



EQUITY INSTRUMENTS – IMPAIRMENT AND RECYCLING

Issued 30 May 2018

ICAEW welcomes the opportunity to comment on the discussion paper *Equity Instruments - Impairment and Recycling* published by EFRAG in March 2018, a copy of which is available from this [link](#).

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MAJOR POINTS

Need to allow time for IFRS 9 to bed down

1. While we understand why EFRAG has issued this discussion paper (DP), we consider it too soon to begin discussing changes to IFRS 9. In our view, the IASB's Post Implementation Review (PIR) is the right mechanism for such discussion and will allow consideration of any concerns that arise on the operation of the standard based on evidence from its use. In our view, raising these questions now is unhelpful. It is important to allow time for entities to gain practical experience of implementing the standard and for evidence to be gathered on the nature of the equity investments for which the FVOCI classification is being used, on the level of disclosure typically made and on whether there are in fact any reporting or business concerns. Raising issues at this stage could also create additional uncertainty about how IFRS 9 should be implemented.
2. A further reason for not proposing changes to IFRS 9 at this time is that the issues addressed in the DP are likely to affect only a narrow group of preparers. The DP acknowledges that holdings of equity instruments were highly concentrated in a small number of respondents to EFRAG's consultation and it is not clear there is a widespread issue that needs to be addressed in advance of a PIR.
3. Furthermore, we consider that users of financial statements do read and take account of information included in OCI and in the notes to the accounts – we do not consider that only information recognised in profit or loss is important. There is nothing to stop preparers making additional disclosures or even providing additional performance measures, if they consider that users need greater insight into the nature and performance of FVOCI investments. Again, it would be helpful to allow a period of time for IFRS 9 to bed down and to speak to users of financial statements in the light of actual practice before proposing changes to the standard.

The investor perspective

4. We do not believe it would be appropriate to introduce recycling for equity securities classified as at FVOCI. In our view, recycling would not lead to information that is useful for investors. This is because there is no time at which cumulative fair value gains and losses recognised in OCI would be relevant to measuring performance for the period or to predicting future performance for such investments. In our view, the change in fair value at each reporting date represents the performance of the security and any gain or loss on disposal reflects its realisation. The timing of the realisation does not reflect the performance of the entity in the period.
5. We do not consider that presenting accumulated fair value changes in profit or loss in a single period on disposal reflects the investor's periodic performance. The gains or losses may have arisen over a number of periods and should be recognised only once, as they arose, in OCI. In our view, therefore, the information resulting from recycling can be potentially confusing and unhelpful for investors.
6. Further, we consider that recycling accumulated fair value changes in respect of individual investments can obscure an entity's performance across a portfolio as a whole and could lead to opportunities for manipulation of profit or loss. As noted in the DP, selective disposals can be made to enhance reported profit; this can occur even when fair values both for the specific investments disposed of and for the portfolio as a whole have declined in the period.

The scope of the FVOCI classification

7. We understand that the IASB intended FVOCI treatment to apply to equity investments held for ‘strategic’ reasons, that is, primarily for non-contractual benefits rather than for increases in value. We are able to support the FVOCI classification for such equity investments since the objective of holding them is not to generate gains or losses. In our view, it is appropriate for other types of equity securities to be measured at fair value through profit or loss. Our views are expressed in that context.
8. In the DP, EFRAG refers to ‘long-term investors’ and to ‘the long-term investment business model’. Although not entirely clear, it appears that EFRAG may have a wider scope of investments in mind than was perhaps originally intended by the IASB. In our view, it is important to be clear about the type of investment being considered in the DP.
9. We do not believe recycling and impairment are appropriate for genuine ‘strategic’ investments. However, even if the FVOCI classification were applied to a wider group of investments, we do not agree that recycling would be appropriate. We also would not support the introduction of a third category of equity securities measured at FVOCI with recycling and impairment. The introduction of the category would itself cause further complexity.

