



**EFRAG – European Financial Reporting
Advisory Group**

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Re: EFFAS Comment Letter on EFRAG
Document regarding the *Equity Instruments*
– *Impairments and Recycling*

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Dear Sir/Madam:

EFFAS' Commission on Financial Reporting ("FAC", "Commission", "we") is pleased to share with you the views of European users of financial statements regarding EFRAG's Discussion Paper (DP) ***Equity Instruments - Impairment and Recycling*** which was published in March 2018 and on which EFRAG is seeking comments from its constituents.

As an introductory comment, we understand that the DP assumes that there are "long-term investors". We acknowledge the work done by EFRAG in this field although we think that it is challenging to define - even principles-based - what a long-term investor is, particularly in terms of financial accounting and -reporting. We would consider a long-term investor an individual or an entity that makes investment decisions based on the expected holding time ("long-term") of the investment.

Based on this we will consider that:

- Any investment can be measured (1) at amortised cost with gains or losses recognised in profit or loss when the investment is derecognised, (2) at fair-value with changes recognised in other comprehensive income (FVOCI) and (3) at fair-value with changes recognised in the income statement (FVPL). As users, we tend to consider the FVPL approach to better represent an investment situation and performance. We also note that this is the approach applied in IFRS 10 for investment entities.



- We also recognise that there is some conceptual confusion about the role of OCI and profit or loss. More precisely the question is whether or not OCI reflects performance. Users focus on the income statement to assess the performance of an entity and consider OCI, though important, a complementary piece of information with regard to the financial position of an entity. From that perspective, we understand that investors that hold on to part of their equity investments for a number of years (“long term”) do not consider annual changes in fair value of those investments as performance. They prefer to avoid reflecting those changes in the income statement. Recognising the fair value changes in OCI implies that information is available.

We understand the position taken by these entities although we note that the FVOCI option in IFRS 9 is on an instrument-by-instrument basis. This hampers the principle of comparability and leaves users considering that entities can choose between OCI and the income statement.

- EFRAG is better placed to assess the precise impact of the FVOCI option on the asset allocation process as it has completed in-depth research on this issue. FAC view is that the accounting principles - whether FVOCI or FVPL – is unlikely to influence the decision of long-term investors that focus on the ultimate return of their investments, as also explained in paragraph 1.9 of the DP. We think that the accounting principle(s) will not influence entities from that perspective. Additionally, several views were expressed in the independent academic literature review on IFRS 9 and long-term investment that EFRAG recently published.

For methodological purposes, we have addressed the DP’s questions that we consider most relevant for users.

Q1.1 what are your views on the arguments presented in paragraph 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 agree with EFRAG’s approach in paragraphs §2.3-2.10. FAC as previously noted believes that there is some confusion with regard to how the income statement relates to OCI and there is a need for clarification. According to the



Conceptual Framework both reflect performance although it is the income statement remains the *primary source* of information regarding the performance of an entity.

In line with paragraph §2.9, we believe that users focus on the income statement to assess an entity's performance and rely on OCI as a useful complement to have a more comprehensive understanding of an entity's financial position. We are therefore reluctant to describe the fair-value fluctuations in OCI as performance as the cash inflows are only realised upon disposal.

FAC considers that reintroducing recycling should be recommendable to gauge the performance of an investor over the entire holding period. We think that this approach is more suitable to assess stewardship particularly when determining how an entity realises capital gains or losses and how successful the entity is in managing its investment portfolio.

In summary we would support the reintroduction of recycling as we think that it will clarify when and how "capital gains" and cash-flows are realised and included in performance.

Q2.1 what are your views on the arguments presented in paragraph 2.11-2.17? Do you consider that, from a conceptual standpoint, recycling should be accompanied by some form of impairment model? Please explain.

Recycling being (re)introduced should in our view be accompanied by some form of an impairment model. Entities should define an impairment model before selling an investment to be able to recognize losses in the income statement. Otherwise entities could hold on to certain investments to avoid some form of loss recognition.

FAC would not support keeping losses in OCI for an undetermined period" - as OCI is not considered the primary source of information to assess performance. Against this background we support recycling these losses when they are as good as certain and not necessarily upon realization of the equity investment.

Q3.1 what are your views on the arguments and analysis presented in Chapter 3 of the DP? Do you agree with the introduction of an initial qualitative assessment?



