STAFF PAPER

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Prepared for the Capital Markets Advisory Committee Meeting

Paper topic	Follow up on issues discussed at the June 2018 Joint CMAC/GPF 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 Joint CMAC/GPF meeting held in June 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 June 2018 Joint CMAC/GPF meeting

Topic	Summary of CMAC views presented	Next steps / action taken by the IASB
Targeted Standards Level Review of Disclosures project	1. The purpose of this session was to seek the views of CMAC and GPF members on which Standard(s) the Board should select for a targeted standards-level review of disclosures. Each breakout group was asked to identify, and list in order of priority, three Standards from a shortlist identified by the staff. 2. Most of the four breakout groups supported reviewing the disclosure requirements of the following Standards: IFRS 3, *Business Combinations;* IAS 19, *Employee Benefits;* and IFRS 2, *Share-based Payments.* ***IFRS 3, Business Combinations*** 3. Three breakout groups supported reviewing the disclosure requirements in IFRS 3 and included it within the top three Standards they selected.	The feedback received from CMAC and GPF members formed part of the staff's analysis presented at the July 2018 Board meeting. At that meeting, the Board decided to test the draft Guidance for the Board by applying it to the disclosure requirements in IAS 19 Employee Benefits and IFRS 13 Fair Value Measurement.

	4. Many CMAC members said that the disclosure requirements in IFRS 3 do not provide them with enough of the information that is necessary for their analysis. In particular, many of those members said that they would like information about the subsequent performance and long-term value generation of the acquired company. CMAC members said this would enable them to better understand both the performance of the acquiring company and the performance of the acquired company before and after acquisition. They added that this information would help with management accountability in respect to acquisitions. A few CMAC members suggested that such types of information could however be provided on a segmental basis. 5. Some GPF members said that the disclosure requirements relating to acquired entities are written in a way that makes it difficult to apply the concept of materiality. One example provided related to sensitivity analysis disclosures about the most ‘significant’ items relative to total goodwill. Furthermore, some GPF members added that the IFRS 3 disclosure requirements are difficult to understand and time consuming to prepare, in particular, after acquired entities have been fully integrated into the acquiring entity.	

	IAS 19, Employee Benefits 6. Three breakout groups supported reviewing the disclosure requirements in IAS 19 and included it within the top three Standards they selected. One group explicitly identified IAS 19 as their first choice. 7. Both CMAC and GPF members said that the disclosure requirements in IAS 19 and information provided in the financial statements about employee benefits are excessive. Many CMAC members added that some of those disclosures are not useful in their analysis, especially when they relate to smaller pension schemes. 8. Furthermore, CMAC members said that the Standard does not require detailed disclosures about information they would find most useful, for example, detailed information about funding requirements and the entity's ability to meet its pension obligations. Many GPF members said that it is very costly to prepare the disclosure requirements in IAS 19 and they questioned the usefulness of some of those disclosures. ***IFRS 2, Share-Based Payments***	

	9. Three breakout groups supported reviewing the disclosure requirements in IFRS 2. One of those groups included it within the top three Standards they selected. However, while it was not in the top three Standards selected by the other two groups, both CMAC and GPF members in those groups nevertheless would support a review of the disclosure requirements in IFRS 2. 10. Some GPF members said that it is very costly to prepare the disclosure requirements and they questioned the usefulness of some of those disclosures. They also highlighted that disclosures in the financial statements about share-based payments are typically very long. 11. Many CMAC members echoed GPF members' remarks that disclosures provided on share-based payments in the financial statements are excessive and added that they do not find some of them useful. Some of these members said that they would like more information about the dilutive nature of share plans that are not yet vested. 12. A few members in one of the breakout groups highlighted similarities between IFRS 2 and IAS 19. They said both Standards have similar disclosure issues and require information that could be obtained through other sources of financial reporting outside the financial statements.	

Consequently, they suggested that the Board should not pick *both* IAS 19 and IFRS 2 for review.

