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icac Instituto de Contabilidad y Auditoría de Cuentas

EFRAG´s Discussion Paper *Equity instruments – Impairment and recycling*
Comment Letter
European Financial Reporting Advisory Group
35 Square de Meeûs
Brussels B-1000
Belgium

Dear Madam/Sir,

In the present letter ICAC gives its view on EFRAG´s Discussion Paper *Equity instruments – Impairment and recycling*.

First of all, ICAC welcomes the EFRAG's initiative aimed to analyze the relevance of recycling in the context of a long-term investment business model and the relationship between recycling gains and losses on derecognition and recognising impairment losses.

ICAC considers that it is necessary to improve the accounting requirements of IFRS 9 for holdings of equity instruments.

Our responses to the questions in the Discussion Paper are explained below.

Question 1 – Recycling gains or losses on disposal

The Basis for Conclusions to IFRS 9 (paragraph BC5.25 (b)) explains why IASB decided not to allow recycling when equity instruments are carried at FVOCI. EFRAG has previously argued that recycling enhances the relevance of the financial information provided to users of financial statements.

The DP (paragraphs 2.3 – 2.10) presents arguments as to why the recycling of cumulative gains or losses into profit or loss on disposal of equity instruments carried at FVOCI might improve the depiction of the financial performance of long-term investors

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.

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. As EFRAG points out in its document, ICAC is of the view that dividend receipts (which are recognized directly in profit or loss), the impairment of the

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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.

However, 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.

Question 2 – Conceptual relationship between recycling and impairment

The DP (paragraphs 2.11 – 2.17) discusses the relevance of an impairment model for equity instruments carried at FVOCI.

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.

ICAC agrees with the arguments presented.

Both impairment losses and losses that occur at the time of derecognition, are accrued losses. The only difference between both is that in the case of impairment losses the possibility of reversal exists.

The general principle that should prevail in accounting for impairment losses is its recognition in the statement of profit or loss according to the accrual principle. If the loss is recycled only at the time of derecognition, this principle would be broken because the accrual has occurred at an earlier date. Therefore, recovery of recycling must be accompanied by some form of impairment model.

Question 3 – Enhancing presentation and disclosure requirements

The DP (Chapter 3) discusses whether and how presentation and disclosure requirements could provide better information on performance from a long-term investing perspective, including potential impairments of equity instruments. The DP presents arguments as to why enhanced presentation and disclosure requirements might not be an adequate substitute for improving the depiction of performance in profit or loss.

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?

ICAC agrees with the arguments and analysis presented in Chapter 3. ICAC also supports the importance of profit or loss as a main indicator of financial performance.

Question 4 – Two models

The DP (paragraphs 4.4 – 4.22) describes 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.

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.

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 is 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.

In any case, the experience in Spain of the application of the thresholds has not solved the doubts that are usually raised in practice in the face of a significant or prolonged decline in fair value. In these cases, it may be usual for companies to maintain that the price quoted on the market is not the best estimate of fair value, because the market at that time does not behave normally. Therefore, if it is decided to reintroduce the recycling in case of deterioration, it must be clarified that, in any case, the quoted price is always the best estimate of fair value.

Question 5 – Quantitative impairment triggers

The DP (paragraphs 4.12 – 4.22) discusses the inclusion of quantitative impairment triggers in its impairment model. Triggers reduce the extent of judgement in assessing whether a decline in fair value below cost represents objective evidence of an impairment, especially if set within the IFRS Standard. This enhances comparability (across entities and over time) but may reduce relevance.

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?

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

If it is chosen an impairment model similar to that of IAS 39, we consider it opportune to include quantitative impairment triggers that the standard should set, not companies.

In Spain there is a presumption that may be rebutted, that an equity instrument shall be considered impaired after a decline of a year and a half and a forty percent of its quoted price with no recovery value. However, it may be necessary to recognize an impairment loss before this period has elapsed or before the quoted price has dropped by the aforementioned percentage.

In order to achieve a homogeneous treatment (comparability between entities and over time) it is suggested that the presumption does not admit evidence to the contrary.

Question 6 – Subsequent recovery in fair values

The DP (paragraphs 5.2 – 5.10) considers whether subsequent recoveries of fair value should be recognised through profit or loss and illustrates some different reversal mechanisms.

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?

We agree to require the reversal of losses. We also consider that the ongoing reversal model recognized in profit and loss is the one that best reflects the true and fair view. Once the impairment is triggered, the financial asset should be measured at FV with changes in profit and loss, until its value recovers and once again exceeds the initial acquisition price (in our example, 100)

Another alternative to consider would be to understand that after recognizing an impairment a new acquisition price is set (in our example 82) from which it is necessary to proceed to follow the initial accounting treatment (increases and decreases against OCI with a new impairment threshold in 74 (90% x 82)).

Question 7 – Other considerations

The DP discusses a number of other relevant considerations, including:

- whether an IFRS Standard should introduce specific requirements for particular sub-sets of equity instruments and, if so, how these sub-sets should be defined (paragraphs 4.23 – 4.29). EFRAG has not developed this approach further;
- the use of rebuttable presumptions for recognising impairment losses instead of automatic triggers (paragraphs 5.11 – 5.13);
- the unit of account in applying the models (paragraphs 5.14 – 5.24); and
- other application issues (paragraphs 5.25 – 5.40).

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?

ICAC is of the view that the unit of account should be the portfolio of equity instruments with similar economic rights.

ICAC agrees with the aspects analyzed in the section on other application issues.

In any case, in order to achieve a homogeneous treatment (comparability between entities and over time) it is suggested that the presumption does not admit evidence to the contrary.

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

The DP (paragraphs 1.15 – 1.16) explains that the scope of EFRAG's project is based on the specific questions in the EC's request for advice and that other aspects of IFRS 9's requirements on accounting for holdings of equity instruments have not been explored.

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.

In ICAC opinion, the option to designate the equity instruments to FVOCI included in IFRS 9 should be eliminated. The main argument that has been used to include the option of the FVOCI is to avoid volatility in the profit and loss account, and consequently, provide adequate criteria so that some entities can express the true and fair view from the performance of their business model (medium and long-term investors).

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

The FVOCI option for equity instruments allows measuring the financial asset to FV but does not present in profit and loss the return provided by the investment, unless the distribution of a dividend is agreed. In our opinion, it is not an adequate criteria, so EFRAG should suggest to the IASB that this option be eliminated. It is also recalled that the FASB requires measurement of equity instruments quoted at FV with changes in profit and loss.

Please, don´t hesitate to contact us if you would like to clarify any point of this letter.

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