Meeting summary

Capital Markets Advisory Committee

Date **6 October 2022**
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This document summarises a meeting of the Capital Markets Advisory Committee (CMAC), a group of nominated members with extensive practical experience in analysing financial information and who are established commentators on accounting matters in their own right or through the representative bodies with which they are involved. The CMAC supports the IFRS Foundation and the International Accounting Standards Board (IASB) in their objectives, and contributes towards the development, in the public interest, of high-quality, understandable, enforceable and globally accepted IFRS Accounting Standards.

CMAC members who attended the meeting

Region	Members
Africa	Larissa van Deventer
Asia-Oceania (including one at large)	Ge Xiaobo* Koei Otaki*
Europe (including one at large)	Deirdre O'Leary Florian Esterer Jacques de Greling* James Hyde Jeremy Stuber Kenneth Lee* Matthias Meitner* Oliver Gottlieb Philip Robinson Terence Fisher
The Americas	Enitan Adebonojo Rosemary Zigrossi*

* Remote participation via videoconference

Primary Financial Statements

Changes to proposals related to the financing category and aspects of management performance

1. The purpose of this session was to obtain feedback from CMAC members on whether the IASB's tentative decisions that result in changes from some proposals in the Exposure Draft *General Presentation and Disclosures* will achieve their objectives and the intended costs and benefits. This discussion forms part of a wider program of feedback collection on:

   (a) classification of income and expenses in the financing category;
   (b) aspects of the disclosure requirements for management performance measures;
   (c) disclosure of operating expenses by nature in the notes when an entity presents operating expenses by function in the statement of profit or loss; and
   (d) unusual income and expenses.

Financing category

2. The staff explained the IASB's tentative decision to change its approach to classifying income and expenses in the financing category from that of the Exposure Draft. The Exposure Draft proposed classifying income and expenses in the financing category based on a definition of 'financing activities'. In response to concerns about the application of this definition, the IASB tentatively decided to revise the proposed approach. The revised approach is based on whether or not the transactions that give rise to the liability arise solely from the raising of finance (see slides 4-6 of Agenda Paper 2). The staff asked members whether:

   (a) any transactions should be captured in the financing category that would not be captured by the proposed revised approach; and
   (b) any issues may arise from the expected change to the Exposure Draft for lease liabilities and amounts payable for goods and services received.

Transactions captured by the definition of financing

3. Members did not raise any concerns over the income and expenses that would be classified in the financing category as a result of the tentative decision.

4. One member expressed agreement with the revised proposal because it would provide more information than is provided today and help improve analysis.

5. One member asked whether capturing 'the return by the entity of its own equity instruments' as a transaction that involves only the raising of finance would have any implications for the classification of equity and dividends. The staff explained that this description aims to help identify transactions that involve only the raising of finance, for the purpose of classifying the related income and expenses. The tentative decision would not change which income and expenses are recognised in the statement of profit or loss and which income and expenses are classified in equity.

6. One member commented that applying the revised definition, amortisation would be included both in the financing category (debt instruments measured at amortised cost) and in the operating category (such as the amortisation of intangibles). The staff acknowledged this and explained that the objective of the financing category is to provide clarity through a consistent classification of financing expenses.

Lease liabilities and amounts payable for goods and services received

7. Members did not raise concerns about the effect of the tentative decision on outcomes for lease liabilities and amounts payable for goods and services received.

8. However, one member raised a concern about the classification of income and expenses arising from assets and liabilities in the scope of IFRS 16 *Leases*; specifically, that according to the tentative decision, interest income is classified in the financing category if it comes from a lease liability, but in the operating category if it comes from a lease receivable by lessors.

9. One member said it was good that the lease expense associated with the lessee would be disaggregated and asked if the lease income associated with the lessor would also

be disaggregated. The staff clarified that it would depend on the general principles of disaggregation being developed in this project.

