EFRAG
European Financial Reporting Advisory Group

Equity instruments: alternative measurement
Cover Note

Objective

1 At its February 2019 meeting, EFRAG TEG approved to recommend to the EFRAG Board the publication of a discussion paper ('DP') in relation to the second request of the European Commission's ('EC') request.

2 The objective of this session is to discuss and approve this DP for public consultation.

Background

3 In June 2018, the European Commission requested EFRAG to investigate alternatives to fair value as the measurement basis for equity long-term investment portfolios of equity and equity-type instruments.

4 In prior discussions, the EFRAG Board indicated that a Discussion Paper would be issued to consult constituents.

(a) Issue a DP for public consultation;

(b) Consider the inputs from constituents; and

(c) Provide its technical advice to the EC.

EFRAG TEG discussion and advice to the EFRAG Board

5 EFRAG TEG carried out discussions on the content on the consultation document between September and February. In these sessions, EFRAG TEG discussed the following issues:

(a) Whether EFRAG should develop a definition of 'long-term investments' and possible ways to do so;

(b) Possible alternative measurement basis, including:

(i) Historical cost;

(ii) Average fair value;

(iii) Approaches based on adjusted cost;

(iv) Approaches based on adjusted fair value;

(v) Long-term expected value; and

(vi) Allocation approaches.

(c) Using these alternatives as a single measurement basis (both in the statement of financial position and to report gains or losses in profit or loss) or in a dual measurement model (with fair value used in the statement of financial position, and OCI used as a bridge);

(d) Assuming there was a different measurement approach for equity instruments, for what other 'equity-type' instruments it could be allowed or required.

6 At its February 2019 meeting, EFRAG TEG voted to recommend the DP for publication with 10 members in favour, 4 against and 2 absentees. The members that voted against recommending the DP for publication expressed a number of concerns about the document and the project in general:

(a) A lack of clarity about the problem definition – it was noted that since the request from the EC originates from the action plan on financing sustainable growth, it would have been appropriate to focus the analysis on those specific investments;

(b) A lack of specificity in the analysis – it was noted that most of the analysis could be applied to financial assets other than equity instruments, such as trade receivables in foreign currency. It was also noted that that it would have been appropriate to focus on a specific type of instrument, such as units in European Long-Term Investment funds.

Contents of the Discussion Paper

7 As noted above, the focus of the DP is the investigation of alternative accounting requirements in the context of reporting performance for entities holding long-term investment portfolios of equity and equity-type investments.

8 It should be considered that EFRAG has already:

(a) Conducted a public consultation to collect data and constituents' expectations about the impact of IFRS 9 on the holdings of equity investments;

(b) Conducted a second public consultation to collect views on the relevance of a impairment model for the reintroduction of recycling, and what the characteristics of an effective impairment model for equity instruments should be.

9 As a consequence, the DP does not address directly the issue of the reintroduction of recycling and the impairment model.

10 The DP also briefly illustrates some disclosure requirements that could assist entities in explaining their long-term performance. However, the DP does not address comprehensively what changes in disclosure requirements would be needed for each alternative measurement approach considered.

Comment period

11 Usually, EFRAG's Discussion Papers have a comment period of at least 90 days. In this specific case, the EFRAG Secretariat is suggesting a comment period until 10 May. The reasons for suggesting a shorter period are as follows:

(a) This DP is a continuation of a prior consultation, and EFRAG Secretariat expects that comments from respondents would be substantially aligned to prior positions;

(b) The original deadline to reply to the EC request is the end of June. While EFRAG has already indicated that it will not be able to meet the deadline, a 90-days comments would mean that EFRAG TEG would consider an initial analysis of the feedback only at its July meeting, and start discussing the technical advice only after the summer. If the comment period ends in mid-

May, it would be possible to complete the discussion on the constituents' feedback before the summer.

Question for EFRAG Board

12 Does the EFRAG Board approve to issue the discussion paper for public consultation?

13 Does the EFRAG Board agree to have a comment period until 10 May?

Next steps in the project

14 The EFRAG Secretariat advises that activity on this project should not be suspended between the publication of the DP and the end of the comment period. Additional work could be performed to investigate what interaction is there between the accounting requirements for equity instruments and the public policy objective of financing infrastructure and sustainable activities.

15 The first objective would be to update the prior analysis of the accounting impacts of the new requirements in IFRS 9. Since IFRS 9 became effective on 1 January 2018 (with the exception of entities with significant insurance activities) data is now available about the impact of the first application – notably, reclassifications from available-for-sale assets to assets at fair value through profit or loss, or fair value through Other Comprehensive Income. However, information in notes may not be specific to equity instruments because other instruments previously classified as AFS may have been transferred to FVPL because they do not meet the SPPI test.

16 It could also be possible to collect data on trends in asset allocation between equity instruments and other classes of financial assets. However, information could be available only for some categories of investors.

17 A second objective would be to try to develop a mechanism of effect – i.e. a chain of reasoning as to why the accounting requirements may impact the public policy objective and what their potential effect is, if any. In particular, it would be necessary to identify what sources of financing for infrastructure and sustainable activities, however defined, are affected by changes in the accounting requirements and what are not.

Question for EFRAG Board

18 Does the EFRAG Board agree that the activities on this project should not be suspended between the date of publication of the DP and the end of the comment period?

Agenda Papers

19 In addition to this cover note, the EFRAG Secretariat provided agenda paper 07-02 – *EFRAG's Discussion Paper on Equity instruments – alternative measurement approaches* for the session.