EFRAG

European Financial Reporting Advisory Group

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

19 April 2017

Dear Mr Hoogervorst,

Re: Exposure Draft ED/2017/1 *Annual Improvements to IFRS Standards 2015-2017 Cycle*

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the Exposure Draft ED/2017/1 *Annual Improvements to IFRS Standards 2015-2017 Cycle,* issued by the IASB on 12 January 2017 (the 'ED').

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of definitive IFRS in the European Union and European Economic Area.

EFRAG understands that the annual improvements process offers a valuable opportunity to deal efficiently with a collection of minor amendments to IFRS. EFRAG agrees that the issues addressed by the IASB within the ED meet the criteria of the IASB Due Process Handbook and therefore they can be resolved as part of the annual improvement project.

EFRAG broadly agrees with most of the proposals in the ED, but is concerned that amending IAS 12 *Income Taxes* without providing guidance on how to determine whether the payments are distributions of profits may not lead to a significant improvement in consistent application compared to the current situation.

In relation to the proposed amendments to IAS 28 *Investments in Associates and Joint Ventures*, EFRAG supports the IASB's decision to address the issue before IFRS 9 *Financial Instruments* becomes effective. EFRAG also considers the proposed amendments to be a practical solution, in that they codify an acceptable interpretation of existing guidance and do not involve extensive changes to that guidance. However, EFRAG also considers that the IASB should provide guidance on the application of the proposed amendments. Moreover, EFRAG considers that this should be regarded only as a temporary solution and that the treatment of long-term interests should be considered more broadly in the IASB's equity method research project.

Lastly, whilst EFRAG understands the benefits from aligning the effective date of the amendments to IAS 28 with the effective date of IFRS 9, we are concerned about the short time period between the expected date of issuing the amendments and the proposed effective date of 1 January 2018. We consider that this will create difficulties for all jurisdictions with a translation or endorsement process, including the European Union. Therefore, EFRAG considers that the IASB should propose an effective date of 1 January 2019, with earlier application permitted and provide transition provisions for entities that will not be able to apply the amendments at the same time as they apply IFRS 9.

EFRAG's detailed comments and responses to the questions in the ED are set out in the Appendix.

If you would like to discuss our comments further, please do not hesitate to contact Ioanna Chatzieffraimidou or me.

Yours sincerely,

Jean-Paul Gauzès
President of the EFRAG Board

Appendix - EFRAG's responses to the questions raised in the ED

Issue 1 - IAS 12 *Income Taxes*: Income tax consequences of payments of financial instruments classified as equity

Question 1 - Proposed amendments to IAS 12

Do you agree with the IASB's proposal to amend IAS 12 in the manner described in the Exposure Draft?

If not, why, and what alternative do you propose?

EFRAG's response

Whilst EFRAG agrees with the proposed amendments to IAS 12 *Income Taxes*, EFRAG is concerned that amending IAS 12 without providing guidance on how to determine whether the payments are distributions of profits may not lead to a significant improvement in consistent application compared to the current situation.

1 EFRAG understands that, as written, paragraphs 52A and 52B could be read to imply that the requirements in paragraph 52B apply only to the circumstances described in paragraph 52A (i.e. different tax rates applied to distributed and undistributed profits or to circumstances where an entity receives tax refunds from the tax deductible payments).

2 Therefore, EFRAG welcomes the IASB's proposal to clarify that the requirements in paragraph 52B apply to all income tax consequences of dividends.

3 However, in assessing whether to present in equity or in profit or loss the income tax consequences of payments on financial instruments classified as equity, the main assessment is to determine whether the payments are distributions of profits.

4 Therefore, without disagreeing with the proposed amendment, EFRAG considers that amending IAS 12 without providing guidance on this key issue may not lead to a significant improvement in consistent application compared to the current situation. This is because we think the diversity will continue in determining whether payments on financial instruments that are classified as equity are or are not dividends.

5 In other words, the proposed amendments to IAS 12 will eliminate one source of diversity but another source of diversity may become more apparent in cases where it is not straightforward to determine whether payments on financial instruments that are classified as equity are 'dividends'.

Issue 2 - IAS 23 *Borrowing Costs*: Borrowing costs eligible for capitalisation

Question 2 - Proposed amendments to IAS 23

Do you agree with the IASB's proposal to amend IAS 23 in the manner described in the Exposure Draft?

If not, why, and what alternative do you propose?

EFRAG's response

EFRAG agrees with the proposed amendments to IAS 23 *Borrowing Costs*.

6 EFRAG supports the IASB's proposal to clarify the accounting treatment of borrowing costs on completed qualifying assets, as part of the annual improvements process. EFRAG agrees that, after the related asset is ready for its intended use or sale, any borrowing that no longer meets the definition of specific borrowing (i.e. borrowing made specifically for the purpose of obtaining a qualifying asset) becomes part of the funds that an entity borrows generally as described in paragraph 14 of IAS 23.

7 Regarding the transition provision, EFRAG generally supports retrospective application of new, or amendments to existing, Standards and Interpretations.

8 However, in this case, EFRAG agrees that the proposals should be applied prospectively (i.e. only to borrowing costs incurred on or after the effective date of the amendment) as the costs for preparers of retrospective application are expected to outweigh the benefits to users in the way of decision-useful information. EFRAG notes that this decision is consistent with the previous decision of the IASB when it first introduced the requirement to capitalise borrowing costs in accordance with IAS 23.

Issue 3 - IAS 28 *Investments in Associates and Joint Ventures*: Long-term interests in an associate or joint venture

Question 3 - Proposed amendments to IAS 28

Do you agree with the IASB's proposal to amend IAS 28 in the manner described in the Exposure Draft?

If not, why, and what alternative do you propose?