Questions and comments on the classification of income and expenses

10. Some members had general questions or comments regarding the classification of income and expenses proposed in the Exposure Draft:

    (a) one member commented that lease expenses make up a large part of total expenses for medical care and airline companies. In this member's view, for such entities, interest expense on lease liabilities is similar to depreciation and thus classifying it in the operating category would result in better comparability between entities than would classifying it in the financing category.

    (b) one member asked how an entity can determine whether investing or providing financing to customers is a main business activity. The staff clarified that the IASB has provided some criteria, including whether investing or financing to customers is a reportable segment, and whether subtotals similar to gross profit, such as net interest income, are key operating performance metrics of entities that invest or provide financing to customers as a main business activity. In response to a question from another member, the staff clarified that an entity assesses whether it invests or provides financing to customers as a main business activity at the reporting entity level.

    (c) in response to a question from a member, the staff explained that according to the IASB's tentative decision, income and expenses from cash and cash equivalents would be classified in the investing category which would be a change from the proposal in the Exposure Draft to classify these income and expense items in the financing category. Another member said that income and expenses from cash and cash equivalents might be classified in either category—this member did not have an opinion on the classification— but it would be helpful to present them in a separate line item so that users of financial statements could split income and expenses from cash and cash equivalents into operating and non-operating cash.

Management performance measures - Rebuttable presumption that measures used in public communications reflect management's view of an aspect of financial performance

11. The staff explained the IASB's tentative decision to introduce a rebuttable presumption that a subtotal of income and expenses communicated in an entity's public communications is presumed to communicate management's view of an aspect of the entity's financial performance. The staff asked for members' views on whether:

    (a) measures that do not represent management's view should not be disclosed as management performance measures; and
    (b) establishing the rebuttable presumption will reduce subjectivity over which measures are not disclosed as management performance measures.

12. Members did not raise any concerns over an entity excluding measures that do not represent management's view of an aspect of its financial performance from its management performance measure disclosures. The members also raised no concern over the introduction of the rebuttable presumption.

13. One member said that they thought the rebuttable presumption was a practical compromise to address the feedback on the proposal in the Exposure Draft and that it will not reduce the improvements from this project. They asked whether similar rebuttable presumptions are used in other IFRS Accounting Standards and whether they work well. The staff responded that rebuttable presumptions are used in other IFRS Accounting Standards, such as IFRS 9, and generally appear to work well.

14. One member asked if the IASB will provide guidance on cases where an entity can rebut the presumption and whether an entity would be required to disclose its use of the rebuttable presumption. The staff clarified that the IASB will provide such guidance and has tentatively decided not to require an entity to disclose whether it has rebutted the presumption because that information is not expected to be material.

Questions and comments on management performance measures requirements

15. Some members had general questions and concerns regarding the management performance measures requirements proposed in the Exposure Draft:

(a) members asked why the definition of management performance measures in the Exposure Draft is not linked to management compensation. Several members said that knowing which measures are linked to management compensation is useful because the corresponding metrics are determined by those charged with governance and thus are more aligned with investors' interests. The staff explained that the objective of the disclosure requirements for management performance measures is to provide information about management's view of an aspect of the entity's financial performance rather than information about the performance of management. The staff acknowledged that overlaps between management performance measures and management compensation measures may exist, but the measures are not always the same.

(b) one member suggested that management performance measures should not only give management's view of performance but also the board of directors' view of performance. An IASB member responded that:

   (i) it would be challenging to revise the definition of management performance measures without causing delays to the project; and

   (ii) the requirement to disclose a reconciliation for each management performance measure provides information to understand management's view, enabling users to make their own adjustments.

(c) one member asked if an entity would be required to disclose how it calculated the metrics included in an entity's public communications that do not represent management's view. The staff explained that metrics required by regulation or local generally accepted accounting principles (GAAP) would be calculated and disclosed in accordance with those requirements and therefore, their disclosure would not likely provide material information.

