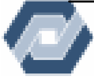
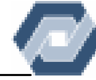


Rechnungslegungs Interpretations
Accounting Interpretations Committee



AIC • c/o DRSC e.V. • Zimmerstr. 30 • 10969 Berlin

Telefon +49 30 206412-12
Telefax +49 30 206412-15
E-Mail info@drsc.de

Berlin, 24 April 2006

Bob Garnett
Chair of the
International Financial Reporting Interpretations Committee
30 Cannon Street

London EC4M 6XH
United Kingdom

Dear Bob

Comment Letter on IFRIC's Agenda Decision *IAS 39 Impairment of an Equity Security*

In the course of its meeting in April 2005 the IFRIC discussed the issue of how to determine whether or not there has been a "significant or prolonged decline" in the fair value of an equity instrument below its cost under IAS 39.61 in a situation where an impairment loss was previously recognised for an investment classified as available for sale. As published in the IFRIC Update June 2005 the IFRIC had decided not to develop any guidance on this issue. The IFRIC noted that IAS 39 referred to the original cost on initial recognition and – unlike US GAAP – did not regard a prior impairment as having established a new cost basis. "Significant" should, therefore, be judged against the cost base measured at initial recognition and "prolonged" should be judged against the period in which the fair value of the investment has dropped below its cost at initial recognition.

The AIC discussed this issue in conjunction with its deliberations on IFRIC D18, but did not include comments with regard to the previous agenda decision in its comment letter on IFRIC D18. Although we are aware that a significant time period has already elapsed since the publication of the agenda decision on equity impairments, we would kindly ask the IFRIC considering the concerns that the AIC discussed during the last two meetings.

Unlike US GAAP, under IFRS a decline in the fair value of an investment in an equity instrument below its cost is regarded sufficiently objective evidence of an impairment, if this decline was significant <u>or</u> prolonged. The AIC believes that – given this wording in IAS 39.61 – the view taken by the IFRIC leads to impairments of equity instruments that are not in line with IAS 39.

Consider the following fact pattern:

- An equity instrument that was initially recognised at 100 became impaired by 20 in 20X1, thus leading to a carrying amount of 80.
- Having remained fairly constant at subsequent reporting dates, the fair value of the equity instrument decreased further to 78 in 20X5 and to 77 in 20X6.
- In 20X7 the fair value increased again.

According to the IFRIC's view the entity would have had to recognise an impairment loss (through profit and loss) in 20X5 and 20X6 because "prolonged" would have to be judged against the period in which the fair value of the investment has been below its cost at initial recognition. Taking IAS 39.69 into account, a reversal of the impairment loss would not be allowed through profit and loss.

According to IAS 39.59 an impairment loss is incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset. The loss events listed in IAS 39.59 (a)-(f) relate to rather material events so that the AIC doubts that in situations where reductions in the stock price are rather small or even immaterial – like those in the fact pattern given – recognition of an impairment was appropriate. In our view, the concept of taking only those changes in economic circumstances into account that are both, objective and material when considering whether or not an impairment has occurred seems to be undermined, if the IFRIC's view was applied when determining the necessity of an impairment charge.

The IFRIC expressed its view on this issue at a time when share prices were broadly increasing. Thus, IFRIC's agenda decision had almost no practical implications. After having liaised with some of our constituents we feel that this might be an important reason why IFRS preparers presumably did not become aware of the accounting implications of the IFRIC agenda decision. We believe that this will change dramatically, should share prices fall below the cost recognised at initial recognition. We recommend the IFRIC should deal with these potential reservations before times of decreasing share prices arise. Furthermore, this would provide an opportunity to reconsider whether it was truly the intention of the IASB to create a difference to US GAAP when amending IAS 39 with regard to the impairment of an equity instrument.

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