Equity Instruments - Research on Measurement

1. Why is EFRAG consulting?

As part of its [Action Plan on Sustainable Finance](), the European Commission ("EC") announced it would ask EFRAG to explore potential alternative accounting treatments to ("FV") measurement for long- term investment portfolios of equity and equity-type instruments.

In June 2018, EFRAG received a request for advice from the EC in relation to the accounting requirements for investments in equity instruments.

The request for advice is part of the EC's initiatives to orient capital flows towards investment in sustainable activities.

The request for advice asks EFRAG to consider alternative accounting treatments to measurement at fair value through profit or loss (FVPL) for equity instruments.

According to the request for advice, such possible alternative accounting treatments should serve the following objectives:
properly portray the performance and risks of long-term investment business models, in particular for those equity and equity-type investments that are much needed for achieving the UN Sustainable Development Goals and the goals of the Paris Agreement on Climate Change;
preferably enhance investors' insight in the long-term performance of investments, as opposed to recognising point-in-time market-based value changes in reported profit or loss during the duration of the equity investment.

2. The questionnaire

EFRAG has developed this questionnaire in order to gather views from constituents on alternative accounting treatments to IFRS 9 *Financial Instruments* requirements for equity and equity-type instruments held in a long-term investment business model. Such alternative treatments should serve the objectives mentioned above. Respondents are encouraged to read the EFRAG Secretariat background paper available here.

The EFRAG Secretariat background paper provides background information on the request for advice. It explains how the consultation relates to the EC's initiatives on sustainable growth, illustrates the accounting requirements in IFRS 9 and explores some possible alternative measurement approaches.

The possible alternatives in the background paper are to be considered as examples; respondents may suggest other measurement approaches that they consider appropriate.

Additionally, the background paper provides indications of how the concepts of 'long-term investment business model' and "equity-type instrument" may be considered in the context of the questionnaire.

In addition to submitting replies to the questionnaire, constituents can provide their input on the topic and ask questions about the survey by writing to:
Fredre Ferreira (*fredre.ferreira@efrag.org*), or Isabel Batista (*isabel.batista@efrag.org*).

Respondents are encouraged to respond to all questions but are not required to do so. EFRAG will still consider their answers.

EFRAG will disclose the responses, unless a respondent asks for confidentiality.

Please complete this survey by 5 July 2019

3. General information about the respondent

1. Name of the individual/ organisation

Instituto de Contabilidad y Auditoría de Cuentas (ICAC)

2. Country of operation

Spain

3. Job title

4. E-mail address

presidencia@icac.mineco.es

5. Are you currently engaging in a long-term investment business model?

6. How do you define long-term investment business model?

7. Are you currently engaging in investment of sustainable activities?

8. How do you define sustainable activities?

4. Question 1

9. IFRS 9 allows an entity to account equity instruments either at FVPL or, if applicable, at fair value through other comprehensive income (FVOCI) without impairment and without reclassification ("recycling") to P&L upon disposal of valuation gains or losses previously recognized through OCI ("IFRS 9 requirements" for equity instruments).
When defining an accounting treatment alternative to IFRS 9 requirements for equity instruments held in a long-term investment business model, which characteristics would you require to identify a *long-term investment business model*?

If you have indicated "Other" please provide details

5. Question 2

10. In your view, is an alternative accounting treatment to IFRS 9 requirements needed to properly portray the performance and risks of equity instruments held in a long-term investment business model?

No

6. Question 3

11. Explain the reasons for your reply to question 2, including the key operational challenges in developing a different accounting treatment to IFRS 9 requirements

First of all, we would like to emphasize that in the opinion of the ICAC, the option of designating the equity instruments to FVOCI included in IFRS 9 should be eliminated.

If fair value is considered to be the appropriate measurement criteria for equity instruments, it should be assumed that this circumstance implies greater volatility of the entity's performance than if the cost model were applied.

By eliminating this option, in addition to allowing comparability between entities, the basic accounting requirement that any performance generated, either gains or losses should be included in profit or loss. ICAC is of the view that dividend receipts (which are recognized directly in profit or loss), the impairment of the instrument and gains or losses on disposal from the sale of equity instruments represent ways to realize the fair value instruments, then any of these events should be presented in the same way.

7. Question 4

12. With reference to equity instruments held in a long-term investment business model, if you support measurement at FV through other comprehensive income with reclassification to P&L upon disposal of the valuation gains or losses previously recognized through OIC (so called “recycling”), which impairment model would you suggest and how it would work in practice?

If the option to designate the equity instruments to FVOCI is maintained, we agree with the re-introduction of recycling, because not recycling positive or negative performance seems to be the worst of the solutions.

