BUSINESSEUROPE

International
Accounting
Standards Board
(IASB)
30 Cannon Street,
London EC4M 6XH,
United Kingdom.

7 April 2017

Dear Board member,

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

BusinessEurope welcomes the invitation to comment on the Exposure Draft ED/2017/1 Annual Improvements to IFRS Standards 2015-2017 Cycle (the ED).

Responses to the questions raised in the ED

Question 1—Proposed amendments (please answer individually for each proposed amendment) Do you agree with the Board's proposal to amend the Standards in the manner described in the Exposure Draft? If not, why, and what alternative do you propose?

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

We agree with the proposed amendments and the proposal for retrospective application with earlier application permitted.

However, we think that the question of how to determine whether a payment made on a financial instrument classified as equity is a dividend/distribution, or not, is fundamental to this issue. We think that the statement in BC5 of the proposed amendment, that an entity would apply judgement to do this, is insufficient to ensure that this potential cause of diversity is adequately limited. We would therefore respectfully suggest that the Board reconsider its decision on this.

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2. **IAS 23 Borrowing Costs: borrowing costs eligible for capitalisation.**

We welcome the clarification proposed for paragraph 14 of IAS 23. We also agree with the proposal for prospective application for this amendment, as specified in paragraph 28A.

We would also like to draw to the Board's attention the fact that we are aware that different constituents interpret the guidance of IAS 23.15 in different ways. Paragraph 15 states: "In some circumstances, it is appropriate to include all borrowings of the parent and its subsidiaries when computing a weighted average of the borrowing costs; in other circumstances, it is appropriate for each subsidiary to use a weighted average of the borrowing costs applicable to its own borrowings." Some interpret this as a requirement to apply judgement as to whether to calculate a single weighted-average capitalisation rate or as many rates as are judged appropriate to the way the financing of the group is organised, whereas others see this as permitting only either a group-wide rate or separate rates for each subsidiary. We think that the former interpretation makes more sense in a principles-based environment and will result in better, more relevant information for the user. If the Board is in agreement with this view, we would request it to consider providing guidance to make this paragraph clear.

3. **IAS 28 Investments in Associates and Joint Ventures**

We do not agree that the proposed solution will result in the most relevant and practical approach to this issue, and, even if the Board were to maintain its approach, we are not convinced that the proposed amendments would provide sufficient clarification for the issues raised.

This issue is particularly confusing as a number of amendments have been made to IAS 28 since 2003, the justification for some of which is not clearly laid out in the Bases for Conclusions. The proposals for amendments in the ED are based on the text of IAS 28 which will become effective when IFRS 9 is applied (1 January 2018), not the text which is effective currently.

Paragraph 38 of the current IAS 28 was introduced in 2003 as an anti-abuse measure in order to prevent entities from structuring the investment in equity-accounted entities with the aim of avoiding recognising losses under the equity method. This implies that the Board considered that the application of the impairment provisions of IAS 39 to the long-term interests in isolation was insufficiently sensitive to reflect deteriorating economic circumstances. Recognition of losses was presumably expected to be accelerated by the net-investment approach. In the Basis for Conclusions accompanying these changes, the Board stated "In widening the base against which losses are to be recognised, the Board also *clarified the application of the impairment provisions* of IAS 39 … to the financial assets that form part of the net investment. (our emphasis)"

The current version of IAS 28 also includes paragraphs 40, 42 and 43 which require that the assessment for evidence of impairment for the net investment be made using IAS 39's requirements (paragraphs IAS 39.59 – 61, the essence of which is incorporated into IAS 28 in future amendments as paragraphs 41A – 41C) and then tested as a single asset using the IAS 36 method (recoverable amount versus carrying amount). The requirement of paragraph 40 to apply IAS 39 imposes the requirement to carry out an annual assessment of the net investment for impairment using the review for impairment "triggers" of IAS 39, but paragraph 42 then requires the test to be carried out for the whole net investment using IAS 36's techniques. This assessment is performed after equity accounting has been applied, irrespective of whether losses have been allocated.

In this context, the requirement of paragraph 41 to determine whether any further impairment loss is necessary for elements which do not form part of the net interest by applying IAS 39 is a logical clarification and should be retained rather than deleted as proposed.

In our view, the above forms a consistent approach based around the notion that the net investment is the appropriate unit of account for the accounting for the interest in the entity, and that the entity should use IAS 39 triggers followed by an IAS 36 impairment test. We are not convinced that, at the time, the Board intended the long-term investment which is in substance part of the net investment to be tested twice for impairment under IAS 39 and then under IAS 36 in addition to having losses allocated to it.

