Rechnungslegungs Interpretations
Accounting Interpretations Committee

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Chair of the
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Dear Bob

Comment Letter on IFRIC Interpretation D18 *Interim Financial Reporting and Impairment*

We appreciate the opportunity to comment on the draft Interpretation IFRIC D18. We fully endorse IFRIC´s aim to support the IASB in establishing and improving International Financial Reporting Standards.

What causes great concerns to us, though, is the insufficient dealing with the underlying premises of IFRIC D18 and the lack of any conceptual foundation of the Consensus. Furthermore, the AIC believes that it is unacceptable that the frequency of reporting determines the accounting in the annual financial statements. Finally, while the AIC appreciates the IFRIC's efforts to clarify the interaction between the requirements of IAS 34 and certain impairment losses, we doubt that the matter can be dealt with in an interpretation and suggest that the IASB should consider taking a project on IAS 34 on its agenda.

Overall, the AIC disagrees with the proposals in IFRIC D18. Our detailed comments are attached to this letter.

If you would like further clarification of the issues set out in this comment letter, please do not hesitate to contact me.

With best regards

Dr. Stefan Schreiber
AIC, Chairman

Detailed Comments of the AIC to the draft Interpretation IFRIC D18

1. Underlying Premises of IFRIC D18

IFRIC D18 is based on three important underlying premises that are not explicitly dealt with in the draft Interpretation, but that are of crucial importance for the development of the Interpretation and the rationale of the Consensus.

1.1 Review for Indications of an Impairment at each Interim Reporting Date

According to IAS 36.9 "an entity shall assess at each reporting date whether there is any indication that an asset may be impaired". Similarly, IAS 39.58 states that "an entity shall assess at each balance sheet date whether there is any objective evidence that a financial asset is impaired". Although the AIC believes that the phrases "at each reporting date" and "at each balance sheet date" refer to both annual and interim periods this should have been made clear by the IFRIC, because IFRIC D18 is based on this underlying assumption. A potential conflict between IAS 34 and IAS 36/39 could only arise, if IAS 36.9/IAS 39.58 were meant to include interim balance sheet dates. If this was not the case, the question of reversing impairments in annual financial statements would simply not arise. Therefore, the AIC suggests that the IFRIC includes some brief guidance on this issue in IFRIC D18.

1.2 Prevalence of the Discrete Approach in IAS 34

As set out in IFRIC D18.BC2+3, IAS 34.28 contains two statements that appear to be in conflict. While an entity is required to apply the same accounting policies in its interim financial statements as are applied in its annual financial statements (first sentence of IAS 34.28 = discrete approach,) the frequency of the entity's reporting shall not affect the measurement in its annual results (second sentence of IAS 34.28 = integral approach.) Although the IFRIC does not explicitly favour one of the two approaches, the wording in IFRIC D18.8 and D18.BC4 make it clear that IFRIC considers the discrete approach to be dominating. Otherwise, there would be no conflict between IAS 34 and IAS 36/39, because the application of the integral approach would prevent that the frequency of (interim) reporting had an effect on the annual financial statements.

The dominance of the discrete approach over an integral approach can be called into question. The AIC believes that the use of the term "however" at the beginning of the second sentence of IAS 34.28 and the second sentence of IAS 34.29 as well as the statement in IAS 34.29 whereupon an interim period is part of a larger financial year indicates that the integral approach prevails over the view that each interim period is an independent stand-alone reporting period. In addition, it seems unacceptable to the AIC that the frequency of reporting should determine the accounting in the annual financial statements. Were the integral approach to be applied, the unsatisfactory result – that the amount of an impairment loss in the annual financial statements depends on the frequency of (interim) reporting – would be avoided.

While the AIC has a preference for the integral approach, the wording in IAS 34.28 and IAS 34.29 seems unclear so that both approaches can be justified and diversity in practice might emerge. Unfortunately, the IFRIC is silent with regard to its reasoning why it prefers the discrete approach. Moreover, it can be argued that the resolution of the conflict within a Standard as well as between Standards must be undertaken by the IASB by amending one or more of the Standards involved; IFRIC Interpretations do not amend Standards and, therefore, should not be used to resolve conflicts between or within Standards.

