Summary of the Capital Markets Advisory Committee discussions

The IASB's user advisory group, the Capital Markets Advisory Committee (CMAC), held its last meeting of 2015 on 6 November.

The meeting took place at 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:

- **2015 Agenda Consultation**
- **Goodwill and Impairment**
- **Trustees' Review of Structure and Effectiveness**
- **Conceptual Framework: Measurement**
- **IFRS 9 Financial Instruments: Education session on new Impairment requirements**
- **Disclosure Initiative Project: Materiality Practice Statement**

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2015 Agenda Consultation

The IASB is required to consult on its work plan and priorities every three years. The Agenda Consultation provides an opportunity for interested parties to have their say on how the IASB prioritises and balances its work.

During the meeting, the staff asked the CMAC members:

- which research topics should the IASB prioritise; and
- does the IASB deliver changes to IFRS at the right pace?

The resulting discussion highlighted the following points:

- Many CMAC members thought that goodwill was an area that the IASB should designate as a priority. Some CMAC members thought that amortisation of goodwill should be considered. Others thought that disclosures about goodwill impairment testing should be developed to provide more information about the assumptions made and the success of previous acquisitions. One CMAC member thought that impairment should be based on an assessment of whether pre-acquisition projections had been achieved.
- Performance reporting was also considered an important topic by many CMAC members. One CMAC member thought that clear requirements about performance reporting would also clarify the effect of fair value measurements in the financial statements. Several CMAC members suggested that non-GAAP measures, or alternative performance measures, should also be covered by the IASB when reviewing this topic. CMAC members also discussed whether any performance reporting proposals would need to be tailored to individual industries such as banking, investment or insurance. Overall, there was a strong view amongst CMAC members in support of the IASB taking forward work on performance reporting.

- Segment disclosures were recommended by many CMAC members as an area that would benefit from additional guidance. Information about operating segments is key to assessing any business. The staff noted that the IASB is proposing a narrow-scope amendment to IFRS to address issues that were identified during its post-implementation review of IFRS 8 *Operating Segments*.
- Many members of the CMAC thought that only changes to items that were on the face of the profit and loss, balance sheet or cash flow significantly affected their analysis. Some CMAC members, however, thought that the IASB changed IFRS too frequently. One CMAC member suggested that changes should be stockpiled and that all changes should be made once every three years. Another member suggested that the research agenda should be limited to two or three issues. Another noted the importance of narrow-scope amendments. Large projects consume time and resources–greater benefits might be achieved through smaller changes that remedy urgent issues. It was noted that a European Investor Group published each year a list of topics that should be addressed to improve financial reporting.

Next steps

The staff noted that the IASB is seeking comment letters on its 2015 Agenda Consultation until 31 December.

Goodwill and Impairment

At the October 2015 IASB meeting, the IASB asked the staff to perform additional work to identify what investors want to know about goodwill and impairment. This will be used to inform the IASB's discussions on whether to consider reintroducing goodwill amortisation and ways to improve the impairment requirements.

At this CMAC meeting the staff asked for CMAC members' views on goodwill amortisation and how they currently use the information provided by entities about goodwill and impairment, eg whether they currently make any adjustments to the information provided by companies. The following is a summary of the main points from the meeting:

- A common thread amongst all CMAC members was that they want to understand what for management had been the key drivers that justified the valuation of the acquisition and hence the additional amount of goodwill.
- Some CMAC members would like to see the Standards requiring the disclosure of a breakdown of the amount of goodwill into the contributing past acquisitions.
- Some CMAC members observed that analysts often add back amortisation of goodwill and other intangible assets and impairment charges because these are non-cash items. However, some noted that these adjustments are made for the purpose of deriving cash flow information and do not imply that analysts do not think these items should be recognised in determining earnings.
- Some CMAC members supported reintroducing amortisation of goodwill. Some thought that amortisation provides useful information about the number of years over which management expects to benefit from the investment. Some noted that acquired goodwill is consumed and replaced by internally generated goodwill over time and this is best reflected by an amortisation model.
- Some CMAC members did not support reintroducing amortisation and supported an impairment-only approach for goodwill. Some considered goodwill to be a long-life asset that does not have a determinable finite life. They thought that amortisation would be only an arbitrary allocation exercise (ie it would not provide useful information). Some members were concerned that amortisation could hide impairment losses, meaning that useful information would be lost, eg about an assessment that management had overpaid.
- Some CMAC members said that conceptually the impairment test was the right approach, even though in practice impairment losses are often recognised too late. They noted that this indicates the need for a more robust impairment test rather than a different approach, eg amortisation. Some thought that the current impairment test provided useful information for the calculation of return on

invested capital, about whether management had overpaid and if the acquisition was a good business decision, and about the value of the organisation and expected future cash flows.

- Some members expressed concerns about the difficulties of comparing organically grown companies with acquisitive companies. However members generally agreed that it would be difficult to resolve these concerns without a radical change, eg either capitalising more internally generated companies or writing off goodwill immediately.

Next steps

The IASB will consider the feedback in its goodwill and impairment project and decide what further information they need from investors.

