CRUF
CORPORATE REPORTING USERS' FORUM

27 September 2021

IFRS Foundation
Columbus Building
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Canary Wharf
London E14 4HD

Via email: commentletters@ifrs.org

Dear Sir/Madam,

Re: Request for information - Third agenda consultation

The Corporate Reporting Users' Forum (hereinafter referred to as CRUF) are delighted to respond to the IASB's request for information on the third agenda consultation.

The CRUF was established in December 2005 and we have been holding regular meetings since.

Responses to the questions raised in the consultation that relate to the issues that concern investors are set out below, and are based on input from the global CRUF. As always, we do not seek to reach a consensus within the CRUF but to reflect a broad spectrum of users' views. Our comments are based on our professional experience.

Overall comments

In terms of the main activities of the Board, we support less focus on SME reporting, and more focus on both digital financial reporting and shareholder engagement.

In terms of criteria, we believe that user needs should be paramount. Some participants noted that practical considerations, such as complexity, should not be a barrier to take on longer-term projects.

Finally, in terms of prioritising potential projects, we view the top three priorities as:

- The statement of cash flows and related matters
- Operating segments
- Intangible assets

We view the bottom three priorities as commodity transactions, foreign currencies and inflation.

Outside of the specific questions raised in the consultation, the CRUF would like to highlight what we think should be the three overarching themes for the Board that should underpin any of the projects over the next five years: ISSB connectivity, FASB co-ordination and non-GAAP metrics.

Regarding ISSB connectivity, the IASB needs to work effectively with the soon to be established ISSB to ensure that climate-related risks and opportunities are neither omitted nor double counted. Consequently, it is desirable that the ISSB have not only knowledge and experience of sustainability, but also a deep understanding of financial accounting, financial analysis and the capital markets. CRUF participants are mindful that connectivity with the ISSB should not reduce the resources spent on the development of long-term accounting standard setting and the communication of these accounting standards.

Regarding FASB co-ordination, global investors value international comparability: ideally, similar transactions and activities should be reported in the same way either under both US GAAP and IFRS. We encourage the IASB to collaborate with the FASB, and to co-ordinate their priority projects, as far as possible.

Regarding non-GAAP metrics, the IASB should be aware that sometimes they capture the underlying economics better than the GAAP based metrics. For example, it is common practice to add back some or all of the amortisation on acquired intangibles to get a better measure of the performance of the business. However, as non-GAAP metrics reflect management's perspective they are subject to bias and are not consistently defined between companies. We welcome the proposals in the Primary Financial Statements project which will require alternative performance metrics (APMs) in the statement of profit or loss to be reconciled to the nearest GAAP metric, as a note in the audited financial statements. Non-GAAP metrics are a particularly sensitive governance topic as management bonuses are often based on these metrics.

CRUF's responses to the consultation questions of most relevance

Question 1: The Board's main activities include:

- **developing new IFRS Standards and major amendments to IFRS Standards;**
- **maintaining IFRS Standards and supporting their consistent application;**
- **developing and maintaining the IFRS for SMEs Standard;**
- **supporting digital financial reporting by developing and maintaining the IFRS Taxonomy;**
- **improving the understandability and accessibility of the Standards; and**
- **engaging with stakeholders.**

Paragraphs 14–18 and Table 1 provide an overview of the Board's main activities and the current level of focus for each activity. We would like your feedback on the overall balance of our main activities.

a) **Should the Board increase, leave unchanged or decrease its current level of focus for each main activity? Why or why not? You can also specify the types of work within each main activity that the Board should increase or decrease, including your reasons for such changes.**
b) **Should the Board undertake any other activities within the current scope of its work?**

Overall, most CRUF participants broadly support the current level of focus. However, we would prefer less focus on IFRS for SMEs and more focus on digital financial reporting and shareholder engagement.

On IFRS for SMEs, one participant noted that many jurisdictions have national standard setters that already have well-developed financial reporting frameworks for non-listed entities. Another participant noted that IFRS are principle-based and the difference between SME and large companies is largely an application issue.

On digital financial reporting, several participants noted its increasing importance, as users increasingly consume and process accounting information electronically, often via data aggregators, rather than reading the printed annual report. The numbers in the main financial statements are already tagged by aggregators, along with some of the notes, but not all. The numbers in the footnotes are often not tagged at all. One participant noted their concern that the data aggregators are effectively setting the *de facto* accounting standards, rather than the IFRS.