The answer given by this Institute is maintained in its reply to the Discussion Paper Equity instruments - Impairment and recycling. That DP described two models for equity instruments carried at FVOCI:

• 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

• an impairment model similar to the model of IAS 39 for equity instruments classified as AFS, but with additional guidance to reduce subjectivity.

Either model would be adequate, but in ICAC opinion, the revaluation model is preferable since it does not involve the problem of identifying the deterioration milestone.

The recognition of impairment losses is a complex issue. The difficulty of identifying a robust model has led the IASB to eliminate the accounting treatment of IFRS 9 for equity instruments classified in the category of available-for-sale financial assets.

The main difficulty in applying this model was to identify the failure to recover the carrying amount of investments in equity instruments due to a significant or prolonged decline in the fair value.

In the event that an impairment model similar to that of IAS 39 was chosen, we consider that the best way to achieve a consistent application of the standard is to introduce thresholds (thresholds set by the standard, not by companies), despite that the thresholds could be rejected by the IASB with the argument that IFRS are standards based on principles and not on rules. Likewise, we believe that the reversal of the impairment loss should be allowed.

8. Question 5

13. Should the different accounting treatment be restricted to equity instruments held in a long-term investment business model?

For more detail, please refer to paragraphs 4.3 to 4.29 of the Background paper.

Yes

14. Please explain your answer

There is a general agreement that fair value provides useful information about investments in equity instruments for users of financial statements. However, some argue that the changes in fair value reported in the profit or loss in case of equity instruments held in a long-term investment business model may not be the best indicator of the performance of these investments. Therefore, if it would be decided to apply a different accounting treatment, it should be restricted to equity instruments held in a long-term investment business model.

9. Question 6

15. As per IFRS 9, equity-type of instruments, such as units of investment funds, do not meet the definition of equity instrument of IAS 32 Financial Instruments: Presentation, therefore are not eligible for the option to mesure them at fair value through comprehensive income ("FVOCI"). At the same time, they are not eligible for measurement at amortised cost (as they have contractual cash flows that are not Solely Payments of Principal and Interest, “SPPI” instruments). As such, IFRS 9 requires to account for them at FVPL; no FVOCI option is granted ("IFRS 9 requirements for equity-type instruments").

Should the different accounting treatment referred to in the previous questions be extended to instruments that are "equity-type"?

For more detail please refer to paragraph 4.30 to 4.39 of the Background paper.

No

16. Please explain your answer

It seems difficult to define the "equity-type" in such a way that it is not complex to apply from a holder´s perspective and that in turn does not introduce inconsistency with the accounting treatment of other financial instruments.

However, in the event that a different accounting treatment is developed and its application for the "equity-type" instruments is extended, we consider that instruments should meet the characteristics indicate in the following question.

10. Question 7

17. If so, which characteristics would you require to define the "equity-type" instruments?

Units of funds and other instruments that meet the 'puttable exception' in IAS 32
The nature of the assets invested in

18. If you have indicated "Other" please provide details

11. Question 8

19. With reference to equity and equity-type instruments held in a long term investment business model, please rate how relevant a different accounting treatment is to the objective of reducing or preventing detrimental effects on investment in sustainable activities in Europe.

25

12. Question 9

20. Are there other characteristics that would justify an accounting treatment different than IFRS 9 requirements for equity instruments and equity-type instruments held in a long-term investment business model? Please provide examples.

13. (untitled)

The following pages include 7 illustrative examples of long term investment. For each scenario, you are invited to answer the questions on the page which follows.

Please consider that for Scenario A, B, C and D IFRS 9 requires to either measure the investment at FVTPL or to elect the option for measurement at FV through other comprehensive income, without reclassification to P&L, upon disposal, of the valuation gains or losses previously recognized through OCI, and without impairment.

14. Illustrative example A - Wind farm with predetermined useful life

21. For scenario A - In your view, is a different accounting treatment needed in order to meet the following two objectives? (i) properly portray the performance and risks of long-term investment business models, in particular for those equity and equity-type investments that are needed for achieving the UN Sustainable Development Goals and the goals of the Paris Agreement on Climate Change; and (ii) preferably enhance investors' insight in the long-term performance of investments, as opposed to recognising point-in-time market-based value changes in reported profit or loss during the duration of the equity investment.

If yes, please explain why.

22. Which element in the scenario is more relevant for your reply?

1. The sustainable nature of the investee's operation
2. The investor's inability to dispose of the shares

23. Which accounting treatments do you support?

Existing requirements are appropriate

In case you would support an Accounting treatment other than the examples explored in the EFRAG Secretariat Background paper and/or you have selected "Other", please illustrate the accounting treatment you would support and why.