Trustees' Review of Structure and Effectiveness of the IFRS Foundation

The IFRS Foundation's Executive Director provided an overview on the background and context for the Trustees' latest review of the structure and effectiveness of the Foundation, on which a Request for Views (RFV) document had been issued in July 2015. Feedback from CMAC members was sought on two particular aspects raised in the RFV that related to ensuring that the relevance of IFRS was maintained, taking into account developments in (a) wider corporate reporting and (b) technology.

On the relevance of IFRS within wider corporate reporting developments, the resulting discussion highlighted the following points:

- Most CMAC members expressed the view that the IASB should stick to its core business of developing Standards for financial reporting, where there was still much to do. IFRS was a strong global brand and the IASB should maintain its attention on keeping the strength of that brand. Taking leadership for areas beyond financial reporting would run the risk of the IASB losing its main focus;
- Some CMAC members acknowledged that it was important to maintain a dialogue with the International Integrated Reporting Council (IIRC) and other bodies operating in the corporate reporting arena, but not at the expense of the IASB being diverted from its core work;
- A few CMAC members saw merit in the IASB devoting some limited resources in this area, in particular in relation to non-GAAP measures.

On the relevance of IFRS within wider technological developments, the resulting discussion highlighted the following points:

- Most CMAC members expressed the view that technology was of increasing importance, and while the Foundation and the IASB should not themselves look to develop technological solutions, they should look to stimulate the development of technological tools by third parties that would assist investors and analysts by giving them rapid access to reliable data;
- CMAC members expressed a variety of views in relation to the IFRS Taxonomy. Some CMAC members saw it as an appealing product, but noted that there had been very little take-up of its use, which was an issue that needed to be explored. One CMAC member took a more positive view, stating that an effective IFRS Taxonomy was a useful tool in helping to achieve consistent application of IFRS. Another CMAC member felt that an important potential role for the IFRS Taxonomy would be in connecting the IFRS numbers in the financial statements to non-GAAP measures.

CMAC members commented on a number of other issues raised in the Trustees' RFV. The resulting discussion highlighted the following points:

- CMAC members were content with the three-tier governance structure and were strongly of the view that the independence of the IASB needed to be maintained in order to avoid politicisation and to protect the brand;
- Some CMAC members acknowledged that the work of the Education Initiative could be enhanced to assist consistent application of IFRS, but they did not want to see this enhancement coming at the expense of the current work being undertaken on investor education;
- Some CMAC members acknowledged the importance of Post-Implementation Reviews (PIRs) as a tool for ensuring consistent application, but felt that the way in which PIRs had been conducted to date (in particular the PIR for IFRS 8 Operating Segments) could have been better.

Next steps

The comment period for the Trustees' Review closed on 30 November 2015. The Foundation staff plan to report the feedback from both the comment letters and outreach undertaken, including that from users, to the Trustees at their next meeting in January 2016.

Conceptual Framework: Measurement

The purpose of the session was to gain feedback from CMAC members on the proposals in the IASB's Exposure Draft *Conceptual Framework for Financial Reporting* on measurement. CMAC members were asked:

- if they agreed with the description of the information given by each of the measurement bases described in the Exposure Draft;
- which measurement basis they thought gave the most useful information for some examples of assets and liabilities, and why; and
- whether their reasons were consistent with the factors to consider when selecting a measurement basis identified in the Exposure Draft.

On the description of the information given by each of the measurement bases, one CMAC member noted that the descriptions of the information given by fair value and of the information given by value in use were very similar. The IASB staff responded that this was intentionally the case. The difference between the two measurement bases was that fair value was based on market participant assumptions and value in use was based on entity-specific assumptions.

Another CMAC member asked whether the description of historical cost information in the statement of financial position was entirely accurate. If the recoverable amount of an asset had increased, that would not be reflected in historical cost. The IASB staff noted that the intention was to make any impairment an integral part of historical cost. Another member noted that IAS 2 *Inventories* requires inventory to be measured at the lower of cost and market value, not the lower of cost and recoverable amount, and asked why that measure had not been used in the Exposure Draft. The staff noted that the *Conceptual Framework* used the term 'recoverable cost' to mean the recoverable part of cost without specifying how recoverability would be assessed, which would be a Standards level decision.

A CMAC member asked why the paper described remeasurements of fair value as being caused by changes in estimates of cash flows, interest rates and the amount or price of risk. He thought that this would only apply to value in use, because fair values were amounts that were observable. The IASB staff noted that Level 3 fair values could be determined by estimating the cash flows, discounting those cash flows and making a risk adjustment. Furthermore, even if fair values were observable, changes in fair value could still be disaggregated into those elements.

