Association pour la participation des entreprises françaises à l'harmonisation comptable internationale

Mouvement des Entreprises de France
MEDEF

EFRAG
35 Square de Meeûs
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Belgium

May 22, 2018

Dear Mr Andrew Watchman

Re: EFRAG Discussion Paper: Equity Instruments and Recycling

We very much welcome this EFRAG Discussion paper relating to the impairment and recycling of equity instruments. Indeed, on the occasion of the different consultations conducted by the IASB (on IFRS 9 and the conceptual framework, for instance), we have constantly reiterated our position that the use of recycling should be systematic. We strongly believe that recycling is absolutely necessary to support net income as a relevant indicator of performance and stewardship, since it is the solution that ensures that all transactions impact net income. We find the IASB's arguments rejecting recycling for these instruments to be very unconvincing and insufficient particularly those based on the grounds of the difficulty of proposing a robust model of impairment.

We therefore appreciate the efforts made by EFRAG to propose alternative models. We accept that in the current IFRS environment, even with a "neutral" concept of prudence, it is appropriate to record in net income a decline in the value of equity instruments as long as it is likely to be realised. That being said, we would not be in favour of a solution that brings increased volatility into net income, which would be contrary to the primary objective of the creation of the FVOCI option. We thus do not support the revaluation model.

While we support EFRAG's initiative on this issue, we wonder, however, about the subsequent stages of the process. We hope that it could lead to a reopening of discussions with the IASB so that the standard setter will be convinced of the need to amend IFRS 9 as a matter of urgency. We would be much more hesitant about a solution that would change the standard only in the European Union and thereby create a parallel accounting framework.

Finally, pursuing the idea of relying on accounting to promote long-term investments, we believe that the FVOCI option should be extended beyond the current limitation to direct investments in equity instruments thus permitting its application to indirect investments through investment funds for example.

If you have any questions or a need for further information, please do not hesitate to contact us.

Yours sincerely,

ACTEO	AFEP	MEDEF
Patrice MARTEAU Chairman	François SOULMAGNON Director General	Agnès LEPINAY Director of economic and financial affairs

Q1.1 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.

We share the arguments and agree with the conclusion presented in paragraphs 2.3 to 2.10. We believe that the current prohibition of recycling does not permit entities to reflect faithfully the way they manage their resources. It is thus contrary to one of the main objectives of financial reporting. The IASB has recently reaffirmed that net income is the most important performance indicator in the revised conceptual framework. When none of the gains and losses related to certain items never impact net income, this result cannot be said to reflect performance and stewardship.

In particular, given the importance of forecast and realised cash flows as a performance indicator, we agree with the suggestion in paragraph 2.10 that the realisation of the cash flows through the sale of an asset is a sufficiently clear and significant event to be used as the trigger for recycling.

Management is also a primary user of financial statements and it is therefore important that it can take ownership of them. Any distortion between accounting and internal performance monitoring leads to a wider use of non-IFRS measures.

Q2.1 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

We share the view that the accounting model for equity instruments should be consistent with that for other assets and we thus consider that it should include both recycling and some form of impairment recognition. We also agree that impairment enhances the relevance of profit or loss for stewardship purposes.

Q3.1 What are your views on the arguments and analysis presented in Chapter 3 of the DP?

Q3.2 Are there other improvements in presentation and disclosure that you would support?

We agree that disclosure should not be used to compensate for an inappropriate or flawed accounting model. Moreover, we are not in favour of obliging entities to provide a very large volume of information in order to allow external users to choose the model that they deem most relevant.

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 do not support the revaluation model which leads inevitably to a great deal of volatility in net income, since this is contrary to the business model which should be reflected by the FVOCI option. Indeed, such a model is not consistent with the long-term management horizon of the portfolios covered by the option. We reject any mechanical approach that denies the importance of the economic environment and sets aside the call for judgement by management.

We acknowledge that the revaluation approach would provide a very easy and straightforward solution for the IASB to adopt, but we believe that accounting should not be driven by anti-abuse objectives.

We would support the second model (described in paragraphs 4.12 to 4.18), which is similar to IAS 39's requirements but with less subjectivity. We believe this would improve transparency and rigour in application.

Q5.1 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?

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

in respect of the thresholds for the notion of "significant decline" and "prolonged decline", we believe that the management should be left responsible for specifying their own definition of these terms with transparent disclosures in the notes. However, we understand the need for a more rigorous approach and we could accept the proposal that the IASB sets rebuttable presumptions in terms of upper limit for both terms, in accordance with paragraph 4.18(c).

This presumption may however be rebuttable when the upper limits are judged to be clearly not relevant for specific equity instruments. In such a case, the entity would have to disclose when and why the presumption has been refuted. This could be the case, for example, for strategic investments with very long holding periods or with a very high volatility that could be demonstrated.

Q6.1 How should subsequent recoveries in fair values be accounted for? Please explain.

Q6.2 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?

We believe that reflecting changes in the adverse effects in the investee's future performance improves the relevance of net income. When the impairment loss is no longer probable, this change should also be translated into net income. Moreover, authorising such reversals to be recognised in net income would probably limit the perceived temptation experienced by entities to defer the recognition of impairment losses in the net result. It will therefore have a beneficial effect on the determination of impairment thresholds.

We are in favour of a reversal model based on the same triggers as those used for impairment since this will lead to a symmetric model and once again will reinforce the reliability of the triggers used for the impairment side, in other words, the impairment model with a limited reversal threshold.

Q7.1 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?

We believe that a single principle-based model could be used for all equity instruments carried under the FVOCI option. Differences in characteristics (volatility) and the management model (the holding horizon) would be taken into account in determining the different specific triggers.

Q7.2 Do you have comments on these other considerations?

Hedging

We support the proposal to set impairment trigger on the basis of the net effect of the hedging relationship.

Portfolio approach

We believe that a portfolio approach should be allowed in the case of linked asset / liability management since in these situations entities arbitrate on a portfolio basis to meet their obligations and not on the basis of individual balance sheet lines.

Q7.3 Are there other aspects that EFRAG should consider?

In the idea of relying on accounting to promote long-term investments, we believe that the FVOCI option should be extended and not limited to direct investments into equity instruments but should also be permitted for indirect investments through investment funds for example.