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Exposure Draft of Proposed Amendments to IAS 36 IMPAIRMENT OF ASSETS and IAS 39 FINANCIAL INSTRUMENTS: RECOGNITION AND MEASUREMENT

We appreciate the opportunity to respond to the International Accounting Standards Board's exposure draft of proposed amendments to IAS 36.

The IAS 36 procedure to ensure that entity's assets are carried at no more than their recoverable amount seems to be in line with a true and fair view of the economic situation of the entity. Whether the carrying amount of an asset exceeds its recoverable amount is determined by a specific evaluation which cannot be based on a mechanical approach.

We believe IAS 36 is a useful framework to apply also to the equity financial instruments classified as Available For Sale (AFS) because the Exposure Draft of IAS 39 does not seem to cover effectively the impairment of such assets. This is due to the fact that:

1. the proposed new paragraph 39.110A includes some impairment triggers that are reasonable but whose application seems to be very subjective and might lead to a wrong interpretation even having regard to the impairment measurement stated in IAS 39. Consequently an entity might consider *"a significant and prolonged decline in the fair value"* occurring only in "extreme" cases (e.g. 90% reduction over a five year period) in order to avoid recognising the difference between the fair value and the carrying amount of the equity in the Profit and Loss account;
2. the irrefutable presumption to consider the fair value as the best estimate of the recoverable amount of an equity instrument may lead to a misleading representation of the performance of the period especially in the case of a very volatile share price. In this situation the entity may recognize as impairment in Income statement "normal" volatility and not a true impairment loss;
3. given the difficulties in determining when an impairment loss on such equity instrument has been recovered, the Exposure Draft IAS 39 proposes that the loss should not be reversed through the income statement even if the conditions change after the recognition of the loss. This is not in line with IAS 39 itself which allows the reversal of an impairment for Held to maturity debt securities and with other international standards (e.g. IAS 2, 36).

We would recommend that the guidance provided in the new IAS 36 on how to apply the impairment procedures is extended to the impairment evaluation of AFS equity securities and not only limited to investment in subsidiaries, associates and join ventures as it is now.

To assess whether there is any evidence that an equity instrument may be impaired, we would recommend adding the following external impairment indicator: "a decline of at least 40% in the fair value during the last year below cost". If this indication is present at the balance sheet date, the entity would be required to make a formal estimate of the recoverable amount. As the current exposure draft states, this is only one of the many indications that an equity instrument may be impaired and it would also require that the entity determines the asset's recoverable amount.

We would also suggest extending the application of the definition of recoverable amount in IAS 36 (e.g. the higher of an asset's net selling price and the value in use) also to AFS equity securities. Usually the net selling price is the best estimate of the value in use for these assets but the entity may demonstrate with objective documentation that in some specific cases the value in use as defined in IAS 36 could be greater than the net selling price due for example to unusual market volatility.

To sum up with an example, let us consider the following situation:

a. AFS Equity share – carrying amount = 100
b. Current year average market value = 50
    i. Consequence: it is required to make a formal estimate of the recoverable amount
c. Recoverable amount evaluation:
    a. Net selling price = 52 (Fair value (52,5) – Transaction fee (0,5))
    b. Value in use = 60
        i. Consequence:
            1. Impairment loss to recognise to Income statement = 100 – 60 = 40
            2. Negative change in fair value to recognise in Equity Reserve = 60 – 52,5 = 7,5
            3. Asset's carrying amount in the Balance Sheet = 52,5

We would also suggest extending the procedures for the reversal of an impairment loss defined in the Exposure draft IAS 36 to AFS equity securities.

Our suggestion to create this link between IAS 39 and IAS 36 for AFS equity securities:
(a) Does not reconsider the fundamental approach to accounting for financial instruments contained in IAS 39,
(b) Simplifies the application of IAS 39,
(c) Provides additional guidance to a very important issue.

Please contact Massimo Romano at 0039040671256 or at MASSIMO_ROMANO@GENERALI.COM if you wish to discuss any of the issues rose in this letter.

Yours faithfully

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