Question 4 - Effective date of the proposed amendments to IAS 28

The IASB is proposing an effective date of 1 January 2018 for the proposed amendments to IAS 28. The reasons for that proposal are explained in paragraphs BC7-BC9 of the Basis for Conclusions on the proposed amendments to IAS 28.

Do you agree with the effective date for the proposed amendments?

If not, why, and what alternative do you propose?

EFRAG's response

EFRAG supports the IASB's decision to address the issue before IFRS 9 *Financial Instruments* becomes effective. EFRAG considers that the proposed amendments to IAS 28 *Investments in Associates and Joint Ventures* are a practical way to address the issue in that they codify and provide an acceptable reading of the existing requirements and do not require extensive changes to those requirements. However, EFRAG considers that the IASB should include an example or similar guidance illustrating the application of the proposed amendments. Moreover, EFRAG considers the proposed amendments should be regarded only as a temporary solution and that the accounting treatment of long-term interests in an associate or joint venture should be considered more broadly in the IASB's equity method research project.

Regarding the effective date, EFRAG considers that the IASB should require an effective date of 1 January 2019, with earlier application permitted and provide transition provisions for entities that will not be able to apply the amendments at the same time they apply IFRS 9.

The proposed amendment

9 EFRAG understands that there is diversity in practice in the application of the requirements of IAS 39/IFRS 9 and IAS 28 to long-term interests. This is not a new issue but its impact is likely to be more significant following the transition to the expected credit loss model under IFRS 9. We therefore support the IASB's decision to address this issue.

10 EFRAG notes that the IASB has a research project on the equity method, although we also understand that work on this may not commence until after the Post-implementation Review of IFRS 11 *Joint Arrangements*. Unless the IASB addresses this issue now, constituents would not have an answer to their question before IFRS 9 becomes effective.

11 EFRAG considers that the proposal to account for these long-term interests applying IFRS 9, including its expected credit loss requirements, provides a practical way to address the issue. This is on the basis that the proposed amendments codify a reading of the existing requirements that is at least an acceptable interpretation, and do not require extensive changes to those requirements.

12 Although we acknowledge that applying two different impairment requirements could create confusion and additional costs to preparers, we understand that the expected credit loss requirements of IFRS 9 and impairment requirements IAS 28/IAS 36 are applied to different units of account (the long-term interest alone and the total net investment respectively).

13 However, EFRAG also considers that some further clarification of the mechanics of the proposed solution is needed. The proposed amendments do not set out the sequence in which the two impairment steps and, if applicable, the loss allocation step in paragraph 38 of IAS 28 should be applied. Accordingly, EFRAG considers that an example or other form of guidance should be included to explain this sequence but without straying into the wider application of the equity method. In EFRAG's view this should illustrate that an entity:

(a) first applies the impairment requirements of IFRS 9 to the long-term interest;

(b) second, recognises any share of net losses of the associate or joint venture in accordance with paragraph 38 of IAS 28;

(c) third, assesses the net investment for impairment in accordance with paragraphs 40 and 41A-43 of IAS 28 and recognises any impairment losses; and

(d) finally, ignores share of net losses or impairment allocated under IAS 28/IAS 36 when applying IFRS 9 in subsequent periods to the long-term interest (in order to maintain the integrity of the IFRS 9 amortised cost measurement).

14 Although EFRAG supports the proposed amendments for the reasons explained (subject to the clarification requested above), we also consider that this should be regarded as only a temporary solution. In EFRAG's view, the following issues concerning the nature of, and accounting for, long-term interests in an associate or joint venture should be considered more broadly in the future:

(a) Firstly, EFRAG suggests that the IASB should consider the adequacy of the guidance in IAS 28 concerning the criteria for long-term interests and the elements that form part of such interests.

(b) Secondly, EFRAG understands that, in some cases, the long-term interest is managed together with the equity interest as a single "package". Some respondents to EFRAG's draft comment letter therefore argue that the long-term interest should be accounted for in the same way as the equity investment. However, EFRAG acknowledges that IAS 28's guidance on the equity method does not address the accounting for long-term interests (apart from the guidance on loss allocation and impairment). Accordingly, it would be necessary to develop new guidance on how the equity method applies to long-term interests if IFRS 9 does not to apply to them.

(c) Finally, EFRAG observes that there is no specific guidance in IAS 28 on how to allocate any impairment of the net investment as a whole between the different components of the net investment (i.e. the investment accounted for using the equity method and the long-term interests). EFRAG is of the view that the allocation of such impairment losses should be clarified.

15 However, EFRAG acknowledges that these issues are too broad to be addressed in the annual improvements process and should instead be addressed as part of the IASB's research project on the equity method. In this project, the IASB should also consider similar issues arising in the separate financial statements of the parent entity, if that entity measures its investments in subsidiaries at cost or using the equity method in accordance with IAS 27 *Separate Financial Statements*. Moreover, the IASB should consider similar issues arising in the financial statements of an entity, if that entity measures its investments in associates or joint ventures at cost in accordance with IAS 27.

Effective date and transition

16 EFRAG understands the benefits from aligning the effective date of the amendments with the effective date of IFRS 9. However, EFRAG is concerned about the short time period between the expected date of issuing the amendments to IAS 28 and the proposed effective date of 1 January 2018. We consider that this will create difficulties for all jurisdictions with a translation or endorsement process, including the European Union.

17 Therefore, we recommend that the IASB includes an effective date of 1 January 2019, with earlier application permitted. This would allow entities without an endorsement or translation process to early apply the amendment, if they want to take advantage of the transition reliefs in IFRS 9.

18 For entities that will not be able to apply the amendments at the same time they apply IFRS 9, EFRAG recommends that the IASB provide transition provisions.