EFRAG
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EFRAG Secretariat: F. Poli
J. Wadier, A. Alcalá

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

Objective

1 The objective of this paper is to provide EFRAG TEG with a preliminary analysis of the replies to EFRAG's Discussion Paper *Equity Instruments – Impairment and Recycling* (DP).

2 EFRAG published the DP as part of an effort to gather views and prepare a response to the European Commission (EC) that requested technical advice on recognition of equity instruments carried at FVOCI.

3 The DP's main focus was whether recycling gains and losses on the disposal of equity instruments carried at FVOCI would better reflect the performance of long-term investors and whether recycling should be accompanied by an impairment model.

4 The DP also included other impairment related issues and illustrated two alternative impairment models for equity instruments carried at FVOCI:

(a) a revaluation model, in which all declines in fair value below the acquisition cost would be immediately recognised in profit or loss and changes in fair value above the acquisition cost would be recognised in OCI and recycled on disposal; and

(b) an impairment model similar to the model of IAS 39 *Financial Instruments: Recognition and Measurement* for equity instruments classified as available-for-sale ('AFS'), but with additional guidance to reduce subjectivity.

5 The comment period of the DP ended on 25 May. At the date of this report, EFRAG received 49 replies. Appendix 1 includes the list of respondents. One respondent is excluded from the list but considered in the analysis as they preferred to keep their response anonymous.

6 In accordance with EFRAG procedures, a full feedback statement will be published in due course.

7 This preliminary analysis summarises the messages received from constituents, noting some key themes identified. Its purpose is to assist EFRAG TEG to consider what the main issues are to finalise the EFRAG technical advice.

Key themes of the responses received

8 Approximately one-third of the respondents to the DP suggested that it might be preferable to wait for the IASB's Post Implementation Review (PIR) of IFRS 9 before raising concerns and suggesting changes to the new standard. Nearly the same number of respondents provided comments or raised concerns about the initiative leading to European modifications to IFRS and preferred IFRS as issued by the IASB. For some of these constituents, one or both of these suggestions substantively represented their complete response to the DP as they did not provide comments to individual questions contained in the DP.

9 Nearly three-fourths of the total respondents expressed a view that the reintroduction of recycling would improve the depiction of financial performance of long-term investors agreed that it would.

10 An overwhelming majority of respondents to the question as to whether recycling needed to be accompanied by an impairment model agreed that it did.

11 Approximately two-thirds of the respondents preferred the impairment model similar to IAS 39, mainly because it attempted to make a distinction between temporary and more permanent declines in fair value. Many favoured quantitative triggers or rebuttable presumptions, and of those that supported quantitative triggers most preferred the trigger to be defined by the reporting entity.

12 Most respondents supported the reversal of impairment losses through profit and loss upon a fair value recovery of an equity instrument. Views were mixed as to whether the reversal should be on an ongoing approach or a symmetrical approach. Some respondents suggested that some of the application problems with impairment under IAS 39 may have been caused by the standard's prohibition of any impairment loss reversals.

13 Several respondents suggested a scope amendment to the FVOCI option of IFRS 9 to include indirect investments in equity instruments, such as UCITs. Some other constituents advocated for a different treatment for equity instruments within the Level 3 fair value hierarchy.

General comments of constituents

14 Some respondents, mainly users; Regulators and National Standard Setters suggested that to ensure a consistent set of accounting standards applied on a global basis, that any re-examination of IFRS 9 *Financial Instruments* relating to the DP – should only be performed on a global level and as part of the IASB's Post Implementation Review (PIR) process rather than pursuing a stand-alone project at the European level. Some mentioned that any modification at European level would result in a decrease in comparability of IFRS financial statements.

15 Many of those respondents noted that entities only just started applying IFRS 9. They considered that it was too early to draw conclusions on the impact of the Standard. Those respondents mentioned that there was no clear evidence that the current requirements, which prohibit recycling, will have a negative impact on long-term investments, nor that the reintroduction of recycling would have a positive impact.

16 A few respondents mentioned that the FVOCI option for equity instruments in IFRS 9 should be eliminated. They considered the appropriate measurement criteria for all equity instruments is FVPL as this option allowed greater comparability between entities.

17 Other respondents, mainly preparers (insurance companies), urged for an amendment to IFRS 9 to reintroduce recycling accompanied by an impairment model. These constituents suggested it would be the only solution to report all the components of the performance of equity instruments in profit and loss. This would also be more consistent with the accounting treatment of debt instruments accounted for at FVOCI.

