Financial reporting in 2018

The perspective of a former standard setter and analyst

Steve Cooper

steve.r.cooper@icloud.com

+44 7979 601041

This presentation

- My brief:
  - ” … your view of the accounting development in the coming ten years, using your ten year experience from the Board as a foundation”
  - “ … your personal reflections on what’s happening, where we are heading and what impact this will have on the preparer”

- Outline:
  - Reflections on 10 years of standard setting – successes and failures
  - Thoughts on the current state of financial reporting
  - The future of financial reporting – hopes and fears

IASB 2007 to 2017 - Achievements

- Global accounting
  - Well nearly
- New and improved standards
  - E.g. IFRS 15 revenue recognition
    - Logical and principles based
    - Investor focused and more principles based disclosures
    - Convergence
- Standards development process
  - Transparent
  - Inclusive
  - Independent

IASB 2007 to 2017 - Frustrations and regrets

- Convergence failures
  - IFRS 9
  - IFRS 16
- Voting for OCI
  - Pensions
- Lack of progress on financial statement presentation
  - Matrix approach
  - Performance reporting project
  - Abandoned financial statement presentation exposure draft

Current state of financial reporting

- Communication through financial statements is improving
  - More relevant disclosures and better explanations
  - A willingness to change
- Disclosure overload?
  - Investor perspective very different from preparers
  - Materiality
- Fair value
  - Too much or not enough?
  - Should financial reporting be ‘closer to cash’?
- Non-GAAP
  - Use of the terms such as ”underlying” should be banned

Non-GAAP can help investors

Free cash flow example ….

	Year Ended December 31,		
	2015	2016	2017
Net cash provided by (used in) operating activities	$ 12,039	$ 17,272	$ 18,434
Purchases of property and equipment, including internal-use software and website development, net of proceeds from property and equipment incentives	(4,589)	(6,737)	(10,058)
Property and equipment acquired under capital leases	(4,717)	(5,704)	(9,637)
Principal repayments of finance lease obligations	(121)	(147)	(200)
Free cash flow less finance lease principal repayments and assets acquired under capital leases	$ 2,612	$ 4,684	$ (1,461)
Net cash provided by (used in) investing activities	$ (6,450)	$ (9,876)	$ (27,819)
Net cash provided by (used in) financing activities	$ (3,882)	$ (3,740)	$ 9,860

All of these free cash flows measures have limitations as they omit certain components of the overall cash flow statement and do not represent the residual cash flow available for discretionary expenditures. For example, these measures of free cash flows do not incorporate the portion of payments representing principal reductions of debt or cash payments for business acquisitions. Additionally, our mix of property and equipment acquisitions with cash or other financing options may change over time. Therefore, we believe it is important to view free cash flows measures only as a complement to our entire consolidated statements of cash flows.

But not always …

Core earnings example …

Adjusted results reconciliation 31 December 2017	Total results	Intangible asset amortisation	Intangible asset impairment	Major restructuring	Transaction -related	Divestments, significant legal and other items	US tax reform	Adjusted results
Turnover	30,186							30,186
Cost of sales	(10,342)	546	400	545	80	–		(8,771)
Gross profit	19,844	546	400	545	80	–		21,415
Selling, general and administration	(9,672)			248		83		(9,341)
Research and development	(4,476)	45	288	263		18		(3,862)
Royalty income	356							356
Other operating income/(expense)	(1,965)				1,519	(220)	666	–
Operating profit	4,087	591	688	1,056	1,599	(119)	666	8,568
Net finance costs	(669)			4		8		(657)
Profit on disposal of associates	94					(94)		–
Share of after tax profits of associates and joint ventures	13							13
Profit before taxation	3,525	591	688	1,060	1,599	(205)	666	7,924
Taxation	(1,356)	(134)	(176)	(209)	(619)	(251)	1,078	(1,667)
Tax rate	*38.5%*							*21.0%*
Profit after taxation	2,169	457	512	851	980	(456)	1,744	6,257
Profit attributable to non-controlling interests	637				42		114	793
Profit attributable to shareholders	1,532	457	512	851	938	(456)	1,630	5,464

Disaggregation rather than reconciliation

My disaggregation of IFRS earnings …

	2014	2015	2016	2017
Earnings metric used for internal business management	4584	3658	4889	5464
Restructuring charges	-540	-1455	-757	-851
Legal expenses	-522	-200	-50	-54
Asset impairment	-121	-156	-15	-512
US tax reform	0	0	0	-1630
Gain or (loss) on divestments	283	8363	296	510
Deferred consideration and NCI put remeasurement				
Interest accretion (estimate)	-38	-166	-328	-393
Remeasurement of deferred consideration and OCI puts	-524	-1220	-2665	-545
Amortisation of acquisition related intangibles	-366	-402	-458	-457
IFRS earnings	2756	8422	912	1532

The future of financial reporting: Hopes

- Truly global accounting
  - Although probably without USA participation
- Successful completion of IASB financial statement present project
  - Less fear of value changes
- Eliminate (or at least no more) OCI
  - Confusing for investors
  - Deal with different types of gains through presentation and subtotals
- More informative use of non-GAAP
  - Disaggregation rather than reconciliation
- Investor focus and investor participation in standard setting

The future of financial reporting: Fears

- Europe and the IASB
  - Continued politicization of standard setting
  - Fair value and divergence from IFRS 9
  - EU request to EFRAG to investigate alternatives to fair value
- Insurance
  - EU (non)endorsement of IFRS 17
- Disclosure reform and investor needs
  - Reform of disclosures goes too far
  - Principles interpreted as an option not to disclose
    - "Tell me where it says I have to disclose this"

QUESTIONS