Minutes of UKEB's Accounting Firms and Institutes Advisory Group meeting on 3 November 2022 from 9.30am to 1.00pm

Present	
Name	**Designation**
Pauline Wallace	Chair, UK Endorsement Board
Sandra Thompson	Chair, AFIAG
Andrea Allocco	AFIAG member
Andrew Spooner	AFIAG member
Chris Smith	AFIAG member
Claire Needham	AFIAG member
Danielle Stewart OBE	AFIAG member
David Littleford	AFIAG member
John Boulton	AFIAG member
James Barbour	AFIAG member
Moses Serfaty	AFIAG member
Richard Moore	AFIAG member
Sharon Machado	AFIAG member
Nick Anderson	IASB member
Nick Barlow	IASB staff
Julianne Rebecca Upmeier	IASB staff

Relevant UKEB Secretariat team members were also present.

Welcome and Introduction

1. The Chair welcomed members to the second meeting of the UKEB's Accounting Firms and Institutes Advisory Group (AFIAG).

Endorsement: Primary Financial Statements

2. The Chair welcomed the IASB's Primary Financial Statements project team, including IASB Board member, Nick Anderson, and members of IASB staff.

3. Nick Anderson explained that:

    a) Extensive consultation and fieldwork had been undertaken on the proposals in the ED *General Presentation and Disclosures* (the ED), which was published in 2019. In response to feedback, some of the IASB's tentative decisions differ from the proposals in the ED.

    b) Further targeted outreach on those tentative decisions was underway during Q4 of 2022 and a summary of additional feedback from this outreach would be presented to the IASB. The IASB would then consider whether the proposals need to be re-exposed.

    c) The AFIAG members were asked to consider the IASB's recent tentative decisions on statement of profit or loss subtotals and categories, disaggregation, and management performance measures (MPMs).

Statement of profit or loss subtotals and categories

4. The IASB project team summarised the ED's proposals and the IASB's subsequent tentative decisions on the proposed profit or loss categories of operating, investing and financing. The following points were highlighted:

    a) The *operating category* is intended to capture income and expenses from an entity's main business activities, including volatile and unusual items.

    b) The *investing category* is intended to capture income and expenses from assets generating returns independently from other resources, share of profit or loss of equity accounted associates and joint ventures, and income and expenses on cash and cash equivalents.

    c) The *financing category* is intended to capture income and expenses on liabilities relating only to the raising of finance, and interest expense on the unwind of the discount on other liabilities.

5. In the ensuing discussion, it was noted that some transactions which were financing in nature, such as supplier finance arrangements, some hedging transactions and commodity transactions, may not be reported in the financing category. This was because the IASB's working definition of a financing transaction is based on receipt and repayment by an entity of cash or equity instruments only.

6. The IASB project team further highlighted that:

    a) The ED had proposed that entities providing financing to customers as a main business activity could take advantage of an accounting policy choice to include in the operating category:

        i. all finance income and expenses; or

        ii. only those items of finance income and expense which relate to the provision of financing to customers.

    b) Since the ED had proposed that income and expenses from cash and cash equivalents should be included in the financing category, the accounting policy choice proposed would have permitted companies providing financing to customers as a main business activity to report income and expenses from cash and cash equivalents in the operating category.

    c) In response to feedback received on the ED, the IASB has tentatively decided to:

        i. explore removing the accounting policy choice for income and expenses from cash and cash equivalents, because it has tentatively decided to require income and expenses from cash and cash equivalents to be included in the investing category; and,

        ii. retain the accounting policy choice for finance income and expenses and to confirm that the accounting policy choice does not include interest related to other liabilities (e.g., provisions) within its scope.

    d) The rationale for exploring the removal of the accounting policy choice for income and expenses from cash and cash equivalents was that many entities that provide financing to customers also invest as a main business activity (e.g., banks). Therefore, such entities would be required to include income and expenses from cash and cash equivalents in the operating category. It would, therefore, be inappropriate to retain an accounting policy choice for income and expenses from cash and cash equivalents for such entities.

7. Some AFIAG members noted that withdrawal of the proposed accounting policy choice for income and expenses from cash and cash equivalents for companies that provide financing to customers would mean that those companies that provide financing to customers but do not invest as a main business activity (e.g., providers of pay day loan or car finance) would no longer have the option to present income and expenses from cash and cash equivalents in the operating category and would be required to present them in the investing category. It was noted that this may not be a faithful representation because, whilst those entities may not invest as a main business activity, income and expenses from cash and cash equivalents are ancillary to their main business activity of providing finance to customers.