On shareholder engagement, one participant noted the increasing quantity and complexity of the accounting standards and exposure drafts, etc. At the same time cost pressures have led to a contraction of the sell-side and a trend for buy-side analysts to increase their coverage. As a result, it has become increasingly difficult and onerous for the general financial statement users other than accounting professionals to understand them accurately in a systematic manner. One participant noted that any attempts to broaden user outreach would be helpful. The introduction of an online survey for this consultation was a very positive step as it makes it as easy as possible to communicate with the IASB. Another participant noted that the same users are often contacted via different organisations. Therefore, it would be more efficient for outreach to be better coordinated, for example between IASB, EFRAG and the UKEB.

Question 2: Paragraph 21 discusses the criteria the Board proposes to continue using when assessing the priority of financial reporting issues that could be added to its work plan.

a) Do you think the Board has identified the right criteria to use? Why or why not?
b) Should the Board consider any other criteria? If so, what additional criteria should be considered and why?

The CRUF broadly agrees with the criteria identified by the Board. The importance of the matter to investors needs to remain paramount. This criterion can alternatively be expressed as any aspect of financial reporting which is in some way deficient in the sense that it impedes the ability of investors to make a well-informed investment decision.

One participant is concerned that two criteria - complexity and feasibility, and capacity – are potential barriers to taking on large, long-scale standards development projects. They understand that large projects do not bear fruit immediately, and involve a lot of time and effort, however, standard development needs to adopt a long-term view. Accordingly, they think the IASB should position the two above criteria as supplementary criteria and ensure that they do not hinder the willingness to take on large projects.

Another participant noted the importance of comparability to financial statement users: if two companies enter transactions with the same economic substance then they should be accounted for in the same way. Perhaps this point on comparability could be more explicitly linked to the second criteria, namely "Whether there is any deficiency in the way companies report the type of transaction or activity in financial reports."

Question 3: Paragraphs 24–28 provide an overview of financial reporting issues that could be added to the Board's work plan.

a) **What priority would you give each of the potential projects described in Appendix B—high, medium or low—considering the Board's capacity to add financial reporting issues to its work plan for 2022 to 2026 (see paragraphs 27–28)? If you have no opinion, please say so. Please provide information that explains your prioritisation and whether your prioritisation refers to all or only some aspects of the potential projects. The Board is particularly interested in explanations for potential projects that you rate a high or low priority.**

b) **Should the Board add any financial reporting issues not described in Appendix B to its work plan for 2022 to 2026? You can suggest as many issues as you consider necessary taking into consideration the Board's capacity to add financial reporting issues to its work plan for 2022 to 2026 (see paragraphs 27–28). To help the Board analyse the feedback, when possible, please explain:**
    i. **the nature of the issue; and**
    ii. **why you think the issue is important.**

According to a poll of CRUF participants, the top three priorities are:

- The statement of cash flows and related matters
- Operating segments
- Intangible assets

The bottom three priorities are commodity transactions, foreign currencies, and inflation.

We have commented on all the projects below to reflect the diversity of views in the global CRUF.

We discuss our top three projects first:

Statement of cash flows and related matters (project number 21)

Please see CRUF's Quick Wins for why we think the statement of cash flows is so important. The key objective of an investor is to value the enterprise value of the business which often entails forecasting cash flows. Most analysts forecast cash flows by forecasting the income statement because the statement of cash flows cannot be tied back to the other financial statements. Ideally there should be sufficient disclosure in the notes to the statement of financial position and statement of profit or loss to allow users to fully derive the statement of cash flows. All the information is on the general ledger, so this should be possible from the preparer perspective.

Several participants noted that cash flow statement has been neglected in revisions to the primary financial statements. This is despite its importance to investors; the inconsistencies between reporting practices around the world; knock-on changes from the new leasing standard; and the frequent use of cash flow measures such as free cash flow in financial analysis.

Another participant noted that it does not require a standard setter to deduct cash from gross debt. They agree that there is great merit in a conceptually sound definition of and presentation of gross debt in the balance sheet.

One participant strongly disagrees that cash flow statements of financial institutions could be abolished. Cash flow statements of financial institutions may not be as useful as they could be, but they do contain essential information on dividends, various forms of capital issued/repaid, and amounts spent/received on acquisitions/disposals.

