



EFRAG
35 Square de Meeûs
B-1000 Brussels

31 May 2018

Dear Sir or Madam,

Re: EFRAG Discussion Paper EQUITY INSTRUMENTS - IMPAIRMENT AND RECYCLING

BusinessEurope is pleased to respond to the EFRAG Discussion Paper Equity Instruments – Impairment and Recycling (the DP).

In accordance with the new Conceptual Framework for Financial Reporting, we think that the recycling in the profit and loss account should be the default treatment for items that have been initially recognised in OCI. We see no convincing argument as to why this would not result in a relevant and faithful representation for gains and losses in respect of the long-term equity investments that are the subject of the DP.

BusinessEurope is also of the view that the recognition of impairment and any subsequent reversal of impairment using a symmetrical model for impairment and reversal would provide more useful information for users than the FVOCI model of IFRS 9. We agree that a more rigorous approach is required than was perhaps the case under the previous IAS 39 model, but we think that it can be achieved.

Although we would be in favour of an amendment of IFRS 9 to reflect an improved FVOCI model, we would not support an EU-only solution in this case. We would therefore request that if the results of the current research indicate that the model should be improved, EFRAG should encourage the IASB to undertake this in the near future.

Our responses to the individual questions posed in the DP are laid out in the Appendix to this letter. If you require any more information, please do not hesitate to contact us.

Yours sincerely,



Pedro Oliveira
Director
Legal Affairs Department

APPENDIX

Please note that our responses are made from the point of view of commercial and industrial corporates, and do not cover banking and insurance entities.

Q1.1 *What are your views on the arguments presented in paragraphs 2.3 – 2.10? Do you consider that the reintroduction of recycling would improve the depiction of the financial performance of long-term investors? Alternatively, do you consider that the existing requirements of IFRS 9 provide an adequate depiction? Please explain.*

BusinessEurope believes that the reintroduction of recycling of gains and losses accumulated in OCI upon the disposal of an equity investment accounted for using the IFRS 9 “FVOCI” model would improve the depiction of the financial performance of long-term investors by making the accounting more transparent and thus more informative and useful for users of financial statements. The disposal of such investments represents a sufficiently significant economic event both to justify recycling and to be used as an unambiguous trigger for recycling.

Thus, in our view, recycling is fully consistent with paragraph 7.19 of the new Conceptual Framework for Financial Reporting, which provides a default position that “income and expenses included in other comprehensive income in one period are reclassified from other comprehensive income into the statement of profit or loss in a future period when doing so results in the statement of profit or loss providing more relevant information, or providing a more faithful representation of the entity’s financial performance for that future period.” In addition, the disposal of the equity investment provides both a “clear basis for identifying the period in which reclassification would have that result”, and “the amount that should be reclassified”.

The use of fair value to measure most equity investments is now broadly accepted but inevitably leads to the problem of how to ensure that a useful and relevant depiction of the consequent gains and losses is provided in the case of certain long-term investments. On the one hand, the presentation of the inherent volatility of this measurement approach in profit and loss is inappropriate for long-term equity investments of a strategic nature (including associates and jointly controlled entities). On the other hand, since the main focus of users of financial statements is on the profit and loss account, the holding of all gains and losses related to such investments permanently in OCI can result in the obscuring of some of the important economic effects of such investments- particularly on a cumulative basis.

Recycling accumulated gains and losses on disposal would appear to reconcile these issues. In addition, the use of the disposal as the triggering event has the advantages of being an easily identifiable and justifiable point of allocation to an accounting period and highlights the realisation of the previously unrealised gains and losses with a link to the cash-flow effect.



Q2.1 *What are your views on the arguments presented in paragraphs 2.11 – 2.17? Do you consider that, from a conceptual standpoint, recycling should be accompanied by some form of impairment model? Please explain.*

BusinessEurope believes that, consistently with most other assets, including intangibles, property plant and equipment and financial assets held at amortised cost, impairment of long-term equity investments would respond to the fundamental qualitative characteristics of relevance and faithful representation of the (new) Conceptual Framework. Recognition of impairment in the profit and loss account would reflect a significant, durable step-change in the economic condition of the equity investment and its effect on the reporting entity. Such treatment draws attention to the change in circumstances and this information would therefore be relevant and useful to users of the financial statements.

Like the disposal or retirement of an asset, a significant deterioration in the economic condition of an asset should be reflected in the performance statement that users look to in the first instance. An impairment model would achieve this.