Simplified approach to calculating the tax effect on reconciling items

16. The staff explained the IASB's tentative decision to revise the requirement for how an entity calculates the income tax effect of the individual items when it reconciles a management performance measure to the most directly comparable total or subtotal specified in IFRS Accounting Standards. The staff asked members' views on whether the revised requirement would provide sufficient information for users to understand the tax effects of the individual items reconciled.

17. Members agreed that the revised proposal for calculating the tax effect on reconciling items provided useful information and was clear for users.

18. However, some members preferred the original proposal for calculating the tax effect on these items because it provided more information. One member commented that the simplified approach might mislead users because the statutory tax rate might differ from the actual tax effect. Several IASB members said that the simplified approach is required because of complexities that may arise when determining the tax effect.

19. Another member said that information about the cash tax rate would be ideal, but acknowledged that requiring such information is not in the scope of this project.

20. In response to a question from a member, the staff clarified that when an entity used the simplified approach to calculating the tax effect, it would apply the statutory tax rate to each part of the transaction in the jurisdiction where it occurs, instead of using the average statutory tax rate across all jurisdictions where the transaction occurs.

Disclosure of operating expenses by nature

21. The staff explained the IASB's tentative decision to require an entity to disclose the amounts in each line item in the statement of profit or loss for depreciation, amortisation, and employee benefits. The staff asked members whether:

(a) the IASB's tentative decision would provide sufficient information about the nature of expenses considering the cost concerns of some stakeholders;
(b) the list of line items included in the requirement should also include impairments and write-downs of inventories; and
(c) similar, or better, information would be provided if the requirement were applied to all other operating expenses disclosed in the notes, subject to an undue cost constraint.

22. Most members broadly agreed with the proposed direction the IASB is taking. Members agreed that an approach that requires an entity to disclose the amounts of depreciation, amortisation and employee benefits included in each line item in the statement of profit or loss would provide useful information. This approach would resolve many of the practical issues for preparers arising from the proposal in the Exposure Draft to disclose operating expenses by nature.

23. Many members said that disclosing the amounts included in each line item for impairments and write-downs of inventories would also provide useful information, in particular helping users to understand the effects of non-cash items. One member said that disclosing impairment should be required because in their view impairment is accelerated depreciation and amortisation.

24. Some members said that impairments and write-downs of inventories are typically one-off items that may meet the definition of unusual income and expenses proposed in the Exposure Draft. These members said that it is important to have more information about impairments and write-downs of inventories now that the IASB has tentatively decided to withdraw the proposals for unusual income and expenses.

25. Some members said the IASB should avoid detailed requirements that can be applied only in annual financial statements. They suggested that the IASB keep the requirements simple and that similar requirements apply to annual and interim financial statements because such an approach would provide more timely information and therefore benefit users more than detailed annual requirements alone would do.

26. One member disagreed with revising the proposal in the Exposure Draft to disclose the totals of all operating expenses by nature. In this member's view, reporting operating expenses by nature provides better information than reporting them by function because it enhances comparability and provides a better link to the statement of cash flows.

27. One member said that the principle-based approach strikes a good balance. In this member's view, the more information that is provided the better, and the principle-based approach would result in more information than is provided today.

Unusual income and expenses

28. The staff explained the reasons for the IASB's tentative decision to withdraw the proposal in the Exposure Draft for the disclosure of unusual income and expenses and asked for members' views on the decision.

29. Some members were disappointed with the decision because they thought the information that would have been provided by this disclosure would have been useful for users. In response to a question from a member asking when the IASB would return to this topic, the staff explained that currently there is no plan to do so. However, the work to date, including the input received from CMAC members, would be considered if the IASB were to return to this topic in the future.

30. Some members suggested that as an alternative the IASB could consider providing a list of potential income and expenses that an entity would be required to be disclosed, and allow users to make their own judgements as to whether the income and expenses disclosed are unusual.

31. Several IASB members said that in the IASB's discussions each member had different ideas of what they consider to be unusual income and expenses, making it difficult to reach a consensus on a definition. They said the IASB acknowledged the that

information about unusual income and expenses would benefit users, and the decision to withdraw the proposal was a balanced decision.