Other Standards

13. Many CMAC members in three of the breakout groups strongly supported a review of IFRS 8; however, they acknowledged that it would be difficult to separate its disclosure issues from the fundamental model in the Standard. Many CMAC members expressed concerns about lack of granular information about segments in the financial statements. Many CMAC members also raised concerns about the allocation of shared assets, costs and other items between segments.

14. One breakout group supported reviewing the disclosure requirements in IAS 12, *Income Taxes* and included it within the top three Standards they selected. CMAC and GPF members from that group said that there are excessive disclosures about income taxes, some of which do not provide useful information. Some CMAC and GPF members from another breakout group also expressed concerns about the disclosures in IAS 12—CMAC members said they would like more granular information about deferred taxes while GPF members said that they find it difficult to provide some of the disclosure requirements, in particular, those relating to reconciliations.

	However, they said that the disclosure issues identified in IAS 12 would be difficult to address without a fundamental reconsideration of the recognition and measurement requirements in the Standard. 15. One breakout group supported reviewing the disclosure requirements in IAS 7, *Statement of Cash flows* and included it within the top three Standards they selected. CMAC members highlighted that companies do not provide sufficient information about cash flows, in particular, restricted cash. Some members from other breakout groups thought that the Board should prioritise other Standards in the shortlist. This was because, in their view, resolving the disclosure issues identified in IAS 7 will require reviewing the broader requirements in the Standard. 16. One breakout group supported reviewing the disclosure requirements in IFRS 13, *Fair Value Measurement*. Some GPF members said that the disclosure requirements are excessive and costly to prepare. A few members from other breakout groups said that, in their view, many of the issues identified about disclosures on fair value could be addressed through better application of materiality.	

Primary Financial Statements — EBITDA and unusual or infrequently occurring items	17. The purpose of this session was to gather feedback from CMAC and GPF members on: (a) the usefulness of earnings before interest, tax, depreciation and amortisation (EBITDA) as a measure for assessing an entity's performance, as well as potential benefits of the Board defining EBITDA; and (b) potential benefits of the Board developing requirements for the disclosure of unusual or infrequent items—in addition to its tentative decisions in the Primary Financial Statements project to date. ***EBITDA*** 18. Many members said that EBITDA is widely used by investors, analysts and lenders. However, members expressed mixed views on the usefulness of EBITDA as a performance measure: (a) some members said EBITDA is a useful starting point for various types of analysis, in particular analysis of creditworthiness, as EBITDA is used as a proxy for operating cash flows. (b) some members said EBITDA had significant shortcomings as a performance measure. Some GPF members said that EBITDA is	The Board will consider the feedback received about EBITDA at a future meeting. The Board considered the feedback received about unusual or infrequent items at its September 2018 meeting (see paragraphs 13–17 of Agenda Paper 21C).

	a poor proxy for operating cash flows and will become a worse proxy as a result of IFRS 15 *Revenue from Contracts with Customers* and IFRS 16 *Leases*. (c) Some members said EBITDA can be misleading today as it is frequently adjusted for items other than interest, tax, depreciation and amortisation. 19. Members expressed mixed views on whether the Board should define EBITDA: (a) some members supported the Board defining EBITDA because: (i) given that the Board has already defined a measure that is similar to EBIT (i.e. profit before financing and income tax), defining EBITDA would be a logical next step and would not require much additional effort. (ii) there is some diversity in how entities currently calculate EBITDA. Some members said an EBITDA measure defined by the Board would be helpful because it would provide a comparable starting point. Some members said that entities should be allowed to make further adjustments to EBITDA as defined by the Board, but such measures would have to be labelled ‘adjusted EBITDA’.	

	(b) other members did not support the Board defining EBITDA because: (i) it would potentially promote the use of EBITDA. They did not support this because they did not consider EBITDA to be a useful performance measure. (ii) it is a low priority issue; defining EBITDA would not be a good use of the Board's limited time and resources. 20. Some members said the Board should allow rather than require EBITDA to be disclosed. Some members also said EBITDA should only be allowed to be disclosed in the notes; it should not be presented in the statement(s) of financial performance. ***Unusual or infrequent items*** 21. Some members supported the Board developing an approach for unusual or infrequent items that is separate from the proposals for management performance measures in the Primary Financial Statements project. 22. Many members said the Board should not attempt to develop a definition of unusual or infrequent items because: (a) it would be difficult to develop a definition that is applicable to all entities, in all industries; and	

(b) some GPF members were concerned about the litigation risks that could arise from disagreements between management and shareholders on what is classified as unusual or infrequent.

