This paper has been prepared by the EFRAG Secretariat for discussion at a public meeting of EFRAG TEG. The paper forms part of an early stage of the development of a potential EFRAG position. Consequently, the paper does not represent the official views of EFRAG or any individual member of the EFRAG Board or EFRAG TEG. The paper is made available to enable the public to follow the discussions in the meeting. Tentative decisions are made in public and reported in the EFRAG Update. EFRAG positions, as approved by the EFRAG Board, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances.

Annual Improvements to IFRS Standards 2015-2017 Cycle Cover Note

Objective

1 The objective of the session is to discuss and agree to recommend to the EFRAG Board a draft comment letter 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').

Background

Content of the ED

2 The ED was approved for publication by ten of the eleven members of the IASB. Mr. Ochi voted against the publication of the proposed amendment to IAS 28 *Investments in Associates and Joint Ventures*. His alternative view is set out in the Appendix to this paper.

3 The ED addresses the following issues:

Issue	Standard	Subject of amendment
1	IAS 12 *Income Taxes*	Income tax consequences of payments on financial instruments classified as equity.
2	IAS 23 *Borrowing Costs*	Borrowing costs eligible for capitalisation.
3	IAS 28 *Investments in Associates and Joint Ventures*	Long-term interests in an associate or joint venture.

4 The IASB is proposing to clarify that the requirements in paragraph 52B of IAS 12 apply not just in the circumstances described in paragraph 52A of IAS 12, but to all income tax consequences of dividends.

5 The IASB is proposing to amend paragraph 14 of IAS 23 to clarify that, when a qualifying asset is ready for its intended use or sale, an entity treats any outstanding borrowing made specifically to obtain that qualifying asset, as part of the funds that it has borrowed generally.

6 The IASB is proposing to clarify that an entity is required to apply IFRS 9, including its impairment requirements, to long-term interests in an associate or joint venture that, in substance, form part of the net investment in the associate or joint venture but to which the equity method is not applied.

EFRAG TEG discussions at the December 2016 meeting

7 At its December meeting, EFRAG TEG discussed the narrow-scope amendments to be included in the IASB's ED.

IAS 12 issue

8 EFRAG TEG was concerned about the IASB pursuing this narrow-scope amendment without providing some guidance on how to determine whether payments on financial instruments that are classified as equity are dividends or not.

9 Some EFRAG TEG members did not consider that the expected narrow-scope amendment to IAS 12 would lead to an improvement compared to the current situation.

IAS 23 issue

10 EFRAG TEG supported the way that the IASB is expected to address the issue related to IAS 23.

IAS 28 issue

11 Most EFRAG TEG members broadly supported the way that the IASB is expected to address the issue, but observed that some clarifications, perhaps in the form of an illustrative example, on the application of the expected amendment to IAS 28 would be useful.

12 Some EFRAG TEG members noted that this was not the best way to address the issue and would prefer to exclude long-term interests from the expected credit loss requirements of IFRS 9 such that impairment would be addressed solely by IAS 28.

EFRAG Secretariat analysis

13 In the following paragraphs we set out how we have incorporated EFRAG TEG's comments raised at the December meeting in our initial draft comment letter.

IAS 12 issue

14 The EFRAG Secretariat agrees with EFRAG TEG's concerns about the IASB pursuing this narrow-scope amendment without providing some guidance on how to determine whether payments on financial instruments that are classified as equity are dividends or not.

15 However, the EFRAG Secretariat considers that the proposed narrow-scope amendment to IAS 12, even without the above guidance, would lead to some improvement compared to the current situation. Specifically, the submitter to the IFRS IC observed that some take the introductory wording of paragraph 52B of IAS 12 to refer only to the circumstances in paragraph 52A of IAS 12, thus restricting the recognition through profit or loss only to circumstances of different tax rates applied to distributed and undistributed profits or to circumstances where an entity receives tax refunds from the tax deductible payments.

