



# IFRS® Standards and long-term investments

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- How do accounting standards contribute to long-term investment?
- Long-term investment and the *Conceptual Framework*
  - Long-term investment **by** an entity
  - Long-term investment **in** a entity
- Long-term investments and IFRS 9
- Role of accounting

Governments wish to promote long-term investment

They view it as a vital tool to promote economic growth



# How do accounting standards contribute to long-term investments?

# How do accounting standards help?

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## IFRS Standards

- Contribute to long-term investment by requiring transparent financial reporting
- Are not designed to encourage or discourage long-term investments or investments of any particular type

## Transparent reporting

- Is a precondition for healthy and efficient capital markets
- Helps investors and lenders make efficient, informed decisions
- Makes investment more attractive, by giving investors and lenders confidence that they will receive the information they need
- Helps investors assess how management has used the resources entrusted to it (stewardship)



# Long-term investment and the *Conceptual Framework*

# The *Conceptual Framework*

## *Conceptual Framework*

- Provides tools that the International Accounting Standards Board uses in setting IFRS Standards
- Does not create / override accounting requirements

## IFRS Standards

- Create accounting requirements, based on the *Conceptual Framework*
- Require entities to produce information designed to be **transparent**

Information is **transparent**

if it is **useful** to investors and lenders

Information is **useful**

if it is **relevant** and **faithfully represent** what it purports to depict

# Long-term investment and the *Conceptual Framework*

- The Board will issue a revised *Conceptual Framework* in 2018
- The revisions will help the Board to answer the following questions:

**1** Does the time horizon for investments by an entity have any implications for standard-setting decisions?

For example, does a different investment horizon make fair value more or less relevant to investors in the entity?

**2** Do long-term investors in an entity need the same information as short-term investors?





# Time horizon for investment by an entity

# Asset valuation under the revised *Conceptual Framework*

Questions to answer in selecting a measurement basis for investments held **by** an entity

Q

What information will that measurement provide on the balance sheet—and in profit or loss?

Will that information:

- be relevant?
- faithfully represent what it claims to depict?

Q

What are the characteristics of the asset?  
For example: is it a simple bond or something with more complicated cash flows?

Q

How will that asset contribute to future cash flows?

# Fair value under the revised *Conceptual Framework*

If an asset is measured at fair value, **changes in fair value**

typically  
are presented  
in profit or loss

in exceptional cases, to enhance the relevance of profit or loss, can be presented outside profit or loss (in other comprehensive income)

This provides:

fair value  
information in  
the balance  
sheet

cost information in  
profit or loss

changes in fair  
value in other  
comprehensive  
income

# Time horizon for investments by an entity—summary

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Under the revised *Conceptual Framework*

not all long-term investments by an entity measured at cost or all at fair value

fair value changes not always recognised in profit or loss

the Board will consider various factors, including the nature of the entity's business activities

# Time horizon of investors in an entity

# Long-term investors in an entity: concerns of some commentators

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“Information needs of long-term investors in an entity may differ from those of its short-term investors”

“*Conceptual Framework* should emphasise the needs of long-term investors”

The Board “focuses too much on the needs of short-term investors and potential investors, and not enough on the needs of existing investors, particularly long-term investors”

The Board “uses too much fair value”

# Long-term investors in an entity: the Board's view

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## Conceptual Framework

- In applying the *Conceptual Framework*, the Board assesses what information is most likely to be useful to both:
  - long-term investors and short-term investors
  - existing and potential investors

## Fair value

- When the Board requires, or permits, fair value, that is not mainly to meet needs of short-term investors
- When fair values are not useful to long-term investors, they are likely to be even less useful to short-term investors

## Input

- The Board routinely seeks input from investors, including long-term investors

# Long-term investments and IFRS 9



## At cost

**Most simple bonds and most simple loans**, if held solely to collect the principal and interest

including

most traditional lending businesses

## At fair value

**All other financial assets**, not held solely to collect principal and interest

including

investments with complex cash flows

all equity investments

all derivatives

bonds or loans with complex cash flows

If a financial asset is measured at fair value, changes in its fair value are generally presented in profit or loss

## Exception 1

in some cases, changes in the fair value of simple bonds or loans **must** be presented outside profit or loss in 'other comprehensive income' (OCI)

Shows fair value in balance sheet, cost in P&L

## Exception 2

an entity may **elect** to present changes in the fair value of some or all equity investments outside profit or loss in OCI if not held for trading

Aimed at strategic investments

## Relevance of fair value

- “For investors who are interested in long-term value creation, fair value is volatile, and is less relevant than:
  - cost information
  - management’s own assessment of the future value of the investment”

## Unrealised gains

- “Including unrealised gains in profit or loss may lead to:
  - dividend distributions that are excessive, imprudent, volatile and not in the best interest of long-term investors
  - inflated management remuneration
  - short-termist behaviour and financial engineering
  - discourage long-term investment”

## Relevance of cost

- For long-term investments, cost is not relevant
  - even if an entity can wait for the value of investments to change
    - for example, for an equity investment acquired five years ago, its fair value is more relevant information than its cost, no matter how much longer it may be held
  - but cost can be relevant if a **simple** bond, or **simple** loan, is held solely (or in part) to collect the principal and interest

## Risk

- Long-term investments may expose an entity to **more** risk, best reflected by fair value

## Dividend and remuneration

- Accounting profit is not (and should not be) the sole determinant of distributions of dividends and management remuneration

# Role of accounting

# Role of accounting: the Board's view (1 of 3)

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1 Accounting is 'just one piece of the jigsaw'

2 Financial reporting provides information for users of financial statements on what is happening

3 Accounting should not mask risk

3 If an entity holds a risky asset, accounting should show this

If an entity takes on risk that makes its results more volatile, the volatility reflects a real economic phenomenon

Transparent accounting encourages appropriate action to be taken

# Role of accounting: the Board's view (2 of 3)

- Regulators (and others responsible for governance) may prefer to avoid outcomes that would force entities either to increase capital or to take other actions to reduce leverage:
  - they have a role to play if they wish to avoid such outcomes
  - in designing Standards, the Board's aim is not to avoid such outcomes. IFRS Standards are intended to provide useful information to investors
  - we work with regulators to facilitate their decision-making

Financial statements provide information about value change.  
Others have responsibility for appropriate governance and  
dividend policies.

# Role of accounting: the Board's view (3 of 3)

Recognising fair value changes in profit or loss may provide useful information

But recognising those changes does not necessarily justify paying dividends or bonuses out of 'unrealised' gains

Distribution policy reflects many factors, such as:

- the entity's financing needs
- the risks faced by the entity
- legal constraints
- remuneration policy and incentive arrangements

These factors differ by entity, by country and over time. Accounting profit is not the only factor.



# Conclusion

- IFRS Standards provide transparency that is a vital support to long-term investment
- The Board will:
  - use tools in the revised *Conceptual Framework* to ensure that IFRS Standards continue to provide transparency
  - update the IFRS Practice Statement 1<sup>(1)</sup> to continue to assist management in presenting useful information about long-term investment
- IFRS 9 provides transparency about financial assets
- Accounting is just one part of the jigsaw
- The Board works with regulators so that changes to IFRS Standards enhance transparency and are coordinated appropriately with regulatory requirements

(1) The Practice Statement *Management Commentary* provides a framework for the presentation of management commentary, including, for example, how management intends to implement its strategies over the long term. In November 2017 the Board decided to start a project to revise and update this IFRS Practice Statement issued in 2010.