23. Some members suggested the Board should instead provide principle-based guidance on what items are expected to be disclosed separately. Some members said entities should be allowed to develop their own definitions for unusual or infrequent items. Some members suggested the Board should require entities to provide meaningful accounting policies describing what items they consider unusual or infrequent.

24. Some members suggested the Board could provide specific guidance on which expenses can be classified as 'restructuring expenses' and how such expenses should be presented.

25. Some members suggested the Board should require unusual or infrequent items to be disclosed in a single location in the notes, which would make it easier for users to find such items.

26. Some members said that there is evidence that some entities already provide good disclosures around unusual and infrequent items today.

Primary Financial Statements — Improving the usefulness of disaggregation in the financial statements	27. The purpose of this session was to seek the views of CMAC and the GPF members on some of the Board's proposals to improve aggregation and disaggregation in the financial statements. The topics discussed were: (a) the disaggregation of functional line items by nature when an entity uses a by-function methodology for an analysis of expenses; (b) the use of quantitative thresholds to disaggregate large 'other' balances; and (c) the potential development of templates for different industries (which would include additional minimum line items). ***Disaggregation of functional line items by nature*** 28. Most CMAC members supported the Board's proposal to require additional information by nature when an entity uses a by-function methodology for an analysis of expenses. A few CMAC members were of the view that there should be disaggregation of expenses by segment. 29. Some CMAC members favoured the Board's preferred approach to present additional information by nature at an entity level. Some other CMAC members supported the approach to provide additional information by nature for specific functional line items such as costs of goods sold, selling,	The Board will consider the feedback received at future meetings and/or during development of the first due process document.

general and administrative (SG&A) or research and developments costs. CMAC members mentioned that natural components such as depreciation, amortisation, research and development costs, employee costs or litigation costs are particularly useful for their analysis.

30. Most GPF members disagreed with the Board's proposal to require additional information by nature, irrespective of how this information is provided, because the accounting systems of many entities are unable to track the original nature of the expenses. This would be the case, for example, in entities using standard costing models or entities capitalising expenses into the cost of an asset (ie inventory). They observed that a requirement to provide additional information by nature would require significant and expensive changes to their accounting systems or arbitrary allocations.

Use of quantitative thresholds

31. Members expressed support for the Board's tentative decision not to require quantitative thresholds to promote the disaggregation of large 'other' balances. In their view, quantitative thresholds should be developed and mandated only by regulators to enforce disaggregation in the financial statements. Members were of the view that the disaggregation of 'other' balances should continue to be based on materiality assessments.

	32. A few CMAC members suggested that the Board requires narrative disclosures to explain the composition of ‘other’ balances. ***Templates (including minimum line items)*** 33. Members did not express support for the development of templates (including minimum line items) because: (a) even companies within the same industry are different; (b) non-mandatory templates could be interpreted as mandatory guidance and could conflict with guidance developed by regulators; (c) peer group standards already exist for some industries; (d) templates may be an impediment to further innovation in presentation or disclosure practices; and (e) audit firms have already developed templates for some industries. 34. A few CMAC members suggested that the Board could consider developing templates for banks and insurance companies, as their presentation practices vary.	

	35. One CMAC member suggested the Board considers defining some of the existing minimum line items, for example to provide a distinction between trade and other payables and financial liabilities.	
Business Combinations under Common Control	36. The purpose of this session was to seek feedback from the CMAC and GPF members about: (a) what type of information about transactions within the scope of the Business Combinations under Common Control project would be most useful for different types of primary users of the receiving entity's financial statements; and (b) whether the benefits of providing that information would outweigh the costs. 37. Most CMAC and GPF members agreed with the staff preliminary view that a current value approach would provide the most useful information for non-controlling shareholders (NCI) of the receiving entity. Some members, mainly users of financial statements, advocated the use of the acquisition method in IFRS 3 *Business Combinations* without modifications. They were concerned that a modified acquisition method would be complex and difficult for users to understand.	The staff will consider the CMAC and GPF members' views as it develops recommendations for the Board.