Operating segments (project number 17)

Please see CRUF's Quick Wins for why we think the statement of segmental reporting is so important. Segmental reporting is particularly important when trying to understand a business comprising divisions with very different operational and financial characteristics. Users often need a much more granular and complete picture of the segments to allow them to, ideally, calculate the return on capital and assess the risks. Users understand that a full statement of profit of loss is difficult to do, because there are common costs such as corporate overheads and taxation which are hard to allocate. However, this difficulty should not be insurmountable as management themselves presumably need to do this exercise to rationally allocate capital.

One participant noted that convergence with US GAAP has resulted in a major loss of usefulness with respect to segmental reporting, which was not remedied by the Post Implementation Review of IFRS 8 *Operating Segments*. They continue to oppose the 'Chief Operating Decision Maker' perspective as they believe reporting should primarily be based on what segments are relevant for investors instead; the former risk and return provided much more granularity and, importantly, consistency over the years. The telecoms industry is a vivid example where analysts want to see a fixed versus mobile segmentation and where nearly the entire industry since the introduction of IFRS 8 started to provide a geographic, mixed, or consumer versus business segmentation. CRUF participants agree that setting requirements that safeguard more granularity in segment definition would improve IFRS 8. Also, they note that most of the new subtotals resulting from the Primary Financial Statement project should become mandatory line items in IFRS 8.

Intangible assets (project number 14)

The CRUF recognises that intangibles have become more important over time as the trend has been for businesses to become less capital intensive.

In general, the CRUF strongly opposes loosening the recognition criteria for allowing the recognition of internally generated intangibles, such as such as brands, efficient business processes and 'big data'. The recognition of more intangibles would lead to even higher amortisation charges in the years following an acquisition, which would further distort the picture of how well the combined entity is performing.

One participant thinks that there is excess focus on the recognition and measurement of intangibles on the balance sheet. The goal of investors is to value the enterprise, and then allocate this value to the debt and equity instruments they are able to purchase. Users are not interested in valuing individual assets, because in most cases they are not able to buy these individual assets.

Several participants believe the topic of intangibles is best addressed through mandating much more expense disaggregation in the statement of profit or loss. In the past selling, general and administrative expenses (SG&A) was a small, fixed cost, unrelated to growth. Nowadays for many businesses, especially those with a digital presence, SG&A is a large, variable cost, closely tied to growth. Users want to know how much is being spent on the growth-related parts of SG&A such as marketing and promotional spend, information technology and training. If these were required line items (if material) then users would have a much better picture of the cost structure of the business and would be able to capitalise some, or all, of these expenses to come up with their own definition of invested capital.

Another participant expressed a similar opinion noting that intangibles are not matters for accounting, they are for investors to value - their only value comes from the cash flows generated. They think that any number in the accounts deriving this value would be circular and would hide more than it revealed.

Several participants noted that there is no current requirement to disclose internally generated and acquired intangibles separately, although many companies chose to do so. In cases when intangibles are not clearly disaggregated is not clear from the names of the intangible assets whether they are internally generated or acquired.

Another participant highlighted the inconsistencies between internally generated and acquired assets and the overlap with IFRS 3 *Business Combinations*. For example, existing inventory is recognised at cost, versus acquired inventory which is recognised at fair value. These distortions are inherently difficult to analyse and do not serve investors. This participant proposes that a target is consolidated using predecessor accounting, on the basis that the predecessor had always applied IFRS in the way the acquirer does.

One participant noted that the IASB should consider introducing the concept of intangible assets held for trading purposes to provide more useful information about intangible assets such as cryptocurrency and carbon credit.

One participant noted that certain assets currently classified as 'intangible assets', such as cryptocurrencies and pollutant pricing mechanisms ('PPMs'), may be better addressed within the scope of another standard.

Another participant noted the importance of connecting intangible assets (and liabilities) to climate-related risks and the new sustainability reporting standards.

Next, we discuss our lowest three priority projects. The common theme was that CRUF participants did not think that these issues were widespread enough across the capital markets.

Commodity transactions (project number 3)

The CRUF believes that compared to other projects, the impact of this project appears to be relatively limited, as it would appear to only affect a limited number of companies.

