USER OUTREACH EVENT
SUMMARY REPORT
MILAN 18 SEPTEMBER 2017

EFRAG
European Financial Reporting Advisory Group

IFRS | aiaf Associazione Italiana degli Analisti e Consulenti Finanziari | OIC Organismo Italiano di Contabilità | EFFAS THE EUROPEAN FEDERATION OF FINANCIAL ANALYSTS SOCIETIES

This report has been prepared for the convenience of European constituents by the EFRAG Secretariat and has not been subject to review or discussion by neither the EFRAG Board nor the EFRAG Technical Expert Group. It has been reviewed by the speakers at the event and has been jointly approved for publication by representatives of EFRAG, IASB, AIAF, EFFAS and OIC who attended the outreach event.

Introduction

EFRAG together with the International Accounting Standards Board (IASB), the European Federation of Financial Analysts Societies (EFFAS), the Associazione Italiana degli Analisti e Consulenti Finanziari (AIAF) and the Organismo Italiano di Contabilità (OIC) organised an investor outreach event in Milan, Italy on 18 September 2017.

This report has been prepared for the convenience of European constituents. The purpose of the outreach event was to:

- stimulate the debate in Europe;
- understand users' needs, in particular from those that did not intend to submit a comment letter to EFRAG or the IASB, and their main concerns;
- learn to what extent the preliminary comments as set out in EFRAG's draft comment letter on the Principles of Disclosure are shared by Italian users;
- receive input from users of financial statements for EFRAG and OIC comments to the IASB on its Goodwill and Impairment project; and
- identify issues relevant to EFRAG's forthcoming draft endorsement advice on IFRS 17 *Insurance Contracts.*

Alberto Borgia (AIAF Chairman) opened the outreach event and welcomed the speakers and participants. The outreach event covered:

Better Communication: what do Analysts and Investors need?

Fred Nieto (Head of Investor Engagement IASB) and Arjuna Dangalla (Assistant Technical Manager IASB) provided an overview of the IASB Discussion Paper *Disclosure Initiative - Principles of Disclosure* (DP) and Saskia Slomp (EFRAG Director Governance &Admin) summarised EFRAG's tentative views on the IASB's DP. This was followed by an open debate with participants led by Tommaso Fabi (Technical Director OIC).

Can Goodwill be improved?

Filipe Alves (EFRAG Advanced Technical Manager) introduced EFRAG Discussion Paper *Goodwill Impairment Test: Can it be improved?* and Fred Nieto provided a summary of the IASB's current thinking on goodwill and the impairment test. This was followed by an open debate with participants led by Alberto Giussani (member of the OIC Executive Board).

What you need to know about the new IFRS 17

Fred Nieto provided an overview of the IASB's new standard IFRS 17 *Insurance Contracts* and Patricia McBride (EFRAG Technical Director) introduced the endorsement process. This was followed by an open debate with participants led by Sabrina Pucci (Chairman of the OIC Insurance Working Group and member of the EFRAG Insurance Accounting Working Group).

The presentation slides and key elements mentioned in the presentation can be found on EFRAG's Website (here).

Summary of observations on IASB DP *Disclosure Initiative - Principles of Disclosure*

Panel members and participants expressed the following views:

- the content of the statement of financial performance varies in practice and entities often provide generic disclosures. Thus, the IASB's initiative on *Better Communication* is key to improve relevance and comparability of financial statements.
- the IASB could develop non-authoritative guidance in the form of implementation guidance with illustrative examples that reflect the principles of effective communication.
- changes in the accounting policies or standards are key for users and this information is often obscured by boilerplate disclosures.
- cross-referencing, if not carefully considered, may lead to fragmented information.
- there is room to improve IFRS requirements on the use of APMs within the financial statements. For example, the IASB could require more disaggregation on the face of the financial statements, include guidelines on the use of well-known APMs such as EBIT or EBITDA and extend the principles in the ESMA Guidelines on APMs to financial statements.
- information about non-recurring and one-off events is important to forecast sustainable future cash flows but there is currently lack of transparency and definition of such items.
- materiality is an entity-specific concept that changes over time and guidance is needed to help entities to make materiality judgements.