18 Most of these respondents encouraged the EFRAG Board to advice the EC to urge the IASB to undertake a narrow-scoped amendment to IFRS 9 on a timely basis as it would be more efficient for insurance undertakings if the quick fix would be effective by the effective date of IFRS 17 *Insurance Contracts*.

Analysis of responses to questions in the DP

Question 1 Recycling gains or losses on disposal

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.

19 Most respondents that answered the question agreed that the recycling of realised gains and losses on equity investments to profit and loss would enhance the relevance of the reported financial performance of long-term investors and increase the consistency in accounting for equity instruments with that of other investments.

20 Some respondents provided further explanations of why recycling enhanced relevance:

(a) paragraph 7.16 of the *Conceptual Framework* established that the statement of profit or loss was the primary source of information about financial performance;

(b) paragraph 7.19 includes a general presumption that the accumulated gains and losses in OCI into the statement of profit or loss in a future period, when this results in the statement of profit or loss providing more relevant information, or a more faithful representation of the entity's financial performance for that future period. Some argued that was the case when the investments were sold, and the gains or losses were realised.

21 While some constituents acknowledged that profit or loss recognised in the period of disposal might not have predictive value, they mentioned that recycling of accumulated OCI to profit and loss when equity instruments were sold would still be relevant.

22 One respondent stated that a disposal of an equity instrument was relevant for the following reasons;

(a) profit and loss recognised on disposal had confirmatory value because it reflected the fact that the equity instrument had been sold and thus would be more useful than the information which merely reflected the fact that the fair value of the equity instrument changed during the period by holding the equity instrument; and

(b) disclosure of the amount reclassified from OCI to profit and loss would enable users to assess the 'quality of earnings' by comparing the total profit or loss amount and the amount that was previously recycled from accumulated OCI.

23 Another respondent pointed out that profit and loss was not only the key performance indicator, it also impacted other performance indicators such as return on capital employed. This might lead to misinterpretations about capital efficiency if it was not adjusted.

24 Respondents that were not in favour of the reintroduction of recycling felt existing IFRS 9 was an adequate depiction of financial performance. They provided further explanations that included:

(a) the timing of a sale of an equity instrument was entirely controlled by the entity and did not help reflect the entity's performance in the year;

(b) any re-measurement gains or losses pertained to holding period and not the period of disposal; and

(c) recycling could lead to manipulation of profit and loss and obscured the performance of an entity's portfolio.

Question 2 Conceptual relationship between recycling and impairment

Do you consider that, from a conceptual standpoint, recycling should be accompanied by some form of impairment model? Please explain.

25 Nearly all respondents recognised the need for an impairment model if equity instruments were accounted for at FVOCI with recycling.

26 Most of respondents acknowledge that some of the negative fair value changes could be of a permanent nature. Most of them also agreed that a robust impairment model increased the relevance of the profit and loss statement as primary source of information of the performance of the company.

27 One respondent did not think it was conceptually necessary to have an impairment model with recycling as both gains and losses would be recognised in profit or loss upon disposal. However, that respondent acknowledged that some of the negative FV changes could have a permanent nature and it would be more appropriate and in line with the principle of prudence to reflect such fair value changes in profit or loss.

Question 3 Enhancing presentation and disclosure requirements

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

Are there other improvements in presentation and disclosure that you would support?

28 Almost all of the respondents to this question agreed that presentation and disclosure solutions could not adequately replace recognition and measurement in the primary financial statements and referred to IAS 1 *Presentation of Financial Statements*. For that reason, it was generally agreed that information recognised in the financial statements was more valuable that information disclosed in the notes.

29 Most respondents also did not support additional disclosure requirements, beyond those already in IFRS 7 *Financial Instruments: Disclosure* paragraph 11A and 11B. However; many acknowledged that if recycling with impairment were introduced there would be a need to disclose information on both the impairment policy and amounts.

Question 4 Two models

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

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

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

30 Several constituents agreed that a robust impairment model needed to provide relevant and reliable information and allow conclusions to be made about comparability. Some constituents suggested relevance should take precedence if there was a conflict between features.

31 Approximately three-fourths of the constituents that expressed a preference for one of the two models preferred the impairment model similar to the one used in IAS 39 for instruments available-for-sale. The main reasons provided in favour of the impairment model similar to IAS 39 included:

(a) It would distinguish between permanent declines in fair value and short-term fair value changes;

(b) It would appropriately reflect the business intention of a long-term investor as a decline in fair value should be recognised in net income if it was based on an adverse change in the environment of the equity investment;

(c) It would be more consistent with the impairment approach used for debt instruments measured at FVOCI;

(d) It would reduce volatility in profit and loss; and

(e) It would better reflect adverse changes in the issuer's economic condition.