Q3.1 *What are your views on the arguments and analysis presented in Chapter 3 of the DP?*

Q3.2 *Are there other improvements in presentation and disclosure that you would support?*

BusinessEurope agrees in general with the view that an appropriate accounting model which faithfully reflects the impact of an event in the primary financial statements will provide more useful information than a description in the notes which is required to compensate for the event not having been accounted for in the most relevant manner. Despite the best efforts of preparers, it appears that events which are accounted for in the primary statements have more of an impact with users than disclosures, particularly when these are related to a complex event and its consequences.

We do not think that it is helpful to require preparers to provide potentially large volumes of information in order to allow users to model the event in the way that they deem most appropriate, since this can lead to “second guessing” and misunderstandings, which can ultimately damage trust and confidence.

In summary, we think that it important to achieve the optimal accounting treatment, and that disclosures cannot compensate for this in a sufficiently efficient manner.

Q4.1 *What should be, in your view, the general objective and main features of a robust model for equity instruments (relevance, reliability, comparability...)?*

Q4.2 *Which, if either, of the two models do you prefer? Please explain.*

Q4.3 *Do you have suggestions for a model other than those presented in the DP? If so, please describe it and explain why it would meet characteristics such as relevance, reliability and comparability.*

BusinessEurope believes that the general objective of a model for equity instruments is the same as for any other aspect of accounting under IFRS. In accordance with the



Conceptual Framework the model should provide useful information, that is, information which is relevant and faithfully represents the underlying transaction.

We have a clear preference for the impairment model “similar to IAS 39 with less subjectivity”. The advantage of this model is that it ensures that significant durable deteriorations in value are made visible by being recognised in the profit and loss account and not obscured in OCI, as is the case under the current IFRS 9 FVOCI approach. This should provide useful transparency for users. Provided that this model can be made sufficiently objective we think it will meet the characteristics of relevance, reliability and comparability.

However, in contrast to the IAS 39 model, we think that reversal of impairment through the profit and loss account in a rigorous and controlled framework would also provide relevant and useful information and would be consistent with the treatment of other assets. In addition, the requirement to reverse impairments through the profit and loss account may well help to overcome the perceived reluctance of entities to recognise impairment charges in a timely manner which has been cited by some parties as a flaw in the IAS 39 model and a reason to restrict all changes of value of these assets to recognition in OCI.

We do not think that the “revaluation model” is appropriate, since this in effect results in a Fair Value through Profit and Loss (FVPL) model with the volatility in profit and loss that is inherent in it. Such volatility is inconsistent with the long-term investment business model that the FVOCI model is intended to depict.

Q5.1 *Do you support the inclusion of quantitative impairment triggers in an impairment model? If so, should an IFRS Standard specify the triggers, or should management determine them?*

Q5.2 *If you do not support quantitative impairment triggers, how would you ensure comparability across entities and over time?*

As stated above, we are in favour of an impairment model similar to IAS 39 but we also recognise some of the criticisms levelled at that standard. We agree that more rigour and consistency is required in respect of the current impairment triggers of “significant decline” or “prolonged decline”. In our view, it is the responsibility of the entity’s management to define rigorous triggers and ensure that they are applied on a consistent and transparent basis. This could be assisted by further guidance as to what the current terms used in the standard mean.

It may also be helpful for the IASB to suggest quantitative triggers and even define quantitative limits which would automatically lead to a presumption of impairment. However, if such presumptions are set as triggers, then they should be rebuttable, since there may be circumstances and business models in which such conditions would not have any relevant economic effect on the entity’s activity. Such circumstances could include assets which are held for very long periods and short-term market volatility (or “noise”). Management should be required to use its judgement and to explain the reasoning behind its conclusions.



The requirement for management to apply judgement in a consistent manner is necessarily accompanied by the requirement to define a clear and robust accounting policy in this area. Whether such a policy need be disclosed would depend on the current requirements for disclosure of the accounting policy and its relevance in a particular period (that is, whether it has had to be applied during the period).

Q6.1 *How should subsequent recoveries in fair values be accounted for? Please explain.*

Q6.2 *If subsequent recoveries in fair values are recognised in profit or loss, which of the approaches in paragraphs 5.2 – 5.10 do you support and why?*

An entity that has opted for the FVOCI accounting approach will presumably have concluded that the continual presentation of fair-value changes in profit and loss (the FVPL approach) will not provide a relevant and faithful depiction of the performance of the entity. However, as discussed above, we think that certain events represent a step-change in the economic condition of the equity investment and should therefore be recognised in profit and loss – the recycling of accumulated gains and losses on disposal or retirement and impairment.