Summary of observations on *Goodwill*

Panel members and participants expressed the following views:

- goodwill is useful, particularly for stewardship purposes so that management can be formally held to account for the investments made.
- goodwill impairment is key for investors however it typically comes "too little and too late".
- instead of focusing on simplification of the impairment test, the IASB could consider providing "anchors" to preparers to reduce the subjectivity of the impairment test (e.g. more use of market inputs).
- welcomed EFRAG's effort to promote debate around the goodwill impairment test but questioned the goodwill accretion approach from a conceptual and cost-benefit perspective.
- users need entity-specific information about a CGU and a clearer link between the CGUs and the lines of business in the segment report.
- IASB should have a broader discussion on the subsequent accounting for goodwill, including the relative merits of an amortisation and impairment approach. Most panel

members believed that goodwill arising on acquisition should be recognised as an asset and amortised over its useful life.

Summary of observations on IFRS 17 *Insurance Contracts*

Panel members and participants expressed the following views:

- IFRS 17 is a new comprehensive approach to account for insurance contracts that is expected to improve comparability. However, investors are concerned about the potential loss of historical information resulting from changes in the requirements. Thus, the transition process from IFRS 4 to IFRS 17 is key.
- investors need a high level of disaggregation and granularity of the information provided on the different lines of businesses.
- some of the key indicators that analysts use are Combined Ratio, Loss Ratio and Duration. This information is not only important for the company as a whole but also for the different lines of businesses.

Discussion on the IASB DP *Disclosure Initiative - Principles of Disclosure*

Key elements of the IASB DP

Fred Nieto and Arjuna Dangalla introduced the key elements of the IASB's DP issued in March 2017.

Fred Nieto explained that the IASB was looking for public feedback on disclosure issues that arise in practice and on the IASB's preliminary proposals to address those issues. Arjuna Dangalla provided an overview of the IASB's *Disclosure Initiative* and related projects. He also explained that the ultimate goal was to improve the disclosures requirements either through amendments to IAS 1 *Presentation of Financial Statements* or development of a new general disclosure Standard.

EFRAG's preliminary views on the IASB DP

Saskia Slomp summarised the history of the disclosure problem, explained some of the European past initiatives and provided EFRAG's preliminary views on the IASB DP.

She explained that, in its draft comment letter, EFRAG had supported the objectives of the IASB DP and *Disclosure Initiative* project but considered that the primary focus for the next phases should be a comprehensive review aimed at developing a coherent package of disclosure requirements and removing requirements that are considered redundant.

Can principles make communication more effective?

Tommaso Fabi welcomed the panel members and opened the round table panel for discussion. The panel members welcomed the IASB's efforts for developing principles of effective communication to help entities to communicate, in their financial statements, financial information more effectively. In particular, panel members welcomed the IASB's effort to provide additional guidelines on presentation and disclosures aimed at improving transparency and comparability.

> The IASB could develop non-authoritative guidance in the form of implementation guidance with illustrative examples that reflect the principles of effective communication.

One panel member considered that the IASB could develop non-authoritative guidance in the form of implementation guidance with illustrative examples that reflect the principles of effective communication. This panel member also suggested that the principles of effective communication should be extended to all forms of financial communication made outside the financial statements (e.g. management report).

Panellists also highlighted that entities often had to make a trade-off between relevance and comparability as entity-specific information was relevant for users but at the same time it reduced comparability. In such cases, professional judgement was key.

Finally, one panel member was of the view that the principles of effective communication should be mandatory and based on a "golden rule". The Golden Rule to make a clear, true and fair financial statements is: *"management should provide all the information about its assets, liabilities, equity, income, expenses and cash flows that it would like to receive had their position reversed"* (to users of financial statements).

What do investors think are useful examples of disclosures in the financial statements?

> The content of the statement of financial performance varies in practice and entities often provide generic disclosures. Thus, the IASB initiative on *Better Communication* is key to improve relevance and comparability of financial statements.

The panel members discussed a number of presentation and disclosure examples of entities reporting their performance. One panel member emphasised that the structure and content of the financial statements varied in practice, even within the same industry. There were also cases where entities only included a few line items in the income statement. Thus, IASB's research project on primary financial statements was key to improve relevance and comparability.

Panel members also expressed concerns about the fact that entities often provide boiler-plate disclosures that simply summarise the IFRS requirements without any entity-specific considerations. These panel members explained that this was related to the fact that management was often concerned about compliance when preparing financial statements. Thus, the IASB's project on principles of disclosure was key to improve the relevance of the information provided in the financial statements.

One panel member added that Alternative Performance Measures (APMs) were often inconsistent or in conflict with IFRS numbers. Finally, this panel member considered that performance indicators such as EBIT, EBITDA, EBIT Adjusted and EBITDA Adjusted used in operating segments could also be presented in primary financial statements to improve consistency of financial statements.