32 The key reasons provided by the constituents in favour of the revaluation model included:

(a) better comparability and less subjectivity;

(b) reduced complexity since it did not involve setting thresholds or triggers; and

(c) mitigated earning management concerns.

33 A few constituents suggested alternative impairment models to the two models illustrated in the DP. The suggested different options included:

(a) an impairment model applied at the level of a long-term investment portfolio;

(b) a value-in-use method based on the future cash flows the entity expects from the asset; and.

(c) an impairment model where the trigger is the reduction of the dividend.

Question 5 Quantitative impairment triggers

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?

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

34 Most respondents that answered the question supported the use of quantitative impairment triggers or rebuttable presumptions. Many of these respondents acknowledged that there were prior practical problems in application of the 'significant' and 'prolonged' criteria used in IAS 39 and believed that more guidance was needed to provide greater comparability.

35 Of those that supported the use of quantitative impairment triggers or rebuttable presumptions, most preferred that the quantitative trigger was established by the reporting entity. The reasons for entity defined triggers included:

(a) a single bright line approach might not be appropriate in all circumstances or for all entities;

(b) more principles based; and

(c) allowed for consideration of the characteristics of the business model or portfolio and relevance was more important than comparability.

36 The primary reason for those in favour of standard based quantitative triggers was that it was more operational and achieves comparability between entities and over time.

37 Some of the respondents that preferred either the entity defined, or the standard defined quantitative trigger commented that a quantitative trigger should include a rebuttable presumption. Some added that a combined approach with the standard defining the upper limits would be their second choice.

38 For those respondents that opposed the use of quantitative triggers, the following were the main reasons provided:

(a) specific judgement must be exercised to convey the correct information;

(b) impairment would become rule-based;

(c) it would fail to provide relevant information in certain circumstances; and

(d) management should determine impairment criteria that apply to a dedicated portfolio.

39 In the absence of quantitative triggers, one respondent suggested that comparability might be improved by the development of illustrative and specific guidance on the meaning of both 'significant' and 'prolonged' in well-defined situations combined with improved disclosure. Another respondent noted that allowing for the reversal of an impairment may improve comparability.

Question 6 Subsequent recovery in fair value

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

If subsequent recoveries in fair values are recognised in profit or loss, which of the approaches do you support and why?

40 Most respondents agreed that recognising subsequent recoveries in profit or loss was appropriate as it would provide more relevant information. The objective of an impairment model would be to capture significant downwards movements in the value of an entity's equity investments. If circumstances changed at a later date and the conditions for an impairment loss no longer applied, recognising subsequent recoveries in profit and loss would be conceptually acceptable and consistent with the principles of other IFRS.

41 One respondent preferred retaining IAS 39's irreversible approach for impairment losses. However, this respondent also advocated for a relatively high impairment threshold.

42 Less than one-third of the respondents to the DP expressed a preference on the method of an impairment reversal. Most of the respondents that did express a preference preferred a limited reversal approach[1] because it was symmetrical with the underlying impairment model and limited undue volatility.

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[1] A limited reversal approach would allow recognition of a reversal only from the moment when the fair value recovers over the initial cost or the impairment threshold. In an impairment model with a 'significant' threshold this would introduce a degree of symmetry – moving across the threshold would trigger both the recognition of downward changes and recoveries in profit or loss.

Question 7 Other considerations

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?

Do you have comments on these other considerations?

Are there other aspects that EFRAG should consider?

43 A clear majority of respondents to the question mentioned that for reasons of comparability and objectivity, the same model should apply to all equity instruments carried at FVOCI. A few of the respondents suggested there should be different impairment models. The suggested exceptions included:

(a) Level 3 instruments, as the market information to conduct the impairment test was not reliable;

(b) equity instruments held by insurers;

(c) strategic investments.

44 Some respondents supported the idea to include a rebuttable presumption into the impairment model with (entity-specific) quantitative thresholds as it would still properly reflect the acknowledgment that some equity instruments were more volatile than others.

45 Respondents generally agreed that the unit of account for the measurement of financial instruments was the individual instrument. However, two respondents had opposing views. One respondent a portfolio approach should be allowed for linked asset/liabilities. Another respondent believed the unit of account should be the portfolio or business model of equity instruments.

46 Respondents commenting on the cost formula when an individual investment had been acquired in multiple tranches generally did not support specifying the formula in an accounting standard.

Question 8 Other aspects of IFRS 9's requirements on holdings of equity instruments

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.

47 Several respondents suggested that the FVOCI election should be allowed for indirect investments in equity instruments, such as Undertakings for Collective Investments Transferable Securities (UCITS), Exchange Traded Funds (ETF) or Authorized Investments Funds (AIF).

