EFRAG
European Financial Reporting Advisory Group

6 April 2006

D18 Comment Letters
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UK

Dear Sir/Madam,

Re: IFRIC Draft Interpretation D18 *Interim Financial Reporting and Impairment*

On behalf of the European Financial Reporting Advisory Group (EFRAG) I am writing to comment on the IFRIC Draft Interpretation D18 *Interim Financial Reporting and Impairment*. This letter is submitted in EFRAG's capacity of contributing to IASB's due process and does not necessarily indicate the conclusions that would be reached in its capacity of advising the European Commission on endorsement of the definitive interpretations/amendments on the issues. Our comments are as follows:

We agree with IFRIC's analysis, as summarised in the Basis for Conclusions section of D18, that there is a conflict between IAS 34 *Interim Financial Reporting* on the one hand and IAS 36 *Impairment of Assets* and 39 *Financial Instruments: Recognition and Measurement* on the other.

In our view the conflict arises for three reasons:

a) IAS 34 applies neither a discrete approach throughout nor an integral approach throughout. (Under a discrete approach, each interim period is accounted for and reported on a stand alone basis and not as an integral part of the full financial year. This means that frequency of reporting will affect the measurement of annual results. The integral approach is the converse: namely, the interim period is integral to the full financial year and the frequency of reporting will not affect the measurement of the annual results.)

b) IAS 36 and IAS 39 prohibit reversals of impairments of goodwill and available-for-sale equity instruments (because it is not feasible to identify that an impairment loss has reversed). This has the effect that entities that are identical except that they have different frequency of reporting or different annual accounting dates would report different profits and losses.

c) The need to provide for an impairment is largely a period-end exercise—not a real-time exercise (ie impairment losses are not provided for as they occur)—so the frequency of an entity's reporting determines the frequency of the search for impairments.

The consensus proposed by IFRIC in D18 effectively amends IAS 34's requirement that the frequency of an entity's reporting shall not affect the measurement of its annual results. It is our understanding that conflicts between standards can be eliminated only by amending one or more of the standards involved; IFRIC interpretations do not amend standards and therefore should not in principle be used to resolve conflicts between standards. IFRIC stated this in its work on interpretations concerning emission rights and service concessions. Therefore, we recommend that the IASB should undertake an urgent project to resolve this conflict by amending IAS 34 or IAS 36 and IAS 39 or all three. In particular, we believe that the Board should consider promptly whether it wishes IAS 34 to follow a discrete or an integral approach.

At the same time we understand that it might take some time to complete such a project and there is a need in the meantime to respond to constituents who need to know now how to resolve the conflicts in financial statements and interim financial reports being prepared. Given the need to achieve consistency in the short term, we can accept, in these specific circumstances, the use of an interpretation as a short-term solution to indicate the way in which IFRIC believes the conflict should be resolved.

In that respect we accept the justification for the D18 consensus in paragraph BC 7 which refers to the reasoning behind the prohibition on reversals of impairment losses recognised on goodwill and equity securities in IAS 36 and IAS 39: if it is not feasible to identify that an impairment loss has reversed that is the case regardless of whether the loss is recognised in the annual financial statements or in the interim reporting. For that reason, we support what the consensus paragraph in D18 is trying to do: which is to require entities to follow the requirements of standards on impairment and not reverse an impairment loss recognised in a previous interim period, even though the frequency of an entity's reporting may affect the measurement of annual results.

D18 proposes that the consensus conclusion should be applied retrospectively. The transitional provisions of the current version of IAS 36 require that the version's requirements on recognition of impairment losses should be applied prospectively from the beginning of the first annual period beginning on or after ***31 March 2004*** and grandfather application of the standard to goodwill and intangible assets in business combinations that took place before ***31 March 2004***. As the conflict with IAS 34 arose when the current version of IAS 36 was implemented, it should be sufficient to include in this interpretation/amendment transitional provisions for goodwill impairment that are in line with the transitional provisions in the current IAS 36. If the intention was that the transitional provisions of this interpretation/amendment should be in line with IAS 36's transitional arrangements, we support the proposal. However, that intention should be clarified. If the intention was different, we think this will be problematical and burdensome.

We also recommend clarifying that the interpretation/amendment applies to investments in equity instruments measured at fair value or unquoted equity instruments carried at cost because fair value cannot be measured reliably. The current reference in the consensus paragraph to "an investment in an equity instrument and a financial asset carried at cost" creates confusion as it suggests that "a financial asset" may be a debt instrument.

We further propose that the basis for conclusions should be amended to provide a much better justification for the D18 consensus than it currently does. For example, the statement in BC 5 that the IFRIC has concluded that IAS 36 and IAS 39 should take precedence over more general requirements in IAS 34 is not in itself a reasoned argument. BC 6's statement that IAS 34 was issued before the reversal of impairment losses on goodwill and equity instruments was prohibited, and hence did not consider these later specific requirements might be interpreted as if the IASB deliberately did not make consequential amendments to

IAS 34 when it revised IAS 36 and IAS 39 (which would appear to be an argument against the consensus in D18).

As we point out above, in our view the main justification for the D18 consensus comes from the reasoning behind the prohibition on reversals of impairment losses recognised on goodwill and equity securities in IAS 36 and IAS 39. We think this is the argument that IFRIC wanted to convey in BC 7, but it is clear from our discussions with constituents that including just a reference to basis for conclusions paragraphs in IAS 36 and IAS 39 is not enough to get across the message. We think that it would be helpful if IFRIC reiterates in the basis for conclusions to D18 the reasons why IAS 36 and IAS 39 prohibit the reversals of impairment losses on goodwill and equity instruments and explain why these reasons are equally relevant for interim reporting as for annual reporting.

If you would like further clarification of the points raised in this letter, Paul Ebling or myself would be happy to discuss these further with you.

Yours sincerely,

Stig Enevoldsen
EFRAG, Chairman