A possible solution would be to amend IAS 34 by including the consensus of IFRIC D18 in the text of IAS 34 rather than IFRIC issuing an Interpretation on this subject. The AIC, however, would decline such an approach because the amendment would not be in line with a principles-based approach of IFRSs. There might be other conflicts between IAS 34 (if the discrete approach is considered dominant) and other Standards apart from the ones addressed in IFRIC D18 that should also be included in such an amendment. Additionally – as will be discussed further in section 2 of this comment letter – the IFRIC did not provide any conceptual reasons why IAS 36 and IAS 39 should overrule IAS 34. The integration of IFRIC D18 into IAS 34 would just be a piecemeal solution that lacks a conceptual foundation. The AIC is aware that a timely reaction of the IFRIC/IASB to the issues addressed in IFRIC D18 could only be achieved in a "quick fix way", but we think that the IASB should be careful in using this kind of amendment, because it leads the way to a conceptually questionable, rule-based accounting that does not resolve the general issues and does not necessarily raise the quality of IFRSs. The AIC, therefore, suggests a more substantial analysis of the existing conflicts within IAS 34 and between IAS 34 and other Standards. The IASB should take care of these issues in a separate project.

1.3 No Diversity in Practice with Regard to the Continuous Monitoring of Indications of Impairment

There is a lack of clarity in the impairment regulations that should have been dealt with by the IFRIC in the course of discussing the issue in IFRIC D18. This refers to the question whether impairments should be monitored continuously, i.e. not only at the (interim) reporting dates. IAS 36.9 requires the assessment of assets for a possible impairment at each reporting date. Additionally, with regard to goodwill and intangible assets with indefinite useful lifes, IAS 36.10 states that an impairment test has to be undertaken at least annually. This seems to imply that the requirement to monitor indications of impairment is limited to the (interim) reporting dates or (in the case of goodwill and intangible assets with an indefinite useful life) to the date of the annual impairment test. It should be noted that IAS 36.10 (b) refers to paragraphs IAS 36.80-99 for further guidance on impairment on goodwill and that IAS 36.90 states that goodwill has to be tested for impairment whenever there is an indication that goodwill may be impaired. This might imply that the indicators for impairment on goodwill should be monitored continuously and not only annually/at the reporting dates. Although there is no explicit statement in IAS 36 on the subject of continuous monitoring with regard to other assets than goodwill, it could possibly be argued that an entity may also make an assessment of a possible impairment continuously in the case of other assets than goodwill, i.e. in addition to the requirement to make such an assessment at each reporting date.

This issue becomes relevant under IFRIC D18. Consider the following example of an impairment on an equity instrument classified as available for sale, i.e. a financial asset within the scope of IFRIC D18: The carrying amount of this equity instrument is 100 in the annual financial statements as of 31 December 20X1. Due to specific circumstances there is an indication of impairment on 25 April 20X2 and the impairment test carried out leads to an impairment loss of 50. It is further assumed that the impairment loss does no longer exist at the following interim reporting date (30 June 20X2). The fair value of the equity instrument remains to be 100 until 31 December 20X2.

According to the continuous monitoring approach, an impairment test would have to be carried out in April 20X2. For the purpose of the interim report of 30 June 20X2, the entity would be required to assess whether there is any indication that the equity instrument may be impaired. This assessment should consequently be made on the basis of the impairment test carried out in April. This means that in the interim report the entity would account for the impairment as of 25 April 20X2 (resulting in a book value of 50 in the interim report) unless there are indicators that a further impairment charge should be recorded. In our example this is not the case. The consequence of IFRIC D18.8 is that in the annual financial statements as of 31 December 20X2 a reversal of the impairment loss accounted for in the interim report would be prohibited so that the carrying amount of the equity instrument would remain to be 50. Without this restriction which is implicit in the discrete approach of IAS 34, the impairment loss would be reversed and the carrying amount in the financial statements as of 31 December 20X2 would be 100.

If, however, the entity were not be monitoring indicators of an impairment continuously and, therefore, referred to the carrying amount of 100 in the previous annual reporting date (31 December 20X1) while carrying out an impairment test on 30 June 20X2, the equity instrument would not be impaired. Since the fair value of the equity instrument is 100 on 30 June 20X2 and on 31 December 20X2 the prohibition in IFRIC D18.8 to reverse the impairment loss in the annual financial statements would have no effect.