16 Consequently, the EFRAG Secretariat does not disagree with the proposed amendment and suggests:

(a) expressing these concerns in our draft comment letter to the IASB; and

(b) including a question to constituents on whether they think the proposed amendment will lead to an improvement compared to the current practice.

IAS 28 Issue

Long-term interests should be addressed entirely under IAS 28

17 The EFRAG Secretariat acknowledges the view that where a long-term interest is in substance part of the 'net investment', it is akin to an equity interest and it would therefore make sense to account for it in the same way as the equity investment. This view would be supported by the guidance in IAS 21 *The Effects of Changes in Foreign Exchange Rates*, which refers to 'items for which settlement is neither planned nor likely to occur in the foreseeable future'. These monetary items are treated similarly with equity investments in a foreign operation in terms of foreign currency translation.

18 However, should these interests be scoped out of IFRS 9, then there would be no basis for classifying and measuring them. IAS 28 does not specify general recognition or measurement requirements for long-term interests. As these interests cannot be accounted for using the equity method, (they are subject to only one part of the equity method procedures), it would be necessary to develop guidance on their recognition and measurement.

Illustrative example

19 Regarding the illustrative example, we understand that the IASB decided not to include an example illustrating the application of the proposed amendment, due to concerns that it was straying into the application of the equity method under IAS 28.

20 However, EFRAG TEG expressed concerns that the expected amendment lacked understandability and some form of clarification was needed. The EFRAG Secretariat suggests that an illustrative example or guidance be included, which would clarify that an entity:

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

(b) second, recognises any share of losses of an 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

(d) finally, ignores losses or impairment allocated under IAS 28/IAS 36 when applying IFRS 9 in subsequent periods to long-term interests.

21 Paragraph 38 of IAS 28 specifies that an entity allocates its share of losses first to investments accounted for using the equity method and then to long-term interests. However, there are no specific requirements in IAS 28 on how to allocate impairment of the net investment to the different components of the net investment (i.e. the investment accounted for using the equity method and long-term interests).

22 Although we think there should be clarity on whether or how to allocate such impairment losses among the components of the net investment, we think that this issue could not be resolved within the Annual Improvements process and would require an amendment to IAS 28. However, we note that the IASB staff has identified that it would be rare (if ever) that an entity would recognise an IAS 28/IAS 36 impairment loss relating to long-term interests, especially if losses have been allocated to those long-term interests applying the loss allocation requirements in IAS 28. If this is the case, then the necessary clarity can be addressed in the IASB's equity method project.

Questions for EFRAG TEG

23 Does EFRAG TEG agree with the EFRAG Secretariat draft comment letter?

24 Does EFRAG TEG agree to recommend the draft comment letter to the EFRAG Board?

Agenda Papers

25 In addition to this cover note, agenda papers for this session are:

(a) Agenda paper 08-02 - a Draft Comment Letter proposed by the EFRAG Secretariat on ED/2017/1 *Annual Improvements to IFRS Standards 2015-2017 Cycle*; and

(b) Agenda paper 08-03 - IASB Exposure Draft ED/2017/1 *Annual Improvements to IFRS Standards 2015-2017 Cycle* - for background only.

Appendix- Alternative view on the proposed amendment to IAS 28 in the ED

1 Mr Ochi voted against the publication of the proposed amendment to IAS 28.

2 Mr Ochi disagrees with proposing amendment to IAS 28 without also specifying the types of interests in an associate or joint venture that an entity accounts for using the equity method, and the types of interests in such entities that an entity accounts for applying IFRS 9. Mr Ochi thinks that interests in an associate or joint venture should be subject to either the requirements in IFRS 9 or the requirements in IAS 28, but not both.

3 Mr Ochi is of the view that the types of long-term interests that, in substance, form part of the net investment are quite limited. He therefore thinks that the IASB could specify the types of interests that form part of the net investment within a relatively short period of time.