European Securities and Markets Authority

The Chair

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ESMA32-61-136

Mr Jean-Paul Gauzès
President
European Financial Reporting Advisory Group (EFRAG)
35 Square de Meeûs
1000 Brussels
Belgium

Ref: IASB's Exposure Draft *Annual Improvements to IFRS Standards 2015–2017 Cycle*

Dear Mr Gauzès,

The European Securities and Markets Authority (ESMA) thanks you for the opportunity to contribute to the IASB's due process regarding the Exposure Draft (ED) *Annual Improvements to IFRS Standards 2015–2017 Cycle*. We are pleased to provide you with the following comments with the aim of improving the enforceability of IFRSs and the transparency and decision usefulness of financial statements.

ESMA agrees that all the issues addressed by the IASB included in the ED meet the criteria of the IASB's *Due Process Handbook* and believe they should be resolved as part of the annual improvements package. We welcome the IASB's proposal to address practical issues submitted by constituents and we believe that the proposals set out in the ED contribute to improving financial reporting.

Like EFRAG, we are therefore generally supportive of the amendments proposed in the ED. In addition, ESMA suggests that the IASB considers bringing additional clarity in the following areas: (i) with respect to the proposed amendments to IAS 12, on how to determine when payments on equity instruments qualify as dividends; and (ii) regarding the proposed amendments to IAS 28, on the definition of long-term interests and the interaction with IFRS 9 *Financial Instruments*. However, unlike EFRAG, we are not convinced that in applying the proposed amendment to IAS 28, the impairment test in accordance with IFRS 9 should precede the allocation of losses according to paragraph 38 of IAS 28 (as stated in paragraph 41 of EFRAG's draft comment letter), as this may result in double counting of impairment losses.

Unlike EFRAG, ESMA supports the effective date proposed by the IASB for the amendments, in order to align the date of application of IFRS 9 and the proposed amendment to IAS 28.

Our detailed comments on the ED are set out in Appendix I to this letter. Please do not hesitate to contact us should you wish to discuss all or any of the issues we have raised.

Yours sincerely,

Steven Maijoor

Appendix I – ESMA's detailed answers to the questions in the ED

Question 1 Proposed amendments

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?

Issue 1: Proposed amendments to IAS 12 *Income Taxes*

1. In its June 2015 agenda item request to the IFRS IC, ESMA asked for a clarification as to whether, according to IAS 12, the tax reductions triggered by the tax-deductible interest payments on (and by any costs of issuing) equity instruments should be accounted for in equity or profit or loss. ESMA referred to the specific example of interest payments on perpetual bonds and asked whether the requirements in paragraph 52B of IAS 12 would be applicable only in the circumstances described in paragraph 52A of that standard (i.e. when income taxes are payable at a higher or lower rate, or when they are refundable depending on whether the net profit or retained earnings of the entity is paid out as a dividend to its shareholders).

2. The IASB proposes to address the requested clarification by deleting paragraph 52B and replacing it with paragraph 58A which reproduces substantially the same provisions, except for the fact that it delinks the tax consequences of dividends from the circumstances indicated on paragraph 52A. By doing so, the proposed amendments to IAS 12 clarify that the reason for the income tax consequences of dividends does not affect where those consequences are recognised (paragraph BC2 of the proposed amendments to IAS 12).

3. ESMA agrees that, by decoupling the income tax consequences of certain payments (i.e. dividends) from the circumstances listed in paragraph 52A, the proposed amendments improve the overall clarity on the recognition requirements for current and deferred taxes.

4. However, ESMA also notes that while in its request it had generically referred to interest payments on equity instruments, the IASB has decided to specifically address a situation in which such instruments meet the definition of dividends, although no specific guidance exist in IFRS on how to determine whether payments on equity instruments qualify as dividends. In this respect, ESMA is concerned that the lack of guidance in this area creates the potential for an inconsistent application of the definition of dividends and therefore would urge the IASB to plan further work in this area. Without further clarifications, ESMA is concerned that the amendment will not achieve the clarification needed and diversity will remain.

5. Notwithstanding these concerns, ESMA agrees with the proposals to amend IAS 12.

Issue 2: Proposed amendments to IAS 23

6. ESMA agrees with the proposed amendments to IAS 23 for the reasons mentioned by the IASB.

Issue 3: Proposed amendments to IAS 28 *Investments in Associates and Joint Ventures*

7. ESMA is of the view that the proposed amendments address an inconsistency between the scope requirements in IFRS 9 *Financial Instruments* and the requirements in paragraph 41 of IAS 28 with respect to long-term interests that form part of a net investment in a joint venture or an associate. Therefore, ESMA agrees with the need for the proposed amendments. ESMA also generally agrees with the IASB's proposal to bring clarity on the issue at hand, however ESMA would also like to highlight the following concerns to help improving the overall clarity of the amendments and their enforceability.

8. Firstly, the proposed amendments do not explain in which order an entity should perform: (i) the impairment of long-term interests according to IFRS 9; and (ii) the impairment of the net investment according to IAS 28. In ESMA's view, the impairment test (both according to IFRS 9 and paragraphs 40-41C of IAS 28) should come after the allocation of losses required by IAS 28 paragraph 38, in order to avoid the risk of double counting impairment losses. ESMA acknowledges that already at present there is no clarity on this aspect, however the inconsistencies arising from an arbitrary ordering would be amplified when applying the expected loss model under IFRS 9 compared to the incurred loss model under IAS 39. Hence, ESMA believes that this would be a necessary clarification to allow entities to consistently apply the proposed amendments. We also suggest to include an example to complement this clarification.

9. Secondly, ESMA notes that the proposed amendments do not clarify what might be considered 'long-term interests' that form part of the net investment of the associate and joint venture. ESMA believes it is important that all those instruments and transactions that are specifically provided for in IFRS are clearly and univocally defined. Therefore, ESMA would urge the IASB to consider providing a definition for long-term interests as soon as possible.

Question 2—Effective date of the proposed amendments to IAS 28 Investments in Associates and Joint Ventures

10. ESMA acknowledges the importance of aligning the effective date of the amendments to IAS 28 with the effective date of IFRS 9.