In our view, the recovery of value, when it is significant and prolonged, represents a similar step-change and should similarly be recognised. This approach would be consistent with both the model discussed above and that used for other assets in IFRS, such as under IAS 36 (other than for goodwill) and for financial assets held at amortised cost under IFRS 9.

In order to avoid irrelevant volatility or undue arbitrariness, the reversal process should be governed by criteria similar to those used for the impairment recognition. We would therefore favour the limited reversal approach using a significant threshold. Under this model, we would expect any fluctuations in fair value to be held in OCI until the appropriate trigger for reversal is reached. At this point, the accumulated net gains since impairment would be in effect recycled at the same time as the recognition of the complementary gain required to bring the asset to its new “unimpaired” value. We think this approach would contribute to the robustness of the selection and application of the impairment triggers. In addition, as suggested above in our response to Q.4., we think that such a symmetric approach to impairment and reversal would help overcome any perceived resistance to recognition of impairment losses.

The ongoing reversal approach is, in effect, an adoption of the FVPL model, even though it might be on a temporary basis, and we think this is contrary to the objectives of the model for equity investments under discussion.

Q7.1 *Do you consider that the same model should apply to all equity instruments carried under the FVOCI election? If not, why not and how would you objectively identify different portfolios?*

Q7.2 *Do you have comments on these other considerations?*

Q7.3 *Are there other aspects that EFRAG should consider?*

BusinessEurope agrees with the discussion paper that equity investments are held in the context of many different business purposes. We think it would be difficult to develop



fine-tuned models for each or sub-groups of these and that multiple accounting models would lead to a complex standard and confusion amongst users and preparers alike. We therefore think that a single model for FVOCI accounting should be available. Any difference in the characteristics of the instruments or in the related business models could be catered for in the definition of the specific impairment triggers.

We think that it is reasonable to deal with the impairment of hedged items on the basis of the net hedged amount (Hedged item plus hedging instrument).

***Q8.1** Are there other aspects of IFRS 9's requirements on accounting for holdings of equity instruments, in addition to those considered in the DP, which in your view are relevant to the depiction of the financial performance of long-term investors? Please explain.*

1. We recognise that the considerations discussed in the DP are the result of a request from the European Commission. We would not be in favour of any Europe-specific amendments, "carve-ins" or "carve-outs" being adopted for this issue. If the project is to be pursued, and we hope that it will be, we would urge EFRAG to encourage the IASB to reconsider its standard. Any Post-Implementation Review should be carried out on a timetable based on the general adoption date for IFRS 9 and not on the deferred date allowed for insurance companies.
2. As a further suggestion, some think that there may be merit, particularly from a cost/benefit point of view, in considering the (re-)creation of a simple cost measurement model for less significant long-term investments, with impairment charges and reversals mechanisms similar to IAS 36, and the recognition of gains and losses on disposal or retirement in the profit and loss account. This would offer the advantages of simplicity and consistency with other non-current assets, while avoiding irrelevant volatility in the profit and loss account and the need to develop a fair-value measurement model for investments which are often not quoted and thus difficult to value.
3. Finally, Business Europe has also identified an issue relating to certain debt instruments that were classified as 'available for sale' under IAS 39 (UCITS, ETFs, etc). Companies can have significant long-term investments in such funds for various reasons, for example to ensure dedicated funding for specific long-term provisions. Funds allow companies to invest in a simple way in a diversified portfolio of financial assets and are therefore interesting instruments from a risk management point of view.

However, from an IFRS 9 perspective, these are debt instruments that don't meet the SPPI criteria, and therefore have to be classified and measured at fair value through P&L. Compared to IAS 39, where the funds were measured at fair value through OCI, this new classification and measurement under IFRS 9 creates unwelcome volatility in P&L. Upon implementation of IFRS 9 some companies have even replaced their existing investments in funds by direct investments in bonds or shares, so as to avoid future P&L volatility stemming from such strategic and significant investments.

We recognise that this topic is not in the scope of this Discussion Paper, but we think it would be useful to address these related issues at the same time as equity instruments. We therefore suggest that EFRAG integrates in its research programme the topic of the appropriate classification and measurement for investment funds and looks into the possibility of classifying and measuring them at fair value through OCI. We will include this suggestion in the BusinessEurope comment letter on the EFRAG Agenda Consultation for a future EFRAG research programme.

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