Impairment

10. We agree that impairment would be necessary to support the recycling of gains, for the reasons set out in the DP. Without the recognition of impairment loss in profit or loss, equity securities would be treated differently to other types of asset, for example an impairment model is applied to revalued property, plant and equipment, even though gains are not recycled on derecognition. There would be incentives for management not to dispose of loss making securities and the profit or loss would not reflect a prudent view of the overall performance of the portfolio.
11. However, we also consider that the introduction of recycling for FVOCI equity investments would cause significant additional complexity which would outweigh any perceived benefits. A major element of this complexity would relate to the impairment model (see our response to question 2.1 below).

RESPONSES TO SPECIFIC QUESTIONS

Question 1.1: 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.

12. No. We do not consider that the reintroduction of recycling would improve the depiction of the financial performance of investments in equity instruments classified as at FVOCI. As set out above, we consider that the FVOCI classification is appropriate for strategic investments and do not believe the accounting for such investments would be improved by recycling. For strategic equity investments, changes in fair value are arguably never of primary relevance to the presentation of financial performance, whether unrealised or realised on disposal. We consider that the performance of other types of investment is better reflected by fair value through profit or loss.

13. We acknowledge that the IASB did not define the type of equity investment to be classified as at FVOCI, and understand that in practice entities may apply the classification to a wider group of equity investments. Even for such a wider group, however, we do not consider that presenting accumulated fair value changes in profit or loss in a single period on disposal would reflect the investor's periodic performance. The gains or losses may have arisen over a number of periods and should be recognised only once, as they arose, in OCI. In our view, therefore, the information resulting from recycling can be potentially confusing and unhelpful for users.
14. Further, we consider that recycling accumulated fair value changes in respect of individual investments can obscure an entity's performance across a portfolio as a whole and could lead to opportunities for manipulation of profit or loss. As noted in the DP, selective disposals can be made to enhance reported profit; this can occur even when fair values both for the specific investments disposed of and for the portfolio as a whole have declined in the period.
15. We do not consider that the presentation of gains and losses in OCI or in profit or loss should be driven by whether they are realised or not; in our view this is not primarily a realisation issue. The DP notes that sales of long-term equity investments are critical events and significant from a stewardship perspective. We consider that such sales are potentially significant from the perspective of realisation and the generation of cash flows, but not necessarily from the perspective of depicting performance of a period.
16. We also consider that the reintroduction of recycling for FVOCI equity investments would cause significant additional complexity which would outweigh any perceived benefits. A major element of this complexity would relate to the impairment model, which we agree would need to be introduced if recycling were applied (see our response to question 2.1 below).
17. There has been insufficient time to assess whether the existing requirements of IFRS 9 provide an adequate depiction. It is important to allow time for entities to gain practical experience of implementing the standard and for evidence to be gathered on the nature of the equity investments for which the FVOCI classification is being used, on the level of disclosure typically made and on whether there are in fact any reporting or business concerns. Raising issues at this stage could also create additional uncertainty about how IFRS 9 should be implemented.

Question 2.1: 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.

18. As explained above, we do not consider that recycling should be reintroduced for equity investments classified as at FVOCI. However, if recycling were reintroduced for such investments, then we consider that recycling would need to be accompanied by some form of impairment model.
19. In general we agree with the points made in paragraphs 2.12 to 2.17 of the DP. In our view, the most significant argument in favour of an impairment model is that otherwise the timing of recognition of losses is entirely within the control of the investing entity. If the fair value of an investment or investments declined, an entity could simply decide not to sell and thereby avoid recognition of any loss in profit or loss. The lack of an impairment model might in some cases provide an accounting incentive to make sub-optimal economic decisions and result in accounting that is not prudent.

20. In addition, we consider that if an impairment model were applied then subsequent reversals of impairments should be included in profit or loss so that the treatment is symmetrical.

Question 3.1: What are your views on the arguments and analysis presented in Chapter 3 of the DP?

21. We do not consider that presentation and disclosure requirements could effectively replace a recycling and impairment model and in general agree with the summary comments made in paragraph 3.24 of the DP. In particular, it is not clear to us how disclosure requirements could provide an effective solution for large portfolios. We consider that the volume of information required could in some cases be very extensive which would run counter to the objective of de-cluttering financial statements.