Does it make a difference presenting information separately in the primary financial statements rather than presenting it aggregated with other information in the primary financial statements and disclosing it solely in the notes?

Changes in the accounting policies or standards are key for users and this information is often obscured by boiler plate disclosures.

The panel members highlighted the importance of considering the primary financial statements and the notes together. In their view, the primary financial statements should provide relevant information to users to make economic decisions that is further explained in the notes. They also noted a decline on the usefulness of financial statements as most investors' decisions were primarily based on earnings release and management presentations. One panel member suggested that a complete set of financial statements and notes should be made available to users at the time of the results announcement (and not at a later stage), to better ensure that the information is effectively used.

When referring to accounting policy disclosures, panel members pointed out that changes in the accounting policies or standards were key for users and that this information was often obscured by boiler plate disclosures on accounting policy.

Finally, one panel member asked the IASB to better explain the role of disclosures in the conceptual framework and to further explore the notion of "integrated reporting".

What is the impact of cross-referencing IFRS information outside the financial statements for investors?

Cross-referencing, if not carefully considered, may lead to fragmented

The panel members cautioned about having information necessary to comply with IFRS Standards being placed outside the financial statements or annual report. They were concerned about not having all the relevant information in a single place and information.

There is room to improve IFRS requirements on the use of APMs within the financial statements. For example, the principles in the ESMA Guidelines on APMs could be extended to financial statements prepared under IFRS to increase transparency.

ending up having fragmented information. In addition, this could raise difficulties in understanding what has been audited. Nonetheless, one panel member considered that information necessary to comply with IFRS Standards could be provided outside the financial statements but within the Annual Report. She also agreed with the proposed amendments to IFRS 8 *Operating Segments* which proposed including a description of an entity's annual reporting package.

Should 'non-IFRS information' be permitted within the financial statements? Alternative (non-IFRS) performance measures in the financial statements: misleading or useful?

Although panel members acknowledged that APMs were widely used by preparers, they provided different views on their usefulness; APMs were either useful, sometimes useful or not useful at all.

One panel member considered that APMs were useful even when included in the financial statements as they provided entity-specific information about its business (e.g. EBIT and EBITDA). Other panel members explained that APMs were sometimes useful but tended to provide a more optimistic picture of the business than IFRS numbers.

All panel members considered that there was room to improve IFRS Standards. Suggestions included:

- requiring additional disaggregation and subtotals on the face of the financial statements;
- including some guidelines on the use of well-known APMs such as EBIT or EBITDA to improve comparability; and
- extending the ESMA Guidelines on APMs to those presented within the financial statements to increase transparency on their use.

These panel members also expressed preference for having expenses recognised in profit or loss presented by nature.

Finally, one panel member considered that all non-GAAP information should be presented outside the financial statements, in the management report. He would also welcome more standardisation of the financial statements to ensure comparability.

Should unusual and infrequent items be separately presented and if so how?

Information about non-recurring and one-off events is important for users to forecast sustainable future cash flows but there is currently lack of transparency and definition of such items.

Panel members explained that users of financial statements are often interested in having information about non-recurring and one-off events to forecast sustainable future cash flows. However, they also considered that there was lack of transparency and definition of such items in the financial statements (e.g. abusive use of restructuring costs).

These panel members provided different suggestions on how to improve IFRS Standards such as:

- improving disclosures on why certain items are considered non-recurring;
- developing guidelines on their use and illustrative examples by industry; and
- reviewing the requirements in IAS 1 on “extraordinary items”.

One panel member added that the role of auditors was crucial in confirming this information.

How important is the application of materiality when deciding what and how to disclose information?

Materiality is an entity-specific concept that changes over time and guidance is needed to help entities to make materiality judgements.

Panel members highlighted that immaterial information could obscure relevant information provided in the financial statements and considered that materiality played a key role. One panel member added that current IFRS Standards were not focused on avoiding immaterial information being provided in the financial statements.

These panel members also emphasised that materiality is an entity-specific concept that changes over time and that guidance is needed to help entities to make materiality judgements when preparing financial statements.

Finally, one panel member considered that there is material information when the information is legal and that the information is legal when it complies with the “Golden Rule”, the laws, the accounting principles and the accounting standards.

Do you think the principles in the DP will address the concerns raised on IFRS 13 *Fair Value Measurement disclosures*?

Users want details on the methodologies and assumptions used to measure fair value, particularly when level 3 inputs are used.