The CMAC members then discussed the examples of assets and liabilities:

- Inventory (eg raw materials to be used in a manufacturing process, not commodity-broker traders)
  Most CMAC members thought that historical cost would give the most useful information, because the inventory would generate cash flows though use in the production process. Some stated that current value would become more relevant if the inventory were held for a long period, or in times of high inflation. Others stated that volatility arising from using current value simply created noise, and that better information was given by showing the gross margin based on inventory measured at historical cost.
- Building (own use)
  CMAC members expressed different views. Some thought that historical cost gave the most useful information, because the building does not generate its own cash flows. Some thought that it would be useful to disclose the fair value, because the fair value could allow financing to be arranged, whereas others thought that fair value information would not be useful if it were not easy for the entity to move to a new location. It was suggested that if an entity moves often and there is a good supply of buildings, then an office building is similar to a financial asset and should be measured at fair value.
- Investment property
  All CMAC members supported the use of fair value for investment properties, because they can be monetised (ie converted into a stream of cash flows). One CMAC member wanted fair value in the statement of financial position, but historical cost in profit or loss, with other comprehensive income (OCI) being used for the difference.
- Equity securities (no active market)
  Most CMAC members preferred fair value rather than historical cost, because the investment generates its own stream of cash flows. One CMAC member supported value in use, and one supported historical cost. Some of those supporting fair value considered it might be most useful to recognise changes in fair value in OCI, because otherwise the effect of the investment in profit or loss might be disproportionate to its role in the entity's activities ('the tail wagging the dog').
- Performance obligations arising from a contract with a customer
  It was decided not to discuss this example because of the complexity added by the need to consider revenue/profit recognition.
- Interest bearing financial liability (not traded) (eg a corporate bond)
  Most CMAC members supported the use of amortised cost, because they regarded changes in discount rates as creating accounting noise in profit or loss (or OCI). CMAC members generally stated that the effect of changes in own credit risk should not be included in a measure of liabilities, but it was noted that this was an issue that needed more discussion than time allowed.
- Decommissioning liability
  CMAC members supported using value in use. Some supported using current interest rates, whereas others supported using a locked-in discount rate because they did not think that the change in value arising from changes in discount rates was useful information.

The IASB staff concluded by noting that CMAC members' discussions had touched on all the factors identified in the Exposure Draft as needing to be considered when selecting a measurement basis. In particular, the way that the asset or liability contributes to future cash flows had been mentioned very frequently. One CMAC member thought that this factor should be ranked higher than some of the others, for example the characteristics of the asset or liability, noting that this would be different to the approach currently in IFRS 9 on the classification and measurement of financial assets.

Next steps

The staff noted that the deadline for comments on the *Conceptual Framework* Exposure Draft closed on 25 November. The IASB will start its redeliberations early in 2016.

IFRS 9 *Financial Instruments*: Education session on new

Impairment requirements

The IASB staff provided an overview and update on investor education activities that have been done recently on educating investors about IFRS 9: Impairment. This session was an information session; it provided CMAC members with a brief background on the differences that investors are likely to observe regarding impairment when financial institutions transition from the current Standard (IAS 39) to the new standard (IFRS 9).

Next steps

The staff plan to conduct additional investor education sessions on IFRS 9: *Impairment* with the wider investment community, and also plan to discuss this change further with those CMAC that expressed an interest in further discussion.

Disclosure Initiative Project: Materiality Practice Statement

The IASB has published an Exposure Draft of an IFRS Practice Statement: *Application of Materiality to Financial Statements (Draft Practice Statement)* to assist management apply the concept of materiality in preparing general purpose financial statements in accordance with IFRS. The Draft Practice Statement is also expected to help other stakeholders, including investors, understand the approach that management follows when making judgements about materiality.

During the meeting, the staff asked the CMAC members whether they had any comments on the content and form of the Draft Practice Statement and also whether they thought it would help an investor to understand the materiality judgements that management makes.

The main messages from the CMAC members are as follows:

- There was general agreement with bringing the guidance currently scattered throughout IFRS together, which may foster dialogue between entities and their stakeholders in the financial reporting process. There was a discussion over whether the document should more clearly distinguish between the authoritative requirements in IFRS and the additional non-authoritative guidance and examples, for example by including the requirements in IFRS separately in an Appendix.
- The CMAC members discussed whether the guidance should be mandatory and whether a Practice Statement was an appropriate form for the guidance. For example, they considered whether it should be implementation guidance to IAS 1, educational material or an IFRS Standard. Although some were in favour of mandatory guidance because of concerns that it might not otherwise be applied by entities, a majority were happy with the non-mandatory Practice Statement format.
- Some CMAC members noted that it addressed two key concerns of users: the inclusion of an excessive amount of immaterial information and also that material information can be obscured by immaterial information, particularly in narrative disclosures. Some CMAC members noted that disclosure overload is often a result of pressure from auditors and regulators and that guidance could not fully address this.
- Some CMAC members said that they liked the fact that the Draft Practice Statement focussed on the primary users of the financial statements and the decisions they make. However, some noted that it is hard for management to assess what investors and analysts want unless they have a similar background.
- Some CMAC members observed that if the IASB does not produce guidance on materiality, it is likely that local enforcers would need to do so.

Next steps

The deadline for comments on the Draft Practice Statement is 26 February 2016. Further details on submitting your comments can be found **here**. Following the receipt of comments from stakeholders the IASB will decide how best to proceed.

Next CMAC meeting

The next CMAC meeting will be held on February 25, 2016.