48 One respondent did not see a need for a discretionary option as contained in IFRS 9 to designate an equity instrument at FVOCI, and instead, believed it should be mandatory depending on the business model. However, another respondent also commented on the option and suggested should be eliminated altogether resulting in all equity instruments at FVPL. It should be noted that several respondents to earlier questions in the DP also expressed support that all equity instruments should be at FVPL.

49 Some respondents mentioned that the DP excluded a discussion on the use of fair value as the measurement basis for all equity instruments. They questioned the reliability of the measurement for certain instruments. One respondent suggested that on-going initiatives related to the accounting for these instruments were coordinated.

50 One respondent favoured using cost rather than fair value for less significant long-term investments, with impairment charges and reversal mechanism similar to IAS 36 *Impairment of Assets*, and the recognition of gain and losses on disposal or retirement in the profit and loss account. This was suggested on the grounds that it was simple and consistent with other non-current assets.

APPENDIX I – List of respondents

Respondent	*Country*	*Type*
ACCA - Association of Chartered Certified Accountants	International	Auditing
Accountancy Europe	International	Business Association
ACTEO – Association pour la participation des entreprises françaises à l'harmonisation comptable internationale AFEP – Association française des entreprises privées MEDEF – Mouvement des entreprises de France	France	Business Association
AFME - Association for Financial Markets in Europe	International	Business Association
AFRAC - Austrian Financial Reporting and Auditing Committee	Austria	Auditing
Allianz	Germany	Preparer
ANC - Autorité des Normes Comptables	France	National Standard Setter
ASBJ – Accounting Standards Board of Japan	Japan	National Standard Setter
ASCG - Accounting Standards Committee of Germany	Germany	National Standard Setter
Assuralia	Belgium	Business Association
BNP Paribas	France	Preparer
BusinessEurope	International	Business Association
Carsten Zielke	Germany	Individual
CFO Forum – European Insurance CFO Forum	International	Business Association
CNC – Comissao de Normalizacao Contabilistica	Portugal	National Standard Setter
Commerzbank	Germany	Preparer
DASB - Dutch Accounting Standards Board	Netherlands	National Standard Setter
DASC - Danish Accounting Standards Committee	Denmark	National Standard Setter

Deutsche Telekom AG	Germany	Preparer
ECB – European Central Bank	International	Regulator
EFAMA – European Fund and Asset Management Association	International	Business Association
EFFAS - European Federation of Financial Analysts Societies	International	Professional Organisation of Users
ESBG - European Savings and Retail Banking Group	International	Business Association
ESMA - European Securities and Markets Authority	International	Regulator
Evonik Industries AG	Germany	Preparer
FBF - French Banking Federation	France	Business Association
FFA - Fédération Française de l'Assurance	France	Business Association
Finance Denmark	Denmark	Business Association
FRC - Financial Reporting Council	UK	National Standard Setter
GBIC – German Banking Industry Committee	German	Business Association
GDV – German Insurance Association	Germany	Business Association
HBA - Hellenic Bank Association	Greece	Preparer
ICAC – Instituto de Contabilidad y Auditoría de Cuentas	Spain	National Standard Setter
ICAEW - Institute of Chartered Accountants in England and Wales	UK	Auditing
ICAS – Institute of Chartered Accountants of Scotland	UK	Auditing
Insurance Europe	International	Business Association
Invest Europe	International	Business Association
ISDA - International Swaps and Derivatives Association	International	Business Association
KBC	Belgium	Preparer
Mazars	France	Auditing
NASB - Norwegian Accounting Standards	Norway	National Standard Setter

OIC – Organismo Italiano di Contabilita	Italy	National Standard Setter
PASC - Polish Accounting Standards Committee	Poland	National Standard Setter
ProSiebenSat.1 Media SE	Germany	Preparer
Siemens AG	Germany	Preparer
Société Générale	France	Preparer
Temasek Holdings	Singapore	Preparer
UK Finance	UK	Business Association
Anonymous Author	Austria	Preparer

APPENDIX II – List of presentations

9 April 2018	Accountancy Europe IFRS 9 Task force
13 April 2018	International Forum of Accounting Standard Setters
2 May 2018	EFFAS Financial Accounting Commission
3 May 2018	EFRAG Financial Instruments Working Group
3 May 2018	Euro Corporate Reporting User Forum
14 May 2018	International Group Organismo Italiano di Contabilitá
15 May 2018	EFRAG User Panel
24 May 2018	BusinessEurope Sounding Board
28 May 2018	Nippon Life Insurance Company
6 June 2018	KBC bank