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EFRAG Equity Instruments - Impairment and Recycling – preliminary analysis of feedback

Objective of the session

1 The objective of this session is to discuss a preliminary analysis of the relies to EFRAG's Discussion Paper *Equity Instruments – Impairment and Recycling* (DP) and to discuss initial views on possible solutions phase of the European Commission's (EC) request.

Background of the project

Objective of the project

2 The IASB issued IFRS 9 *Financial Instruments* in July 2014. IFRS 9 is effective for annual periods beginning on or after 1 January 2018. In accordance with IFRS 9, equity instruments are measured at fair value with changes in fair value recognised in profit or loss ('FVPL'). At initial recognition, an entity may make an irrevocable election to present changes in the fair value in other comprehensive income ('FVOCI election'). This FVOCI election is not available for equity instruments that are held for trading or are contingent consideration recognised in a business combination. The entity may apply the FVOCI election on an instrument-by-instrument basis.

3 If the entity applies the FVOCI election, changes in fair value are presented in other comprehensive income ('OCI'). These changes are not reclassified into profit or loss ('recycled') on disposal and there is no requirement to assess these instruments for impairments. Dividends from the instruments are however recognised directly in profit or loss.

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') equity instruments in IAS 39 *Financial Instruments: Recognition and Measurement* were very subjective.

5 In its Endorsement Advice on IFRS 9, EFRAG noted that the default requirement to measure all equity investments at FVPL may not reflect the business model of long-term investors, including entities undertaking insurance activities and entities in the energy and mining industries. EFRAG also noted that the FVOCI election was not likely to be attractive to long-term investors because the prohibition on recycling gains and losses may not properly reflect their performance.

6 EFRAG assessed that it was unlikely that long-term investors would change their investment strategy as a result of the implementation of IFRS 9. However, EFRAG acknowledged that its assessment was based on the limited evidence available at that time.

7 The objective of the project is to consider possible alternative models for the impairment of equity instruments designated at FVOCI, with a view to allow the recycling of gains and losses on disposal.

8 EFRAG published a DP in March 2018 to gather views on the issue of recycling and impairment of equity instruments designated at FVOCI.

Scope of the project

9 During the development of the project, the following topics are discussed:

(a) the significance of an impairment model to the re-introduction of recycling of disposal gains or losses of equity instruments; and

(b) identifying an impairment model for equity instruments.

10 For the purposes of this project, the EFRAG Secretariat will not challenge or reconsider the following aspects of IFRS 9's requirements on accounting for investments in equity instruments:

(a) equity instruments are measured at fair value in the statement of financial position; and

(b) the FVOCI election is neither removed nor made obligatory.

11 The project will not address any changes in the definition of an equity instrument under IFRS Standards.

12 In May 2017, EFRAG received a request from the EC for technical advice. The request had two distinct phases: an assessment phase and a possible solutions phase:

(a) in the assessment phase, the EC asked EFRAG to collect quantitative information about current holdings of equity instruments and their accounting treatment. The EC also requested EFRAG to obtain information of the entities' expectations in relation to:

(i) the extent to which they plan to use the FVOCI election and the factors that will influence their choices; and

(ii) the anticipated effects of the new requirements in IFRS 9 on their decisions to invest in equity instruments or other categories of financial assets and their holding periods (including quantification where possible).

(b) in the possible solutions phase, the EC asked EFRAG to assess, from a conceptual perspective, the significance of an impairment model to the re-introduction of recycling. If EFRAG concludes that an impairment model is a precondition to re-introduce recycling, then EFRAG is asked to consider how the existing impairment model under IAS 39 for equity instruments could be improved or propose other impairment approaches, possibly by looking at other national or third-country Generally Accepted Accounting Principles. EFRAG is also asked to consider if, in the absence of a robust impairment model, alternative presentation or disclosure requirements could be used to provide users with the necessary information to make the adjustments deemed necessary to the reported profit or loss.

Past history

Past discussions of other EFRAG TEG Working Groups

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. EFRAG User Panel members did not express support for a specific model.

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, foreign currency issues and whether the timing of issue of financial statements should impact the impairment assessment.

Planned final outcome

15 The expected outputs of the project would be:

(a) an assessment phase report, which will be sent to the EC and be made public on EFRAG's website;

(b) a possible solutions phase discussion paper, which will be exposed to gather constituent's views and be made public on EFRAG's website; and

(c) a possible solutions phase position paper, which will be sent to the EC and be made public on EFRAG's website.

Next steps

16 The EFRAG Secretariat will bring to the EFRAG TEG at its July 2018 meeting:

(a) a draft Feedback Statement on EFRAG DP Equity Instruments Recycling and Impairment; and

(b) a draft possible solutions phase position paper in response to the second phase of the EC request

Questions for EFRAG TEG

17 Views are split between those who support EFRAG recommending to the EC to consider modifying IFRS 9; and those who would not promote changes at this stage, one of the reasons being that there is not yet sufficient evidence of the impacts of IFRS 9 on investments. Which position does EFRAG TEG support?

18 Most respondents that expressed a position on the impairment model favour an IAS 39-type solution but acknowledged that it should be improved. Suggestions on how to improve it are however split, with some respondents giving priority to entities' judgment to ensure relevance and other giving priority to increased comparability. Which position does EFRAG TEG support?

19 What kind of activity would you suggest the EFRAG Secretariat to undertake to develop the final advice? Please consider that the timetable requires EFRAG TEG to express a recommendation to the Board at the early July TEG meeting.

Agenda papers

20 In addition to this cover note, agenda paper 09-02 *Issues Paper Equity Instruments – Impairment and Recycling - TEG 18-06-13* has been provided for the session.