32. Several members agreed with withdrawing the proposal for disclosure of unusual income and expenses. One member said that unusual income and expenses are generally one-off gains and losses and they think that much of the information that would have been provided applying these proposals will be provided through the proposals for management performance measures.

33. In contrast, another member said that they are sceptical that the proposals on management performance measures and the guidance on disaggregation will fill the gap. The staff explained that further work is being undertaken to strengthen the disaggregation requirements.

Next steps

34. The IASB will consider the feedback from members when it considers all of the proposals at a future IASB meeting.

IAS 37 Provisions, Contingent Liabilities and Contingent Assets (discount rates)

35. This session sought CMAC members' views on the discount rates companies use to measure liabilities within the scope of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, with a focus on provisions for asset decommissioning and environmental rehabilitation costs.

Rates used

36. The staff explained that entities use a variety of bases for determining discount rates. Some entities use market-based risk-free rates; other entities use higher 'credit-adjusted' rates, which reflect the entity's own credit risk.

37. Members were asked for their views on:

(a) whether information about the provisions would be more useful if all entities used the same basis to determine the discount rates for their provisions; and, if so

(b) whether IAS 37 should require entities to use risk-free rates or credit-adjusted rates.

38. Some members said they would prefer a requirement to use credit-adjusted rates. The reasons they gave were that:

(a) conceptually, from the perspective of an equity investor, any economic measure of a liability reflects the possibility that the entity might go bankrupt and, if it does, would avoid having to settle the liability. The counterparty—which might be a government in the case of decommissioning and environmental liabilities—might have to pick up the costs and therefore share the burden of the liability.

(b) provisions calculated using credit-adjusted discount rates are more comparable with other liabilities, because these other liabilities typically reflect credit-adjusted rates.

(c) provisions measured applying IAS 37 with credit-adjusted discount rates would be comparable with those measured applying US GAAP (which require provisions to be measured using a credit-adjusted rate).

39. Other members said they would prefer a requirement to use risk-free rates. They said:

(a) the economic value of the liability is not useful information for them:

(i) an equity analyst said that in valuing an entity, she subtracts the cost of liabilities.

(ii) credit analysts said information about the amount and timing of the cash flows required to settle the obligation is more useful than knowing its economic value. Reducing measures of liabilities by an estimate of the credit risk in those liabilities is not helpful because analysts are trying to assess this risk themselves. Furthermore, even in bankruptcy, administrators would be seeking a settlement larger than the credit-adjusted amount.

(b) credit adjustments are highly subjective.

40. Members noted that equity analysts supported credit-adjusted rates more than credit analysts did.. Members suggested ways in which financial statements could satisfy the needs of both groups and overcome concerns about the subjectivity of credit adjustments. Suggestions included:

(a) requiring entities to measure provisions using a credit-adjusted rate, but also to disaggregate (or gross up) the measure to disclose its inputs, which include:
   (i) the undiscounted cash flows;
   (ii) the effect of the time value of money (based on a risk-free rate of interest); and
   (iii) the effect of the credit risk adjustment;

(b) requiring companies that use a rate higher than a risk-free rate:
   (i) to disclose the reason(s) for adjusting the risk-free rate and the size of the credit adjustment; and
   (ii) to provide a sensitivity analysis, for example identifying the effect a one percentage point change in the discount rate would have on the measure of the provision.

Disclosure of information about discount rates used

41. CMAC members were asked for their views on:

(a) whether entities with long-term provisions disclose enough information about the discount rates they used to measure these provisions; and, if not,

(b) what further information would be useful.

42. Members suggested that:

(a) the basic information should include the discount rates used, and a description of the basis used to determine the rates.

