adjust for the goodwill recognised and look at the net tangible assets for the entities that they analyse. Several other members stated that they use the carrying amount of goodwill in their analysis for a variety of reasons: a. one member stated that the carrying amount of goodwill is an indicator of how good the management is at growing the entity; b. one member highlighted that the proportion of goodwill to the entity's net assets acts as an indicator of risk during market downturns. According to research performed by the member, entities with a larger proportion of goodwill are more likely to suffer a greater loss in market value during market downturns than entities with a lower proportion; and c. another member commented that a trend analysis of goodwill to net assets can be used to analyse how successful an entity's management is at making business acquisitions. According to that member, if the ratio of goodwill to net assets is increasing over time, that suggests that management has not been successful in generating positive returns from past acquisitions.	