

International Financial Reporting Interpretations
Committee
First Floor
30 Cannon Street,
London EC4M 6XH
United Kingdom

22 June 2009

Dear Sir/Madam

IAS 39, Financial Instruments: Recognition and Measurement ('IAS 39') – Meaning of 'significant' or 'prolonged'

We have noted the International Financial Reporting Interpretations Committee's ('IFRIC') response to a request in its May 2009 update to provide guidance on the meaning of 'significant or prolonged' in recognising impairments on available-for-sale equity instruments in accordance with IAS 39.

We note that despite the IFRIC agreeing with the submission that significant diversity exists in practice on this issue the IFRIC has not decided to add this issue to its agenda noting that the Board has accelerated its project to develop a replacement for IAS 39. Whilst we understand that the replacement for IAS 39 would seek to resolve this issue through the application of different requirements for such equity instruments (by permitting the recognition of all future changes in the fair value of designated equity instruments in the fair value category directly to other comprehensive income) we believe that the IFRIC should take this issue onto its agenda. This is because the IFRIC has agreed that there is diversity in practice. We also understand that the replacement for IAS 39 has a proposed effective date of years commencing on/after 1 January 2012 (although earlier application may be possible), thereby resulting in a further possible period of diversity in practice of at least 2 ½ years.

Whilst the IFRIC noted some of the ways the requirements are being implemented which has resulted in diversity in practice, we believe that the IFRIC should add this issue onto its agenda to develop further comprehensive guidance.

We have noted below some of our recommendations that we have in this regard.

Recommendations

1. We believe that diversity in practice has arisen, in part, due to the requirements of IAS 39, Para 69: *'Impairment losses recognised in profit or loss for an investment in an equity instrument classified as available-for-sale shall not be reversed through profit or loss.'* Many have voiced their concerns with this requirement that any impairment losses recognised may not

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be reversed at a later date through profit or loss. Many of those concerns note that it is a drop in fair value below original cost that initially triggers the impairment loss, but that subsequent increases are not permitted to be seen as a trigger to reverse such previously recognised losses. It is therefore possible that many have interpreted the requirements of IAS 39, Para 61 in such a way as to avoid the recognition of impairment losses noting that they will be unable to reverse such losses through profit or loss at a future date. This is especially the case where a decline below fair value may exist at a reporting date but has subsequently recovered by the time at which the financial statements have been finalised. We recommend that it be considered whether the requirements of IAS 39, Para 69 may be amended to permit the reversal of impairment losses through profit or loss.

2. We note that the Board in finalizing its amendments to IAS 39 in 2003 changed the wording from 'significant *and* prolonged' to 'significant *or* prolonged'. A decline in the fair value of an equity instrument may not be significant but it may have been prolonged thereby resulting in the requirement to recognize an impairment loss. For instance, an equity instrument of cost CU100¹ declines in fair value to CU95. The decline is not considered to be significant but the decline continues to exist for a period of a year. The decline is considered to be prolonged and results in the recognition of an impairment loss of CU5. We recommend that it be considered whether impairment losses for equity instruments should only be recognised where the decline in fair value below cost is considered to be 'significant *and* prolonged'. This will seek to require the recognition only of those losses that are considered to be significant and that have existed over an extended period of time. Such a change would permit an entity to consider whether any loss is of a temporary or other than temporary nature and would also increase the likelihood that losses are only recognised when there is little or no chance of those losses reversing in a subsequent period (which would in many respects address the concerns noted in point 1 above).
3. The requirements of IAS 39, Para 61 have been accepted as having to be applied at the balance sheet date. IAS 10, Events after the Balance Sheet Date, Para 9 provides the following examples of an adjusting event after the balance sheet date:

"the receipt of information after the balance sheet date indicating that an asset was impaired at the balance sheet date, or that the amount of a previously recognised impairment loss for that asset needs to be adjusted. For example:

- (i) the bankruptcy of a customer that occurs after the balance sheet date usually confirms that a loss existed at the balance sheet date on a trade receivable and that the entity needs to adjust the carrying amount of the trade receivable; and*
- (ii) the sale of inventories after the balance sheet date may give evidence about their net realisable value at the balance sheet date.'*

We recommend that IFRIC consider the application of similar guidance to the determination of whether an impairment loss should or should not be recognised at the balance sheet date based on changes in the fair value of the equity instrument between the balance sheet date and the date that the financial statements are authorized for issue. We believe that such guidance would assist in the determination of whether the decline in the fair value of the equity instrument is temporary or other than temporary at the balance sheet date.

4. Guidance does not exist on how the word 'significant' should be interpreted. There are a number of interpretations of the word 'significant' being applied including that it should be at least 20% of the original cost price of the equity instrument (possibly arising from the reference to 20% as being significant influence in IAS 28, Investments in Associates). We recommend that qualitative guidance be provided on what is meant by significant in this instance to reduce diversity in practice.

¹ As with IFRSs, CU = currency units.

5. Many have also noted that a decline in fair value below its original cost should not necessarily result in the recognition of an impairment loss and that other factors should be considered (in addition to information about significant changes with an adverse effect that have taken place in the technological, market, economic or legal environment in which the issuer operates). For instance, the 'normal' fair value of an equity instrument may be argued to be equal to the present value of the expected future cash flows arising from that equity instrument of which dividends may be a significant component. Therefore, the recoverability of future expected cash flows should also be considered in determining whether an impairment loss should be recognised. For instance, the recognition of an impairment loss where the fair value of an equity instrument is below its original cost appears to be inconsistent with the fact that the present value of the future expected dividends exceeds its original cost. Any difference between the fair value and the cost of the equity instrument could be as a result of other market factors, some of which may be temporary in nature, such as times of extreme market illiquidity.

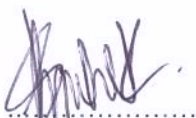
Closing

We recommend that, despite the Board accelerating its project for the development of a replacement for IAS 39, IFRIC add this item to its agenda noting, in particular, that significant diversity exists in practice and that such diversity could continue to exist for a period of at least 2 ½ years.

We also recommend that IFRIC consider amending IAS 39 for points 1 and 2 above and providing additional qualitative guidance relating to points 3, 4 and 5.

Should you wish to clarify any aspects of this document, please feel free to contact me on either +2711 (0) 686-0977 or Stephen.brickett@standardbank.co.za.

Yours faithfully



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