	38. However, some members emphasised that a current value approach should be applied only if NCI is ‘substantive’. The members did not discuss how to distinguish ‘substantive’ NCI from ‘non-substantive’. Some members, mainly preparers, disagreed with using a current value approach when there is NCI in the receiving entity. Some of those members argued that it would be difficult to distinguish substantive NCI from non-substantive and therefore a predecessor method should be applied in all cases. Some members, mainly preparers, also expressed concerns about costs, complexity and measurement uncertainty involved in applying a current value approach. 39. CMAC and GPF members expressed mixed views about the type of information that would be most useful for lenders and creditors of the receiving entity. (a) Some CMAC and GPF members agreed with the staff preliminary view that the information needs of lenders and creditors of the receiving entity can be met by disclosing current value information without recognising the acquired assets and liabilities at fair value. (b) Some CMAC members argued that the information needs of lenders and creditors are the same as the information needs of	

	NCI and therefore the same information should be provided. A few CMAC members emphasised that disclosing information about current values would not be sufficient. (c) CMAC and GPF members discussed whether the information needs of all lenders and creditors are the same or whether different information is need by different types of lenders and creditors (eg lenders vs trade creditors). Members expressed mixed views. 40. Most CMAC and GPF members agreed with the staff preliminary view that a predecessor method would best meet information needs of the controlling party at a cost justified by the benefits.	
Management Commentary Practice Statement	41. The purpose of this session was to obtain CMAC and GPF members' views on: (a) aspects of the current management commentary reporting practices that could be improved; and (b) guidance that could be provided to support such improvements.	The Management Commentary Consultative Group, whose aim is to advise the Board in developing proposals for updating IFRS Practice Statement 1 *Management Commentary*, held its first meeting on 28 September 2018. The group, which draws members from different stakeholder

	42. Members were asked to select and discuss the aspects of management commentary practice where improvement should be prioritised. They chose to focus on the following topics: (a) business strategy (including business model and risks); (b) medium-term operational performance; and (c) long-term operational performance. 43. Members views regarding business strategy, business model and risks included the following: (a) entities should provide better descriptions of how their business model generates returns by creating value. To provide context for such descriptions, entities should also discuss their competitive environment; (b) entities should provide more focused discussion on the key risks and describe both the risks themselves and as the strategy for mitigating those risks; (c) risks should be discussed separately from opportunities so as not to downplay the risks; and	groups including investors and analysts, discussed: • the approach to revising the Practice Statement, based on the *Conceptual Framework for Financial Reporting;* • the objective of management commentary; • the scope and boundary of management commentary; • the application of materiality to management commentary; and • principles for preparing management commentary, including coherence, balance and comparability. The staff considered the views expressed by CMAC and GPF members when preparing the papers for the consultative group's meeting and will do so for subsequent meetings and in the preparation of papers for the Board.

	(d) entities should provide information that is tailored to their unique circumstances and avoid boilerplate descriptions of generic risks. 44. The views expressed regarding medium-term and long-term operational performance included the following: (a) improvements are needed in the following areas: (i) providing performance information at an appropriate level of aggregation so that information about divergent trends across the business is not obscured; (ii) the reporting of asset-based and investment-based measures (such as Return on Capital Employed, and Return on Investment)measures reported generally need to be more relevant to an understanding of the business's prospects and greater clarity is needed over exactly what the measure represents and how it has been calculated; (b) entities should place more emphasis on disclosing measures that provide insight into entities' progress towards their longer-term goals rather than on providing forecasts; (c) entities should provide a more balanced discussion of both long-term and short-term performance prospects; and	

	(d) there are challenges related to proving information about long-term operational performance, including: (i) identifying an appropriate disclosure horizon – with some members suggesting that measures should reflect the entity's business cycle or investment cycle; (ii) legal constraints and perceived legal constraints; (iii) competitive constraints; and (iv) auditability constraints.	