Question 3.2: Are there other improvements in presentation and disclosure that you would support?

22. There are no other improvements in presentation and disclosure that we would wish to support at present. In our view, it is too early to propose changes to IFRS 9's existing requirements; to do so would prejudice the results of the PIR. It would be preferable to wait until there is evidence of the actual disclosures made by entities in practice.

Question 4.1: What should be, in your view, the general objective and main features of a robust model for equity instruments (relevance, reliability, comparability...)?

23. In order to meet the fundamental qualitative characteristics set out in the Conceptual Framework for Financial Reporting (relevance and faithful representation), we consider that any model designed to accompany measurement at FVOCI with recycling should reflect an entity's business purpose in holding the investments. Only then is it really possible to comment on what the main features of the model should be as there will inevitably be a trade-off between different objectives (for example, between relevance and comparability). In our view, this question is therefore bound up to a degree with the scope issue referred to in our response to question 1.1 above.
24. As a general point, we do not believe simplicity and practicality should be sacrificed in trying to achieve an appropriate compromise.

Question 4.2: Which, if either, of the two models do you prefer? Please explain.

Question 4.3: 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.

25. We do not have strong views on which of the two models proposed in the DP would be preferable. We consider that any impairment model would involve complexity and create difficult questions of judgement. However, on balance we think that a model similar to the IAS 39 impairment model would be preferable. A principal reason for that is our view that, when fair values are volatile, the original cost of an investment loses much of its relevance. A revaluation model in which presentation of gains and losses in profit or loss is driven by the cost at initial recognition is therefore less relevant in our view. It could also introduce further complexity such as how fungible equity securities purchased at different initial costs should be treated, ie LIFO, FIFO or weighted average.
26. Given our view that recycling should not be introduced for equity investments at FVOCI, we do not wish to make any suggestions for an impairment model.

Question 5.1: 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?

Question 5.2: If you do not support quantitative impairment triggers, how would you ensure comparability across entities and over time?

27. Again, given our overall position regarding recycling, we do not have strong views on these questions. One approach is that an impairment model should include quantitative triggers and that such triggers should be specified in an IFRS rather than determined by management. Comparability and, to a certain extent, simplicity are the main drivers for this approach. However, this would result in the sacrifice of relevance, since it is unlikely that the standard could specify a trigger that would be relevant for all types of security. The alternative is to leave triggers up to management judgement, which could sacrifice comparability and understandability.
28. Any such model would be imperfect and unlikely to fit all cases appropriately. As a result, information would lose significantly in relevance and comparability. In particular, it is unclear how a model with quantitative triggers would deal with holdings in a single equity instrument acquired at different times and at different costs: for example, a quantitative trigger might be reached for only part of a holding in an equity instrument.
29. The inherent limitations and compromises in such an approach illustrate the difficulties that recycling would create and provide support for our view that it should not be introduced. We consider that any advantages would be outweighed by the disadvantages.

Question 6.1: How should subsequent recoveries in fair values be accounted for? Please explain.

Question 6.2: 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?

30. We consider that subsequent recoveries in fair value should be recognised in profit or loss. This is on the basis that we support a broadly symmetrical approach: if impairment losses are to be recognised in profit or loss then we see no good reason for not accounting for reversals of such losses in a similar way.
31. Of the approaches outlined in paragraphs 5.2 – 5.10 of the DP, we would support ongoing reversal rather than either of the alternatives. In particular, we consider that any quantitative trigger should be a one-way trigger in respect of declines in fair value. However, as noted by the DP there are additional complexities involved in introducing recoveries.

Question 7.1: 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?

Question 7.2: Do you have comments on these other considerations?

Question 7.3: Are there other aspects that EFRAG should consider?

32. As set out in the introduction, we consider that the FVOCI election is most appropriate for those equity investments within the narrow interpretation of scope we understand the IASB intended. However, whatever the scope, once in this classification we consider that the same model should apply to all equity investments, without sub-

categories. The creation of sub-categories would add significantly to complexity: each sub-category would require clear definition, creating difficulties around the boundaries.

Question 8.1: 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.

33. There are no further aspects on which we wish to comment at this time.