This example shows that even if the frequency of interim reporting of two entities is identical and the fair value of the equity instrument is the same at the interim and the annual reporting date, the application of IFRIC D18.8 could result in different impairment losses being recognised in the annual financial statements. While – in the example – the application of the continuous monitoring approach results in an impairment loss of 50 in the financial statements as of 31 December 20X2 the impairment loss would be nil if impairments are not monitored continuously. This shows that it is crucial to clarify if continuous monitoring is prohibited, allowed or even required for the assets within the scope of IFRIC D18 and that the IFRIC should give guidance on this issue. From a conceptual point of view the IFRIC should not limit its clarification on the assets within the scope of IFRIC D18, but rather make a general statement on the issue of continuous monitoring of indicators of impairment.

2. Rationale for the Consensus as set out in BC5-8

Even if the conceptual and procedural shortcomings of IFRIC D18 addressed in section 1 of this comment letter are faded out, the Consensus in IFRIC D18.8 and the rationale set out in BC5-8 are not convincing.

In BC5 the IFRIC simply decides that some rules should take precedence over other rules, the only reason being that the rules in IAS 34 are considered being more general than the rules in IAS 36 and IAS 39. However, if IAS 34 were regarded a specific set of rules for interim financial statements while all other standards (including IAS 36 and IAS 39) apply to annual financial statements, the rules in IAS 34 should determine how the issue addressed in IFRIC D18 is to be dealt with.

The IFRIC noted in BC6 that IAS 34 had been issued before the reversals of certain impairment losses were prohibited in IAS 36 and IAS 39 and hence did not consider these later requirements. If this had really been the intention of the IASB, we feel that a consequential amendment of IAS 34 should have been made. Since it is common practice that existing standards are changed by consequential amendments when new standards are issued or related standards are amended, one could argue that the IASB intentionally did not amend IAS 34 when introducing the prohibition of reversals of certain impairment losses in IAS 36 and IAS 39. This severely challenges the IFRIC's rationale as set out in BC6.

What strikes us most with regard to BC5 and BC6 is the inconsistency of these paragraphs with the IFRIC's underlying assumption that the discrete approach is prevailing in IAS 34. Under the discrete approach there is no doubt that impairment losses recognised on assets within the scope of IFRIC D18 in an interim report cannot be reversed in the annual financial statements. To corroborate the Consensus in IFRIC D18 the IFRIC should, therefore, have explained in the Basis for Conclusions why it supports the discrete approach. However, instead of doing so the IFRIC tries to justify in BC5 and BC6 why the provisions in IAS 36 and IAS 39 prevail over the integral approach in IAS 34. This contradicts the approach taken in the Consensus.

Finally, the restriction of the scope of IFRIC D18 to impairment losses on goodwill and certain financial assets and the explicit prohibition of applying IFRIC D18 to other impairment losses by analogy (see BC8) is unsatisfactory from a conceptual point of view. Furthermore, it contradicts the IFRIC's argument in BC5 that IAS 36 and IAS 39 should be considered being the more specific rules in comparison to the provisions in IAS 34. If the IFRIC does not intend to switch to a fragmentary rule-based accounting this view should be taken consistently, thus allowing for an application of IFRIC D18 to issues not included in its scope by analogy.

3. Legal Status of Interim Financial Statements

Apart from our reservations discussed above the Consensus of IFRIC D18 is problematic in countries where the legal status of interim financial statements differs from the legal status of annual financial statements. This is the case in Germany, because interim reports are not subject to mandatory audits. The coming into effect of IFRIC D18 as proposed would imply that unaudited impairment losses accounted for in an interim report would determine the accounting in the annual financial statements.

4. Application

Assuming that IFRIC D18 is finalised in the way proposed, the AIC does not support the IFRIC's decision to require an unlimited retrospective application of the Interpretation. Although the AIC acknowledges the IFRIC's general principle of retrospective application of its Interpretations we doubt that this is appropriate in the specific circumstances addressed in IFRIC D18. Since it will often be impracticable in practice to retrace all the information needed for a retrospective application of IFRIC D18 – especially when several years have already elapsed – the AIC would recommend limiting the retrospective application of IFRIC D18 to reversals of impairment losses that have been accounted for in periods for which comparative information is included in the financial statements.