8. One AFIAG member asked whether rising interest rates and consequent increases in finance expense were likely to have changed stakeholder views on the proposals relating to finance expense in the two years since the consultation on the ED. The IASB project team acknowledged that the current targeted outreach provided the opportunity for stakeholders to voice any changes in their views.

Disaggregation

9. The IASB project team highlighted that:

   a) Following feedback from preparers that it was prohibitively costly, the IASB had reconsidered the ED proposal to disclose an analysis of all operating expenses by nature in the notes to the financial statements when presented by function in the statement of profit or loss.

   b) The IASB had tentatively decided to explore three potential approaches for the disclosure of operating expenses by nature where an entity presents operating expenses by function in the statement of profit or loss. The three potential approaches were:

      i. To require disclosure of an analysis by functional category of depreciation, amortisation and employee costs.

      ii. In addition to (i), to require disclosure of an analysis by functional category of impairments and inventory write-downs.

      iii. In addition to (ii), to require disclosure of an analysis by functional category of any other expense separately disclosed in the notes to the financial statements.

   c) Early feedback from preparers was that disaggregating specified expenses by functional category (as in i and ii above) was feasible and much less costly than the full analysis by nature proposed in the ED.

10. Whilst the AFIAG was supportive of the IASB's tentative decision and thought that providing the disclosures proposed in i and ii above would not require much additional cost, the following points were made:

a) Since inventory write-downs would always be allocated to the cost of sales functional category, the proposal to require analysis by functional category of inventory write-downs would provide limited additional information.

b) Cost of sales was not defined in IFRS, and some entities did not disclose which costs comprised cost of sales in the accounting policies note. Whilst the IASB was not currently prioritising a project on cost of sales, it may be possible for the final Standard to state that disclosure of the costs that comprise cost of sales could be included in the accounting policies note.

Management Performance Measures (MPMs)

11. The IASB project team explained that the IASB had made a tentative decision to:

a) Change the definition of an MPM to "a subtotal of income and expenses not specified by IFRS Accounting Standards that is used in public communications outside financial statements."

b) Include a rebuttable presumption that a subtotal used in public communications represents management's view of an aspect of an entity's financial performance.

c) Allow a simplified approach to calculating the tax impact of reconciling items between MPMs and the closest IFRS subtotal. The tentative decision is intended to balance cost and benefit.

12. In discussion the following points were raised:

a) The proposed rebuttable presumption for the definition of MPMs would still leave the challenge of identifying MPMs, given the proposed scope extended to MPMs in any public communications outside financial statements.

b) It would be important to clarify whether the simplified approach to calculating the tax and non-controlling interest effect of adjusting items was an accounting policy choice or whether the simplified approach could be used selectively, e.g., on cost grounds. The IASB representatives confirmed that this point will be covered in future IASB discussions.

c) The IASB does not intend to prohibit the use of columns or boxes in the statement of profit or loss. However, an MPM can only be shown in the statement of profit or loss if it fits within the proposed new structure. This could be made clear in the draft Standard or updated ED.

d) Educational material on this topic would be important.

Research: Subsequent Measurement of Goodwill

13. The UKEB Secretariat provided an update on the UKEB's research project on subsequent measurement of goodwill and asked AFIAG members for their and their network's views on subsequent measurement of goodwill.

14. The UKEB Secretariat provided the following context:

    a) The IASB's Discussion Paper *Disclosures, Goodwill and Impairment* (the DP) was published in March 2020. The purpose of the IASB's project was to explore whether, at reasonable cost, it was possible to provide investors with more information about acquisitions. The feedback to the DP was finely balanced on the question of subsequent measurement of goodwill.

    b) The IASB requested national standard setters, including the UKEB, to undertake further research in Q4 2021 on how the useful life of goodwill was estimated under domestic GAAP and whether a transition to an amortisation-based model for subsequent measurement of goodwill would have a significant adverse impact on financial stability.

    c) The UKEB's research project on the subsequent measurement of goodwill also explored whether a transition to a hybrid model for subsequent measurement of goodwill would be practicable. The research was published and presented the findings at the September 2022 meetings of the European Financial Reporting Advisory Group (EFRAG), International Forum of Accounting Standard Setters (IFASS) and Accounting Standards Advisory Forum (ASAF).

    d) At the IASB October Board meeting, the IASB staff brought a comprehensive summary of all the research it had undertaken in this area. The IASB will vote on whether to proceed with further research on amortisation at its November Board meeting.