We consider that in many cases information provided in the disclosures complement the information recognised in the primary financial statements (paragraph § 3.3). We think that it is important to present information - both qualitatively and quantitatively information in the notes when this information is relevant.

We largely support the comments in Chapter 3. The idea of FVOCI should be to give appropriate information in the notes about how the fair-value of the equity instruments have evolved over the reporting period. Although not recognised in profit or loss it would allow users to assess the performance of the investment portfolio and the impact on the financial position.

Q4.1 what should be, in your view, the general objective and main features of a robust model for equity instruments (relevance, reliability, comparability...)?

Q4.2 which, if either, of the two models do you prefer? Please explain.

Q4.3 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?

We consider an impairment model to have more merit than a revaluation model. We do not see declines in fair-value below cost necessarily as an impairment. Markets fluctuate and share prices decrease, sometimes significantly at a point in time. This does not necessarily imply that the drop in fair value is not recoverable. The model is a practical solution and we consider that reliability and comparability to be key points. As noted in paragraph § 4.8, we think that an entity's information related to its investment strategy will be partly in OCI and partly in the income statement.

We agree that the model should attempt to reduce the subjectivity of using the time concept of "significant and prolonged" period. The possibility that a significant drop in value recovers giving a prolonged period of time is more unlikely than likely. Hence, it is unlikely that the cost of the investment can be recovered which implies that the loss might be definitive. Although each entity should be able to assess this situation, we agree with the DP's view that to date this has not lead to more useful and comparable information.



We think however that defining a quantitative threshold is not necessarily a suitable solution. The question arises about which is the appropriate threshold to impair an entity when its share price declines for instance 40% in 3 years or 20% in 5 years. And what about comparability if entities can define the thresholds themselves? We would like to underline that, as stated in a recent DP published by EFRAG, the impairment test on goodwill encounters similar limits (“too little, too late”).

Moreover, we think that the concepts of “significant and prolonged”, should remain as a principles-based approach introducing qualitative guidance and some quantitative thresholds. This in our view should provide consistency across entities and over time.

Regarding the propose introduction of a model around some type of “strategic investment” concept, we think that it can introduce confusion within the context of the FVOCI discussion. Equity investments have a different character than, for instance, a material investment in PPE or similar. FVOCI was created for long term investors and the possibility of introducing additional volatility in the income statement should be avoided. The FVOCI option is on an instrument-by-instrument basis and we think that entities could use the FVOCI option for what they regard as their strategic investments. This, being the case, it should be useful to disclose it in the notes.

Q5.1 Do you support the inclusion of quantitative impairments triggers in an impairment model? If so, should and IFRS Standard specify the triggers, or should management determine them?

Q5.2 if you do not support quantitative impairment triggers, how would you ensure comparability across entities and over time?

FAC considers reversals, as stated in Chapter 5, as a concept that should be included. If the decline in the value of an equity investment is useful information, a recovery will also be useful information. An impairment charge recorded in the income statement should in our view be reversed in the income statement. This will be consistent with the fact that an impairment charge accounted for in the OCI is to be reversed in OCI.



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We believe that the “ongoing reversal” method will signal the reversal when the value has picked up again. We would not necessarily reject some kind of a “reversal with threshold” method as a recovery, using the example in the DP, is not necessary a real reversal. It may be a kind of short term upswing depending on the facts and circumstances.

If you would like to further discuss the views expressed in this letter, please do not hesitate to contact us.

Javier de Frutos
Chairman
On behalf of EFFAS
Commission on Financial Reporting

EFFAS was established in 1962 as an association for nationally-based investment professionals in Europe. Headquartered in Frankfurt am Main, EFFAS comprises 22-member organizations representing more than 16,000 investment professionals. The Commission on Financial Accounting is a standing commission of EFFAS aiming at proposing and commenting on financial issues from an analyst standpoint. FAC members are Javier de Frutos (Chairman, IEAF-Spain), Jacques de Greling (Vice-Chairman- SFAF, France), Rolf Rundfelt (SFF, Sweden), Friedrich Spandl (ÖVFA, Austria), Henning Strom (NFF, Norway), Serge Pattyn (BVFA/ABAF, Belgium) and Luca D' Onofrio (AIAF, Italy).