(b) additional information is needed if the rates used are not risk-free rates, that is, if the rates are adjusted for other factors, such as credit risk. This information might include:
   (i) the reasons for adjusting risk-free rates, the logic followed in calculating the adjustments, and the effect of the adjustments; and
   (ii) a sensitivity analysis, to allow analysts to adjust the amount of the provision if they want to use rates other than those used by the company.

(c) the undiscounted amount and timing of the cash flows (the cash flow profile) assumed in estimating the provision would be particularly useful.

(d) the date on which it is assumed the decommissioning or rehabilitation activities will start should be included. At this time there will be a sudden switch from net inflows to net outflows.

(e) a discussion of the uncertainties affecting the assumptions is also needed.

43. A member noted that some companies already disclose the types of information that members suggested would be useful.

Next steps

44. The IASB expects to decide early in 2023 whether to develop proposals to amend IAS 37 so that it either requires companies to include credit risk in the rates they use to discount provisions, or prohibits them from doing so. The IASB will consider the feedback from CMAC members in reaching its decision.

Post Implementation Review of IFRS 9—Impairment

45. The purpose of this session was to ask CMAC members to share their views on the application of the impairment requirements in IFRS 9 *Financial Instruments* and the related credit risk disclosures in IFRS 7 *Financial Instruments: Disclosures*, as well as matters to be considered by the IASB in the Post-implementation Review (PIR) of these requirements.

46. Members were asked whether:

(a) information required by credit risk disclosures in IFRS 7 allows users of financial statements:
  (i) to understand the amount of expected credit losses (ECLs)—the basis for the measurement of the allowance—and the reasons for changes in ECLs during the period;
  (ii) to obtain entity-specific information on the main judgements and estimates involved in measurement of ECLs;
(b) a significant lack of consistency has been observed related to credit risk disclosures and if so, what the main reasons for that are; and whether
(c) the IASB should investigate any other matters during Phase 1 of the PIR.

47. Some members said they observed a lack of consistency in credit risk disclosures. Members noted that the detail provided in disclosures differs between entities and between jurisdictions. The lack of consistency makes it difficult for analysts to compare disclosures between entities and affects the usefulness of information to users of financial statements.

48. Members commented that the lack of consistency in disclosures is mainly due to:

(a) *objective-based disclosures*—lack of prescriptive or standardised requirements in IFRS 7 for credit risk disclosures leads to different levels of aggregation and detail in the information provided about ECLs; and
(b) *credit risk management practices*—one member said that an entity's credit risk management practices determine the quality of its disclosures.

49. A few members commented on management adjustments to impairment models. One member said that a management adjustment to impairment models is determined at the discretion of an entity's management, resulting in a lack of consistency across entities. Another member said that it is challenging to understand how management adjustments to impairment models are determined and it would be helpful if the assumptions and reasons for such adjustments are disclosed.

50. A member said that the IASB should investigate the topic of determining significant increases in credit risk. The member said that there is diversity in practice because entities assess such increases in credit risk using different approaches.

51. A member suggested the IASB provide standardised disclosure templates in order to reduce the lack of consistency in disclosures. Another member suggested that the information required by paragraph 35H of IFRS 7 about the reconciliation from the opening balance to the closing balance of the loss allowance should also show separately the changes in the loss allowance during the reporting period for financial instruments for which the credit risk rating grades have changed. Currently only the credit risk exposures by credit risk rating grades at each reporting date are required (see paragraph 35M of IFRS 7).

Next steps

52. The IASB will continue to seek feedback over the coming months to identify matters for public consultation. These matters will be published in the request for information, which is expected in the first half of 2023.

Post Implementation Review of IFRS 15 *Revenue from Contracts with Customers*

53. This session provided CMAC members with an overview of the project plan for the postimplementation review of IFRS 15 and sought members' views on the implementation and application of IFRS 15.

54. Members were asked whether:

    (a) financial statements prepared applying IFRS 15 provide information useful for their analysis of the timing and amount of entities' revenue;
    (b) they have found disclosures provided under IFRS 15 more informative than those provided under the previous revenue requirements;

(c) revenue information is comparable between different entities within an industry and between different industries;

(d) the information provided in the first set of IFRS 15 financial statements was useful in understanding the changes in revenue recognition; and whether

(e) they incurred any unexpected costs related to the implementation of IFRS 15.