One panel member explained that users of financial statements need disclosures that help them to understand how fair values have been determined, particularly when level 3 inputs are used to measure fair value. This would include details on the methodologies and assumptions used. This panel member noted that the inputs and assumptions used had a significant impact on the outcome of fair value measurement and this could be a source of earnings management. Therefore, clear information on this area was key in understanding the financial position and performance of the entity.

Discussion on *Goodwill and Goodwill Impairment*

Key elements of EFRAG DP on Goodwill

Filipe Alves explained EFRAG's research activities on Goodwill and Goodwill impairment, including the EFRAG Discussion Paper *Goodwill Impairment Test: Can it be improved?* and the EFRAG quantitative study *What do we really know about Goodwill and Impairment?.*

EFRAG is seeking the views of European constituents on the EFRAG DP on goodwill impairment test. The deadline for comments is 31 December 2017.

Current thinking of the IASB on goodwill and impairment test

Fred Nieto summarised the IASB's discussion on its research project *Goodwill and Impairment*. He explained that the IASB is exploring whether the existing impairment test for goodwill can be improved or simplified, whether goodwill should be amortised and which intangible assets should be separated from goodwill. The IASB will continue its discussions through the second half of 2017 before deciding the next steps on the project.

Do you use goodwill in your analysis or do you eliminate it?

Goodwill is useful, particularly for stewardship purposes so that management can be formally held to account

Panel members considered that information about acquired goodwill was useful, particularly for stewardship purposes so that management could be formally held to account for the investments they had made.

for the investments made.

However, one panel member explained that it was often difficult to understand the factors that make up the acquired goodwill and would welcome more information about the composition of goodwill and its separate components.

Another panel added that information about goodwill was crucial in the first years. However, after a number of years it would be difficult to follow up the acquired goodwill due to organisational changes and constant goodwill reallocation. He would prefer having information about the expected payback period for the business acquired.

Is impairment in goodwill 'too little and too late'? If so, how do you assess impairment?

Goodwill impairment is important for investors however it typically comes "too little and too late".

The panel members considered that information about goodwill impairment is important for investors however it typically comes "too little and too late".

One panel member further explained that impairments in the financial statements did not provide new information to the markets as investors had already incorporated this information into the share price when the impairment was announced. A panel member provided a real-life example where a major European company delayed the impairment recognition by about 10 years.

Another panel member would welcome more detailed information of what was being impaired. For example, whether the impairment was related to M&A overpayment, issues with non-recognised intangibles or other.

Is the complexity of the impairment test only an issue for preparers?

The IASB could consider providing "anchors" to preparers to reduce the subjectivity of the impairment test.

Panel members acknowledged that the goodwill impairment test is complex and involves significant judgement, which increases the likelihood of earnings management.

Nonetheless, one panel member explained that it would be difficult to simplify the impairment test, given the current structure. Instead, the IASB could consider providing anchors to preparers to reduce the subjectivity of the impairment test. For example, use of more realistic assumptions based on the market in which the entity operates.

Which of the suggestions in the EFRAG Discussion Paper would you agree with?

> Panel members welcomed EFRAG's effort to promote debate around goodwill impairment test but questioned the goodwill accretion approach from a cost-benefit perspective.

In general, panel members welcomed EFRAG's effort to promote debate around goodwill impairment test. When referring to specific parts of the EFRAG Discussion Paper, panel members saw some merits on idea of having entities making an adjustment to eliminate the effect of the internally generated goodwill in the impairment test. They agreed that any increases in the value generated long after the acquisition are more likely to be related to the actions taken and investments made by the acquirer rather than to the acquisition itself.

However, panel members considered that it would be difficult to distinguish acquired goodwill from internally generated goodwill and questioned the goodwill accretion approach from a cost-benefit perspective. As an alternative, one panel member questioned whether the IASB should improve the accounting for intangible assets in general and reduce information asymmetry that typically arises with intangibles.

One participant in the event considered that it would be useful to have more disclosures about the reasons for the payment of goodwill and a comparison of actual versus target performance for a specified number of years following a business combination.

> Should Goodwill arising on the acquisition be amortised over its useful life?

Finally, most of the panel members were in favour of the amortisation of goodwill. Therefore, panel members considered that the IASB should have a broader discussion on the subsequent accounting for goodwill, including the relative merits of an amortisation and impairment approach. One panel member noted that the current approach has cut the link between the income statement (no amortisation) and the cash-flow statement (out cash flow), a key feature for investors.

How important is the allocation of goodwill to cash generating units for users? What information do you need?