15. The following points were noted during the ensuing discussion:

    a) The UKEB research paper had stimulated strongly held and diverse views on the subsequent measurement of goodwill.

    b) While it would be possible to estimate a useful life for goodwill, some auditors were concerned that the estimation of the useful life of goodwill could be arbitrary.

    c) There was a risk that useful life of goodwill would not be reassessed under an amortisation-based model.

    d) If amortisation were to be reintroduced, preparers might default to a rebuttable presumption for the useful life of goodwill, which might not be the subject of much challenge.

e) The IASB had heard similar feedback on the useful life of goodwill. Many thought that it could be estimated but many had also asked for a default period. There was a concern that a default period would become the norm.

f) The UKEB research could have gone further in terms of investigating what disclosures were needed by investors and could bring further value to the discussion by exploring the costs and benefits of different options.

g) The impairment-only model took a holistic approach to the performance of an acquisition, by considering how that acquisition was embedded in the business.

h) It was good to have the goodwill research paper on the agenda, alongside the intangibles research paper, as it is difficult to separate the two topics.

i) The IASB representatives pointed out that no entity becomes insolvent because it has a lot of goodwill; rather, an entity becomes insolvent because it cannot finance its debt or cover its liabilities.

Research: Accounting for Intangibles

16. The UKEB Secretariat provided an update on the UKEB's intangibles research project and highlighted the following points:

a) Intangibles was one of the three projects added to the IASB's work plan following the IASB's Third Agenda Consultation.

b) The UKEB was undertaking a project to understand UK stakeholders' perspectives on accounting for intangibles and ways to enhance the accounting for and disclosure of intangibles.

c) Intangibles are recognised as an important source of economic growth and are growing significantly. According to ONS (Office for National Statistics) surveys, approximately £670bn of intangibles are present in the UK economy but are largely unreported in companies' financial statements.

d) In 2022, the UKEB had agreed to conduct a multi-output, proactive research project on intangibles.

e) The UKEB Secretariat was finalising qualitative research setting out UK stakeholder views on accounting for intangible assets. Simultaneously, the UKEB Secretariat had begun quantitative analysis of the reporting of intangibles in the UK, to be followed by a user survey.

17. The Secretariat noted that the following issues were emerging during the current research phase:

a) Limited recognition of intangibles.

b) Inconsistent accounting treatment.

c) Poor disclosures.

18. The UKEB Secretariat asked AFIAG members to consider:

a) What, if anything, was problematic with accounting under IAS 38 *Intangible Assets*?

b) What could be done to improve the accounting for intangibles?

19. The following points were noted during the ensuing discussion:

a) If costs of internally generated intangible assets are capitalised, one key issue is determining when to stop capitalising (i.e., the difficulty in pinpointing the point of transition from the research and development expenditure phase to the usage phase).

b) An ACCA survey looking at 7,200 companies globally found that:

i. 53% of these companies did not specifically mention research and development (R&D) in their financial statements, suggesting they were R&D inactive.

ii. However, in annual reports, words such as ‘innovation’ and ‘research and development’ were being used, even though R&D expenditure might not be separately disclosed.

iii. Geographically, China and Korea appeared to have the lowest concentration of R&D inactive companies, whereas in South America the concentration of R&D inactive companies was much higher. Europe was somewhere in the middle. This was something worth investigating further.

iv. Intangibles were core to businesses but there might be no reference to intangibles in financial statements.

c) It was possible that few auditing issues were identified in relation to intangibles because, in general, entities were conservative about when they started to capitalise.

d) Software, an intangible that was currently permitted to be recognised, was a challenging area, with questions around what could be capitalised (i.e., what is the unit of account), and when amortisation should begin.

e) Practice and complexity may differ between the larger listed FTSE companies and the medium or smaller ones on AIM, with the latter more likely to capitalise internally generated intangibles.