Effects of IFRS 15 on timing and amount of revenue

55. CMAC members indicated that the effects of IFRS 15 varied depending on industry. Contrary to expectations prior to issuing the Standard, it did not result in significant changes for entities in the telecommunications and aerospace industries. The Standard had a bigger effect on other entities, for example, entities that moved from recognising gross revenue to net revenue. In addition, one member said that while IFRS 15 may not have significantly affected amount of annual revenue, in some cases it led to changes in the pattern of revenue recognition during the period.

56. Comments on specific industries included:

(a) *telecommunications*—analysts find it easier to reconcile revenue to cash flows after the transition to IFRS 15. Disaggregation of revenue between handsets and services is also useful. However, one member expressed disappointment that some telecommunication entities started re-aggregating revenue information, for example, combining revenue for mobile and fixed services.

(b) *software*—many entities are now making the transition from recognising revenue at a point in time to recognising revenue over time because their business models are changing from on-premise to cloud solutions. During the transition period—which in some cases is very long—analysts find revenue information in IFRS financial statements hard to use, especially for predicting future cash flows. In addition, entities have adopted various non-GAAP performance measures which lack consistency and complicate comparisons between companies.

Disclosures

57. Overall, CMAC members found disclosures provided under IFRS 15, in particular those related to disaggregation of revenue, more informative than disclosures under the previous revenue requirements. However, many members said that:

(a) the quality of disclosures varies between companies.

(b) disclosures are rarely provided in a tabular format as illustrated in the slide deck for the session. Instead, the information is distributed through the notes, which makes analysis more challenging. One CMAC member said that even when reading through the notes it is difficult to get some of the information provided in the illustrations, such as information on movements in contract assets or timing of order books.

58. A few members suggested additional disclosures that would be useful to users of financial statements:

(a) information on assumptions companies make about the timing of revenue recognition when they receive upfront payments from customers for servicing an asset over the asset's life; or alternatively, a sensitivity table based on different generic assumptions that would be applicable to an entity type.

(b) reconciliation of cash balance to contract liabilities, especially for entities with long-term contracts involving significant upfront payments for installation and servicing of equipment. For example, such contracts are frequent in the engineering, construction, aerospace and utilities industries. Members suggested such reconciliations would help them model the company's KPIs, for example, working capital and enterprise value, by including the investment income earned on the upfront payment in the project margin calculation.

Comparability

59. CMAC members indicated that more rigorous requirements for recognition and disclosure of revenue in IFRS 15 improved consistency of information between companies. One member also highlighted the importance of convergence of the

revenue requirements with US GAAP which has led to increased comparability across capital markets, including the US and Asia.

Transition

60. CMAC members said that companies used a mixture of full retrospective and modified retrospective transition methods. Explanatory disclosures in the year of transition were very useful and helped users better understand not only the new accounting policies, including accounting for long-term contracts, but also accounting under the previous standards. One member commented that although disclosures on transition were helpful, generally users prefer a newly introduced standard to require full retrospective application because it provides them with the best information for assessing trends.

61. Overall, members said that in their experience the implementation of IFRS 15 went smoothly and did not result in unexpected costs for users of financial statements. In addition:

    (a) one member mentioned additional ongoing costs related to adjustments users have to make to analyse organic growth.
    (b) another member was interested in hearing preparers’ views on the cost-benefit result of the IFRS 15 implementation. Preparers were expected to incur significant implementation costs, so it would be interesting to find out whether accounting profitability under IFRS 15 moved closer to contract profitability and whether the Standard had any other benefits for companies, for example, better internal controls.

Next steps

62. The IASB will consider the feedback from CMAC members when identifying matters to include in the request for information. The request for information is expected to be published in the first half of 2023.