> Users need entity-specific information about the CGU and a clearer link between the existing CGUs and the lines of business reported in the segment report.

In general, panel members considered that information about the allocation of goodwill to cash generating units (CGUs) was very important for investors. However, panel members considered that entities should be required to provide more detailed information about their CGUs, including entity-specific information about the CGUs and a closer link to the lines of business reported in the segment report. One panel member would also welcome more detailed information about the purchase price allocation.

Discussion on IFRS 17 *Insurance Contracts*

Background on IFRS 17 *Insurance Contracts* and the reason for the change

Fred Nieto provided background information on how IFRS 17 had been developed and provided an overview of how IFRS 17 would work in practice. More specifically, he explained what investors and analysts could expect to see in the primary financial statements and disclosures once IFRS 17 was implemented.

Introduction to the endorsement process in Europe

Patricia McBride explained the endorsement process of IFRS Standards in Europe and EFRAG's role in that process. She also provided details on the endorsement process of IFRS 17, including the current status, topics that might be analysed by EFRAG in the endorsement process and expected timeline of endorsement.

Presentation of AIAF working group on insurance indicators used in IFRS insurance reports

Luca D'Onofrio explained the work developed by the AIAF working group on insurance indicators used in IFRS insurance reports. In particular, this working group was currently analysing the interaction between the new solvency and accounting requirements for insurance entities and their impact on the key performance indicators.

Does IFRS 17 help financial analysts and investors in comparing financial statements of insurance companies in different countries?

> IFRS 17 is a new comprehensive approach to account for insurance contracts that is expected to improve comparability.

Panel members acknowledged that, under IFRS 4 *Insurance Contracts,* insurance contracts were accounted for differently in different countries and considered that IFRS 17 represented a new comprehensive approach to account for insurance contracts that is expected to improve comparability.

In particular, panel members considered that IFRS 17 introduced more discipline to the accounting for insurance contracts and was a significant improvement to the measurement of the insurance liabilities and related disclosures (e.g. level of risk and economic mismatches).

Nonetheless, one participant detailed that comparability issues were not only related to the accounting but also to the complexity of the insurance market.

Are insurance analysts analysing financial information by line of business? How do you split the accounting data below segments in the financial statements?

Investors need a high level of disaggregation and granularity of the information provided on the different lines of businesses.

The panel members explained that investors use different indicators for different segments of business (e.g. life and non-life) and provided some real life examples of key elements of financial statements and ratios used by investors (e.g. premiums, combined ratio).

The panel members explained that they would start by splitting the insurance business by life and non-life. Subsequently, investors would split further these segments into different components and regions. For each, users would look at the key performance ratios and key figures that would be found in the financial statements, management presentations and public entities (e.g. regulators). Thus, users needed a high level of disaggregation and granularity of financial information about insurance contracts.

Are historical data such as claims ratios useful for analysing life and non-life business?

Investors are concerned about the potential loss of historical information resulting from changes in the requirements. Thus, the transition process from IFRS 4 to IFRS 17 is key.

Some panel members noted that IFRS 17 introduced significant changes to the accounting for insurance contracts and highlighted the importance of the transition process from IFRS 4 to IFRS 17. In particular, they were concerned about the potential loss of historical information resulting from changes in the requirements, particularly the key elements of the financial statements and ratios. Therefore, these panel members called for some form of reconciliation between the previous and the new accounting framework.

One other panel member referred to the challenges related to the level of aggregation of contracts for the accounting for insurance contracts and the level of risk of the different lines of business that investors need to analyse. He called for clear information in the disclosures about the risk components of the different lines of businesses (e.g. the link between the level of aggregation of contracts and mutualisation).

Are the main indicators used by analysts to evaluate a non-life and life business company provided by the IFRS 17 disclosures?

> Some of the key indicators that analysts use are *Combined Ratio*, *Loss Ratio* and *Duration*. This information is not only important for the company as a whole but also for the different lines of businesses.

One Panel Member explained that for non-life business one of the most important ratios is the *Combined Ratio*. This panel member believed that with IFRS 17 entities would provide a combined ratio for the business as a total. However, he noted that investors needed to have the different components of the combined ratio. The same would apply to the *Loss Ratio*.

One Panel Member explained that the life business had also different subsets of businesses which included products such as participating contracts, unit-linked contracts and pure-life products. In addition, there were also geographical considerations to take into account.

This panel member also stated that information about how management calculated *Asset and Liability Duration* was key for investors and he was not certain whether entities would be required to provide this information under IFRS 17.