20. The UKEB Secretariat highlighted initial views from research with UK stakeholders on potential enhancements to accounting for intangibles. The key points and themes which emerged were:

   a) There appeared to be a strong desire amongst many stakeholders to enhance recognition.

   b) There was a lot of focus on a cost model, whereas there was less desire for fair value.

   c) Much was said about enhanced disclosure but not in the sense that it was the only solution.

21. The following points were noted during the ensuing discussion:

   a) Instances of carbon credits were becoming more frequent.

   b) Amending the recognition criteria for internally generated intangibles should be considered.

   c) Appetite for recognition of intangibles at fair value was not generally high.

   d) It would be worth considering whether the subsequent measurement method used should depend on the purpose for which the intangible is held (use in operations, speculation or investment).

   e) When using the cost model, particularly with respect to carbon credits, recognition on the balance sheet was relatively easy. However, reflecting the consumption of benefit over time was much harder given the lack of guidance in the Standard. For example, should carbon credits be expensed when they are retired or when the emissions they are intended to offset are made?

   f) If more intangibles are recognised or disclosed, there will be a need for more guidance around definitions and what costs to include in intangibles such as customer relationships.

Horizon Scanning

22. In this session, AFIAG members were asked to share:

   a) Relevant insights for the IASB's upcoming Post-implementation Review of IFRS 15 *Revenue from Contracts with Customers.*

   b) With regard to the IFRS Interpretation Committee (IFRIC)'s tentative Agenda Decision *Cash Received via electronic transfer as Settlement for a Financial Asset (IFRS 9)*, their views on whether the proposals in the IASB's October Board paper would address the practical problems that had been identified with the tentative Agenda Decision.

c) With regard to the proposed amendments to IFRS 16 *Leases,* their views on the prevalence or otherwise in the UK of sale and leaseback transactions with variable lease payments that do not depend on an index or rate.

d) Any other emerging issues.

Post-implementation Review of IFRS 15

23. The Chair noted that the IASB's Request for Information for the Post-implementation Review of IFRS 15 was expected in the first half of 2023. AFIAG members were asked for their views.

24. On costs relating to IFRS 15, AFIAG members noted that there had been significant one-off costs on implementation but that these costs were now largely spent, and that ongoing costs had stabilised.

25. The general consensus was that there were no 'fatal flaws' in IFRS 15. The questions received most often on the application of IFRS 15 related to the following areas:

a) Principal / agent considerations, particularly in the gaming industry;

b) The application of the concept of control (and when control passes) to purchase transactions;

c) The application of net and gross revenue recognition, due to a degree of divergence between US GAAP and IFRS 15 (although this divergence is generally accepted and understood); and

d) The application of definitions of contract assets, receivables, contract liabilities and financial liabilities, particularly in relation to renewals accounting and modification of licences.

26. Members noted that IFRS 15 was a significant improvement on IAS 18 *Revenue*. ACCA research had found that, in some cases, IFRS 15 had led to greater collaboration between finance and business functions.

Cash Received via Electronic Transfer

27. The IFRIC tentative Agenda Decision *Cash Received Via Electronic Transfer as Settlement for a Financial Asset (IFRS 9)* was discussed briefly.

28. Some members noted that the proposed accounting policy choice for derecognition of a financial liability seemed a sensible approach, although others felt the scope might be too narrow and should include other payment types such as cheques. A question was raised about whether the concept of control should be considered, because it could make application to other payment types more challenging.

29. There were also calls for further clarity on the assessment for financial assets (i.e., there seems to be confusion due to the IFRIC's tentative Agenda Decision not being ratified). Members felt that issuing application guidance as part of the same Agenda Decision and subject to the same effective date as that for the accounting policy choice for derecognition of financial liabilities would be helpful.

Amendments to IFRS 16: Lease Liability in a Sale and Leaseback

30. AFIAG members confirmed the initial view of the UKEB Secretariat, that these types of transaction were not prevalent in the UK; most members had not come across a transaction of this type in the UK.

Suggestions for Future Horizon Scanning

31. Classification of ESG (Environmental, Social and Governance) loans was suggested as a topic for the horizon scanning session at a future AFIAG meeting.

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32. The UKEB Secretariat outlined the UKEB project on the IASB's proposed amendments to IAS1 *Presentation of Financial Statements* and, given the time constraint, invited AFIAG members to submit comments by email after the meeting.

33. The AFIAG Chair noted that the next meeting would take place on 30th March 2023.

End of meeting