Foreign exchange (project number 9)

The CRUF appreciates that such a project could result in valid improvements and improved consistency, but we are not sure how significant the impact of such a project would be on the market overall.

Inflation (project number 13)

The CRUF notes that very few jurisdictions qualify for hyperinflation accounting and therefore this topic is only relevant for a limited number of companies. One participant noted that the resulting hyperinflation accounting is quite complex to interpret for investors.

Finally, we discuss the remaining projects and comments from individual CRUF participants. The order is based purely on the project number assigned in the agenda consultation rather than by our view of importance.

Borrowing costs (project number 1)

One participant noted that a sound definition of borrowing costs needs to be considered together with the definition of gross debt, which is one of the key IFRS defined subtotals that is still missing. This participant noted that a conceptually sound distinction between 'capital' (equity and gross debt combined), and other liabilities is of great importance for estimating the value of the equity instruments of a reporting entity.

Climate-related risks (project number 2)

The CRUF fully subscribes to the importance of climate-related disclosures, however careful consideration needs to be made about which disclosures should be dealt with by the soon to be established ISSB and which should be addressed by the IASB. Only existing deficiencies in the current disclosures -for example the extent to which climate-related risks result in impairments - should be prioritised by the IASB.

One participant noted that once assets are impaired, either for climate reasons or other reasons, a revaluation of them generally is not allowed if over time their future turns out to be better than anticipated. In this case investors lose valuable information.

Cryptocurrencies (project number 4)

The CRUF recognises that cryptocurrencies are an important emerging area and there should be clear and consistent accounting. Several individual participants viewed this as a high priority area, although some participants think this could be integrated into the wider projects on intangibles or financial assets.

One participant noted that given the high potential risks associated with this asset class, the Board should consider what threshold of meaningful exposure to cryptocurrencies should result in disclosures by the reporting entity, for example a 'more than insignificant' threshold. Although cryptocurrencies currently are not yet widely held by listed entities, this might change substantially over the next few years. Apart from financial risk there is also a significant sustainability dimension to cryptocurrencies as 'crypto-mining' requires material energy consumption.

One participant thinks that cryptocurrencies should always be accounted for at fair value through the profit and loss. They think that recognising cryptocurrencies as an intangible asset is problematic as most intangible assets are traditionally not measured at fair value through the profit and loss. Furthermore, there often is no liquid/active market with near continuous price discovery in the assets currently classified as intangible assets, whereas there is for cryptocurrencies. This participant therefore opposes classifying cryptocurrencies as intangible assets. This participant would support the recognition of cryptocurrencies under IFRS 9 as a financial instrument. However, if the IFRS 9 route turns out to be rather complex and may take several years to effectuate, there may be merit in a parallel pragmatic, fast-track solution that forces fair value accounting through profit and loss and a requirement to present the fair value of any cryptocurrency exposure (gross long and gross short), either outright or through traditional derivatives, separately in the financial statements. It should be clear from the Standards that cryptocurrencies in principle do not qualify as cash and cash equivalents; with a potential exception for future central bank issued cryptocurrencies.

Another participant does not believe that there is a need for a separate standard on cryptocurrencies, rather it is a type of financial asset, acting as a store of value.

If cryptocurrencies were adopted as a unit of account and accounting currency, then there would be a need to consider the implications for financial reporting.

Discontinued operations and disposal groups (project number 5)

Although not a top three priority, the CRUF poll rated this as a high priority project. This is closely related to our Quick Win on M&A.

One participant observes that the controversy around how to account for IFRS 5 is affecting many financial statements. They agree that a single line-item may not provide useful information for investors. Unfortunately, we fear that the Board may be restricted in fundamentally improving a standard if the process is following the due process of a Post Implementation Review. Most notably the Post Implementation Review of IFRS 8 *Operating Segments* laid bare many shortcomings in the standard, but somehow did not result in effectively addressing them.

Discount rates (project number 6)

One participant noted discount rates are an important area for better disclosure. Users need transparency from companies on the discount rates they use so that they can make their own assessment of their reasonableness, and potentially recalculate assets and liabilities on the balance sheet in their own models.

Another participant noted the sensitivity of the choice of discount rates when calculating liabilities for insurance companies and decommissioning provisions for oil companies.

