Equity instruments – impairment and recycling

A discussion paper issued by the European Financial Reporting Advisory Group (EFRAG) in March 2018

Comments from ACCA
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Further information about ACCA's comments on the matters discussed here may be obtained from the following:

Richard Martin
Head of Corporate Reporting, ACCA
Telephone: +44 (0)20 70595748
Email: richard.martin@accaglobal.com

ACCA
+44 (0)20 7059 5000
info@accaglobal.com
www.accaglobal.com
The Adelphi 1/11 John Adam Street London WC2N 6AU United Kingdom

ACCA welcomes the opportunity to provide views in response to the consultation from EFRAG. This has been done with the assistance of the members of ACCA's Global Forum for Corporate Reporting. They have considered the questions raised and their views are reflected in the following comments.

SPECIFIC QUESTIONS ON WHICH COMMENTS ARE REQUESTED

Question 1 – Recycling gains and losses on disposal

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

We are generally content with IFRS9 as it stands. We are aware however that recycling in the fair value through other comprehensive income (FVOCI) option has been raised as a concern, and so we have engaged with EFRAG's discussion paper. The outcomes of these issues with EFRAG should be the first steps in the Post-Implementation Review (PIR) of IFRS9 and not the basis for any EU-only alteration to IFRS9. The timing of this PIR should on balance be sooner rather than later given concerns about the issue and the impending application of IFRS9 by insurance companies.

We consider that the most appropriate depiction, in the majority of cases for the financial performance of long-term investors in equities, is the fair value through profit or loss (FVPL) treatment that is the standard approach in IFRS9. Annual financial statements, especially the profit or loss, are recording their performance against their long-term objectives of receiving income and realising gains in the value. The best measure of that performance in the period is the dividend income and change in fair value, where reliable fair values are available.

Where there are liabilities that are essentially to be met by the investments in equities (for example with certain insurance contracts) we accept that the accounting treatment for the assets needs to have regard for the treatment of the liabilities. Insurance companies will be

among the largest holders of equities among companies applying IFRS and they may fall into that category. Those companies have yet to apply IFRS9.
Equally there may be strategic investments where the investments are held primarily for business reasons other than for dividend income and fair value gains. FVPL may not be the most relevant depiction of performance and the FVOCI model in IFRS9 seems appropriate for them. Hence we agree with the option for FVOCI.

However we accept that there are issues with the lack of recycling of the cumulative gains into profit or loss on realisation in the FVOCI model in IFRS9. Some who are using the option would prefer to see recycling, as they consider that profit or loss is the key performance measure and that realised gains or losses are a key component of performance. It seems inherently suboptimal that there are gains that will never appear in profit or loss, even for the strategic investments. The common tax treatment is that on realisation of the gains and without a recognised gain in profit there can be scope for confusion.

Any reconsideration of recycling really needs to have the conceptual basis for profit or loss and OCI to have been established. There seems currently no clear concept to which we should be aiming and existing IFRS seem to have come to different conclusions on the recycling issue.

Question 2 – conceptual relationship between recycling and impairment

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.

We agree that if there is to be recycling then there needs to be an impairment requirement. The aim of recycling is to have an income statement that is on a historical cost basis even though the balance sheet may be at fair value. The principle to be upheld is that assets in the historical cost model should be at the lower of cost and realisable value.

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?

We agree that changed disclosures and presentation will not address the issues raised.

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

If there is to be recycling then we would favour the revaluation model. We do so on the grounds of

- Less complexity
- More consistency with the treatment of the impairment of other assets (such as property, plant and equipment)
- Greater comparability between reporting entities
- Less scope for earnings management

There is evidence of the range of judgements on the meaning of ‘significant decline’ or ‘over a prolonged period’ that have evolved under the IAS39 model.

The key characteristics of the revaluation model would be representational faithfulness and comparability.

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?

As stated above we support the revaluation model for impairment and so would not see the need for quantitative impairment triggers.

Question 6 – Subsequent recovery in fair values

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 in paragraphs 5.2 – 5.10 do you support and why?

If the reasons and assumptions for the original estimate have changed then the impairment model should allow for the revision of those estimates including upward revisions. The revaluation model is clear on this.

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?

As noted above in answer to Q1, there may be scope for different models for strategic investments and for insurers.

Question 8 – Other aspects of IFRS9'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.

No further comments.