However, matters are complicated by paragraph 14 in the "Equity method" section of the current IAS 28, which appeared in the 2012 Red Book with an effective date of 1 January 2013. This states that IFRS 9 does not apply to interests that are accounted for using the equity-accounting method but that instruments containing potential voting rights that do not currently give access to ownership returns are accounted for under IFRS 9. Paragraph BC4 of the 2011 amendment states that the Board had not reconsidered some of the requirements incorporated into IAS 28 from other standards and implementation guidance, and it seems to us that non-mandatory implementation guidance has thus been incorporated into IAS 28 as a mandatory requirement, but with the relevant standard being changed from IAS 39 to IFRS 9, which is not yet effective:

"BC4 IAS 28 as amended in 2011 superseded IAS 28 (as revised in 2003 and amended in 2010). As stated in paragraph BC3, in amending IAS 28, the Board did not reconsider

all the Standard's requirements. The requirements in paragraphs 5– 11, 15, 22–23, 25–28 and 32–43 relate to the assessment of significant influence and to the equity method and its application, and paragraphs 12–14 relate to the accounting for potential voting rights. With the exception of the Board's decision to incorporate the accounting for joint ventures into IAS 28, those paragraphs were carried forward from IAS 28 and from the Guidance on Implementing IAS 27 Consolidated and Separate Financial Statements, IAS 28 Investments in Associates and IAS 31 Interests in Joint Ventures that was withdrawn when IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements and IAS 28 (as amended in 2011) were issued. As a result, those paragraphs were not reconsidered by the Board."

"Implementation Guidance IAS 27: IG7 IAS 39 Financial Instruments: Recognition and Measurement does not apply to interests in subsidiaries, associates and jointly controlled entities that are consolidated, accounted for using the equity method or proportionately consolidated in accordance with IAS 27, IAS 28 and IAS 31 respectively. When instruments containing potential voting rights in substance currently give access to the economic benefits associated with an ownership interest, and the investment is accounted for in one of the above ways, the instruments are not subject to the requirements of IAS 39. In all other cases, instruments containing potential voting rights are accounted for in accordance with IAS 39."

We think that the requirements of IAS 28 have been inappropriately translated into the text that will become effective at the same time as IFRS 9 and that the current proposals will lead to unnecessary complications in the accounting for the long-term interest element of the net investment.

In our view, the future standard should require that elements which do not constitute part of the net investment in substance should be subject to all the requirements of IFRS 9. However, those long-term items that are, in substance, part of the net investment should be initially recognised and measured under IFRS 9 (using the effective interest method), but subject to only the impairment requirements of IAS 28 alone (as explained in the current text, based on the IAS 39 impairment assessment and the IAS 36 impairment test). The Board may have to define what elements form part of the relevant long-term interests, but IAS 28 paragraph 38 already provides a good basis for this and this should therefore be possible within a relatively short period of time, as stated by Mr. Ochi in his dissenting opinion. We think that this is a clearer and simpler approach to the issue.
However, if the Board wishes to press ahead with the proposed amendments, we think that further guidance would need to be provided in order clarify how the inter-play between IFRS 9's measurement and impairment requirements and IAS 28's equity-accounting and impairment requirements should be dealt with in practice.

Further guidance would also be required, in our view, in respect of the subsequent accounting under IFRS 9 and IAS 28 once equity-accounted losses or impairment have been recognised for the net investment (or interest) in excess of the investment in ordinary shares. In particular, we think it is necessary to expand upon the comment made in the May 2016 IFRIC Update "...the entity then ignores those losses or that impairment when it accounts for long-term interests applying IFRS 9 in subsequent periods...".

The Board might consider providing a worked example which should make clear the order in which the various requirements should be applied. The basis for such an example was included in one of papers provided for the Board's discussions of the topic.

Question 2—Effective date of the proposed amendments to IAS 28 Investments in Associates and Joint Ventures. The Board 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 those proposed amendments? If not, why, and what alternative do you propose?

We are concerned that the short period that will be left between the finalisation of the re-deliberations of these proposals and 1 January 2018 may be insufficient to enable some entities to apply the amendments appropriately. We would therefore suggest a mandatory effective date of 1 January 2019 with earlier application permitted. In this case, it would simplify work for entities if all three proposed amendments in the ED were to have that same mandatory effective date.

If you require any further information on the matters discussed above, please do not hesitate to ask.

Yours sincerely,

p.p.

Jérome Chauvin
Deputy Director General