Employee benefits (project number 7)

The CRUF noted that companies typically offer defined contribution schemes rather than defined benefits or hybrid plans, therefore the importance of defined benefit schemes will diminish over time.

One participant noted that there is room for improvement in pension accounting. However, they are wary of the tremendous complexity of and variety in the different pension plans around the globe. To develop a standard that addresses all the highlighted complexities could take an excessive amount of resources. They are not in favour of yet another individual standard-specific approach for a (long term) discount rate for liabilities. Instead, they suggest rolling pension accounting into a potential discount rate project which harmonises the principles for choosing a discount rate throughout the IFRS framework.

Expenses – inventory and cost of sales (project number 8)

The CRUF notes that for capital markets overall, inventory and the cost of sales has diminished in importance over time, as many companies use just-in-time manufacturing and there are many more service companies. As a result, we are not sure how significant the impact of such a project would be on the market overall.

One participant noted that the focus on expenses should be on the disaggregation of SG&A rather than cost of goods sold (COGS) as this is key to addressing the problem of accounting for intangibles.

Another participant observed that during the current pandemic supply chains have been disrupted and therefore inventory may become more of a focus in the future.

Going concern (project number 10)

The CRUF notes that in practice very few listed entities that fail are liquidated. In most cases a company is reorganised or parts of its operations are sold while still a going concern. As a result, liquidation accounting is not helpful for investors in assessing the value of a company that is being reorganised. One participant is not in favour of lowering the thresholds for applying liquidation accounting.

The CRUF would support improved disclosures about the going concern assumption, and a company's ability to refinance debt over the next 12 months would be more helpful for investors, especially since this information would then become subject to the rigour of audit. We therefore would welcome enhanced specific disclosure requirements about the going concern assumption.

Government grants (project number 11)

The CRUF notes that accounting for government grants has become an increasingly important topic for many companies during the Covid pandemic. Grants are often material for investors. IFRS currently allows for a number of accounting options that make it very difficult for investors to assess (and compare with peers) how the reporting entity would have fared without the government grants. We would applaud the reduction of options to reduce the diversity in practice.

Income taxes (project number 12)

The CRUF agrees that there is significant room for improvement in accounting for income taxes. One participant thinks that a comprehensive review of income tax accounting could absorb too much of the scarce resources of the IASB, however, they would support improving disclosure objectives and requirements, and possibly a few targeted improvements in measurement.

Another participant notes that current disclosure is very limited for such an important part of the financial statements and valuation. It would be helpful to require a note analysing the cash tax paid to allow users to understand which periods the cash payment relates to and reconciling the cash tax to the tax expense, providing clear reasons for the differences. Country-by-country disclosure of tax paid would also be very helpful to understand the risks associated with the tax strategy.

Interim financial reporting (project number 15)

The CRUF agrees that there is room for improvement in the requirements for interim financial reporting. We support targeted improvements that (a) 'develop enhanced disclosure requirements to provide an update on the latest complete set of annual financial statements (likely to be a small project)' and (b) 'clarify what transition disclosures are required in interim financial statements in the first year of applying a new Standard or major amendment (likely to be a small project)'.

Negative interest rates (project number 16)

Investors often model projections for interest expense for future years. The standard approach is to link interest expense to the levels of financial debt and the interest income to the levels of cash. It is hard to imagine an alternative manner that is as useful for investors. Investors calculate historic interest rates by dividing selected elements of financial debt and equivalents by selected elements of interest expense and selected elements cash and cash equivalents by selected elements of interest income. One participant noted that the return on assets, whether positive or negative, should be disclosed separately from the return on liabilities, whether positive or negative.

Other comprehensive income (project number 18)

The CRUF would encourage the Board to articulate a clear rationale for the statement of other comprehensive income.

One participant would not be in favour of changes in the fair value of financial liabilities attributable to a company's own credit risk; nor recycling of gains and losses from investments in equity instruments designated at fair value; nor the recycling of actuarial gains and losses arising from defined benefit plans going through other comprehensive income. However, they are comfortable with the IFRS 9 requirement of recycling gains and losses on financial assets measured at fair value through other comprehensive income.

Another participant suggests that "other comprehensive income" be discussed in conjunction with the definition of operating profit/loss in the statement of profit and loss. The exclusion of gains or losses on the sale of shares from operating profit or loss would seem to mitigate the argument for accounting treatment that does not allow for recycling, with the aim of eliminating manipulation of profit or loss. They believe that all non-recycling treatment of other comprehensive income should be abolished. All gains and losses arising from non-capital transactions should be reflected in net income.