15. Illustrative example B - Unlisted single equity instrument

24. For scenario B - In your view, is a different accounting treatment needed in order to meet the following two objectives? (i) properly portray the performance and risks of long-term investment business models, in particular for those equity and equity-type investments that are needed for achieving the UN Sustainable Development Goals and the goals of the Paris Agreement on Climate Change; and (ii) preferably enhance investors' insight in the long-term performance of investments, as opposed to recognising point-in-time market-based value changes in reported profit or loss during the duration of the equity investment.

If yes, please explain why.

25. Which element in the scenario is more relevant for your reply?

1. The fact that the investor does not have a put option
2. The sustainable nature of the investee's operation

26. Which accounting treatments do you support?

Existing requirements are appropriate

If you would support an Accounting treatment other than the examples explored in the EFRAG Secretariat Background paper and/or you have indicated "other", please illustrate the accounting treatment you would support and why.

16. Illustrative Example C - Open portfolio of equity instruments held with a view to service a long-term insurance liability

27. For scenario C - In your view, is a different accounting treatment needed in order to meet the following two objectives? (i) properly portray the performance and risks of long-term investment business models, in particular for those equity and equity-type investments that are needed for achieving the UN Sustainable Development Goals and the goals of the Paris Agreement on Climate Change; and (ii) preferably enhance investors' insight in the long-term performance of investments, as opposed to recognising point-in-time market-based value changes in reported profit or loss during the duration of the equity investment.

If yes, please explain why.

28. Which element in the scenario is more relevant for your reply?

1. The fact that the shares are unlisted

29. Which accounting treatments do you support?

Existing requirements are appropriate

If you would support an Accounting treatment other than the examples explored in the EFRAG Secretariat Background paper and/or you have indicated "other", please illustrate the accounting treatment you would support and why.

17. Illustrative Example D - Open portfolio of equity instruments held with a view to service a long-term liability

30. For scenario D - In your view, is a different accounting treatment needed in order to meet the following two objectives? (i) properly portray the performance and risks of long-term investment business models, in particular for those equity and equity-type investments that are needed for achieving the UN Sustainable Development Goals and the goals of the Paris Agreement on Climate Change; and (ii) preferably enhance investors' insight in the long-term performance of investments, as opposed to recognising point-in-time market-based value changes in reported profit or loss during the duration of the equity investment.

If yes, please explain why.

31. Which element in the scenario is more relevant for your reply?

1. The fact that the shares are unlisted

32. Which accounting treatments do you support?

Existing requirements are appropriate

If you would support an Accounting treatment other than the examples explored in the EFRAG Secretariat Background paper and/or you have indicated "other", please illustrate the accounting treatment you would support and why.

18. Illustrative example E - Long-term investment held indirectly through a unit fund - listed

33. For scenario E - In your view, is a different accounting treatment needed in order to meet the following two objectives? (i) properly portray the performance and risks of long-term investment business models, in particular for those equity and equity-type investments that are needed for achieving the UN Sustainable Development Goals and the goals of the Paris Agreement on Climate Change; and (ii) preferably enhance investors' insight in the long-term performance of investments, as opposed to recognising point-in-time market-based value changes in reported profit or loss during the duration of the equity investment.

No

If yes, please explain why.

34. Which element in the scenario is more relevant for your reply?

1. The investor's ability to redeem or sell

35. Which accounting treatments do you support?

Existing requirements are appropriate

If you would support an Accounting treatment other than the examples explored in the EFRAG Secretariat Background paper and/or you have indicated "other", please illustrate the accounting treatment you would support and why.

19. Illustrative example F - Long-term investment held indirectly through a unit fund – non listed

36. For scenario F - In your view, is a different accounting treatment needed in order to meet the following two objectives? (i) properly portray the performance and risks of long-term investment business models, in particular for those equity and equity-type investments that are needed for achieving the UN Sustainable Development Goals and the goals of the Paris Agreement on Climate Change; and (ii) preferably enhance investors' insight in the long-term performance of investments, as opposed to recognising point-in-time market-based value changes in reported profit or loss during the duration of the equity investment.

No

If yes, please explain why.

37. Which element in the scenario is more relevant for your reply?

1. The investor's ability to redeem or sell

38. Which accounting treatments do you support?

Existing requirements are appropriate

If you would support an Accounting treatment other than the examples explored in the EFRAG Secretariat Background paper and/or you have indicated "other", please illustrate the accounting treatment you would support and why.

20. Thank You!

Thank you for taking our survey. Your response is very important to us.