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EFRAG Research Project Equity Instruments - Impairment and Recycling Cover note

Objective of the session

- 1 The objectives of this session are to:
 - (a) discuss specific details of a 'modified IAS 39' impairment approach for equity instruments (paper 11-02);
 - (b) discuss the significance of an impairment approach for equity instruments to the re-introduction of recycling (paper 11-02); and
 - (c) provide an update on the information collection efforts to fulfil the European Commission ('EC') request (paper 11-03).
- 2 The EFRAG Secretariat is still working to identify other approaches to impairment for equity instruments. We have reached out to other jurisdictions to collect information on other approaches in use. The last part of paper 11-02 illustrates for information purposes the approaches in US and Japanese GAAP.

Background of the project

Objective of the project

- 3 IFRS 9 *Financial Instruments* was issued by the IASB in July 2014 and is effective for annual periods beginning on or after 1 January 2018. For equity instruments, other than those held for trading and contingent consideration recognised in a business combination, the IASB has introduced an irrevocable option at inception on an instrument-by-instrument basis that permits those instruments to be accounted for at fair value through other comprehensive income ('FVOCI') with no impairment losses recognised in profit or loss and no reclassification in profit or loss of gains or losses upon derecognition.
- 4 In the Basis for Conclusions of IFRS 9, the IASB notes that one of the primary reasons for not allowing recycling is that it would create the need to assess these equity instruments for impairment. The IASB also noted that the application of impairment requirements of available for sale ('AFS') in IAS 39 *Financial Instruments: Recognition and Measurement* was very subjective.
- 5 In its Endorsement Advice to the EC related to IFRS 9, EFRAG noted that the prohibition of recycling may be considered as limiting the relevance of the information, since profit or loss is the main indicator of performance, and could affect in particular long-term investors.
- 6 The objective of the project is to consider possible alternative approaches to the impairment of equity instruments designated at FVOCI under IFRS 9.

Scope of the project

- 7 During the development of the project, the following topics will be discussed:
 - (a) the significance of an impairment model to the re-introduction of recycling of disposal gains or losses of equity instruments;
 - (b) improvements of the impairment test of AFS equity instruments in IAS 39; and
 - (c) identifying a different impairment model for equity instruments.
- 8 The project assumes that:
 - (a) equity instruments are measured at fair value on the statement of financial position;
 - (b) the FVOCI option is neither removed nor made obligatory for specific equity instruments; and
 - (c) the prohibition of recycling of disposal gains and losses limits the relevance of information.
- 9 The project does not intend to address in general the relevance of profit or loss versus OCI and will leverage on the prior work performed by EFRAG in the context of the endorsement of IFRS 9 and its discussions on the revision of the Conceptual Framework for Financial Reporting.
- 10 In May 2017, EFRAG received a request from the EC for technical advice on the issue. The request has two distinct phases:
 - (a) Phase 1, which is due by the end of 2017, consists of information about the significance of the equity portfolio for long-term investors under IAS 39 and whether the new requirements in IFRS 9 will affect asset allocation decisions.
 - (b) In Phase 2, which is due by the end of mid-2018, the EC wants EFRAG to assess, from a conceptual perspective, the significance of an impairment model to the re-introduction of recycling. If an impairment model is considered to be a precondition for recycling, then the EC wants EFRAG to consider possible alternatives of a robust impairment model. The EC requests EFRAG to consult publicly to the maximum extent possible within the given timeframe.

Past history

Past discussions of the EFRAG Board

- 11 At its September 2016 meeting, the EFRAG Board decided to add the project to EFRAG's research agenda.

Past discussions of EFRAG TEG

- 12 EFRAG TEG had several meetings to discuss the project and tentatively agreed to the following:
 - (a) the scope of the project and the project plan;
 - (b) the development of an effective impairment model is a requisite to re-introduce recycling;
 - (c) the impairment model should apply to all investments in equities. No distinction should be made between short-term and long-term investments, or listed and unlisted;
 - (d) while some members supported a different model for 'strategic investments', there is no practical way to define them; and

- (e) the discussion paper should include a 'lower of cost and fair value' model, under which all changes in fair value above the original cost are recognised in OCI, and all changes below are recognised in profit or loss.

Past discussions of the EFRAG User Panel

- 13 The EFRAG User Panel expressed some reservations to the project, as they noted that recycling gains on disposal allows entities to decide the timing of recognition. The EFRAG User Panel agreed that any impairment solution should be applicable to all investments in equity instruments. They did not express support for a specific model.

Past discussions of EFRAG FIWG

- 14 The EFRAG FIWG supported the reintroduction of recycling of disposal gains. They suggested that the project should also look at the issue of reversals of impairment losses.

Planned final outcome

- 15 The expected output of the project would be two papers, one summarising the data collection efforts and another discussing the possible impairment models.

Agenda papers

- 16 In addition to this cover note, the following agenda papers have been provided for the session:
 - (a) 11-02 *Issues paper on a modified IAS 39 approach and the significance of an impairment model to recycling CFSS 17-09-20*; and
 - (b) 11-03 *Issues paper on update on the quantitative data on Equity instruments CFSS 17-09-20*.

Appendix 1: Tentative project timeline

Sep '16	Oct '16	Nov '16	Dec '16	Jan '17	Feb '17	Mar '17	Apr '17	May '17	Jun '17	Jul '17	Aug '17	Sep '17	Oct '17	Nov '17	Dec '17	Jan '18	Feb '18	Mar '18	Apr-June '18
EFRAG Board adds project								EFRAG Board meeting						EFRAG Board meeting					EFRAG Board meeting
EFRAG TEG agrees project plan																			
	Input from users							Input from users											
	Quantitative data and initial ideas for impairment approaches																		
				EFRAG TEG meeting		EFRAG TEG meeting			EFRAG TEG meeting			EFRAG TEG meeting	EFRAG TEG meeting	EFRAG TEG meeting	EFRAG TEG meeting				EFRAG TEG meeting
				Data collection from EFRAG FIWG and ideas for improvements to AFS															
							Develop other possible impairment models and gather quantitative data												
												Input from academics							
															End of Phase 1				
																			End of Phase 2