Pollutant pricing mechanisms (project number 19)

The CRUF rates this an important area, however, is not a top three priority in our opinion due to the overlap with climate change and the activities or the soon to be established ISSB. The CRUF observes that there is already a significant number of listed entities are involved in PPMs. There is every reason to expect that PPMs will apply to more jurisdictions and across more industries. The value of PPM rights are likely to remain very significant for investors. A conceptually sound approach to accounting for income, expenses, assets and liabilities resulting from PPMs, but also disclosures on how many rights were granted and what the net excess or shortfall in any year has been is of great importance to investors.

Separate financial statements (project number 19)

The CRUF agrees that investors are interested to learn how high the distributable reserves are and what dividends are permissible. However, nearly all effort that goes into financial analysis of reporting entities by investors is not focussed on separate financial statements, but on consolidated financial statements. Instead of launching a project that addresses separate financial statements, we would prefer a disclosure solution as this is much more practical and would take fewer resources from the IASB. The Board could simply require companies to disclose in the notes to the consolidated financial statements the permissible distribution of dividends. A valid distinction needs to be made between permissible dividends resulting from company law and permissible dividends resulting from all limitations, including limitations agreed in covenants with banks and in indentures.

Variable and contingent consideration (project number 22)

The CRUF questions the significance of the impact of such a project. Generally, if companies engage in service contracts that span beyond the reporting period, they do so in higher volumes, and these are well distributed over time.

However, variable and contingent consideration are important for many acquisitions. The current application results often in counterintuitive accounting: if an acquisition fares better than expected, this will cause the reporting entity to report a loss because of a higher than expected variable contingent consideration that needs to be paid to the former owners. This accounting treatment may be a disincentive for acquirers to agree contracts that share the risks of an acquisition with the selling party. One participant would support an approach where the variable and contingent consideration paid is added to the goodwill in the subsequent year if it exceeds expectations, and subtracted if it falls short of expectations.

Question 4: Do you have any other comments on the Board's activities and work plan? Appendix A provides a summary of the Board's current work plan.

The Board has very few members with a background as a user of accounts as either an investor or financial analyst. One participant believes that the IASB needs to listen to the practical problems that arise as corporate behaviour changes and respond more urgently. For instance, the response to concern about accounting for and presentation of reverse factoring did not satisfy many of those who had raised the issue.

About the Corporate Reporting Users' Forum (CRUF)

The CRUF was set up in 2005 by users of financial reports to be an open forum for learning about and responding to the many accounting and regulatory changes that affect corporate reporting. In particular, participants are keen to have a fuller input into the deliberations of accounting and auditing standard setters and regulators. CRUF participants include buy and sell-side analysts, credit ratings analysts, fund managers, investors and corporate governance and ESG professionals. Participants focus on equity and fixed income markets. The Forum includes individuals with global or regional responsibilities and from around the world, including Australia, Canada, France, Germany, Hong Kong, India, Japan, New Zealand, South Africa, UK and USA.

The CRUF is a discussion forum. Different individuals take leadership in discussions on different topics and in the initial drafting of representations. In our meetings around the world, we seek to explore and understand the differences in opinions of participants. The CRUF does not seek to achieve consensus views, but instead we focus on why reasonable participants can have different positions. Furthermore, it would not be correct to assume that those individuals who do not participate in a given initiative either agree or disagree with that initiative. This response is a summary of the range of opinions discussed at the CRUF meeting(s) and provided by participants in drafting the response. Local country differences of opinion are noted where applicable.

Participants take part in CRUF discussions and joint representations as individuals, not as representatives of their employer organisations. Accordingly, we sign this letter in our individual capacity as participants of the Corporate Reporting Users' Forum and not as representatives of our respective organisations. The participants in the Forum that have specifically endorsed this response are listed below.

Signatures

Greg Collett CFA
Pictet Asset Management

Peter Parry
ShareSoc

Jane Fuller FSIP

Sue Milton
SSM Governance Associates

Lothar Weniger
AnnieLake Int. Advisers GmbH

Charles Henderson
UK Shareholders' Association

Jeremy Stuber

Kevin Harding

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