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

Feedback to constituents – EFRAG Final Comment Letter

April 2017

Summary of contents

Introduction

Objective of this feedback statement

This feedback statement summarises the main comments received by EFRAG on its draft comment letter in response to the IASB's Exposure Draft ED/2017/1 *Annual Improvements to IFRS Standards 2015-2017 Cycle* ('the ED') and explains how those comments were considered by EFRAG during its technical discussions leading to the publication of EFRAG's final comment letter.

Background to the ED

The ED proposed amendments to three IFRS Standards as result of the IASB's Annual Improvements project.

The IASB uses the Annual Improvements process to make necessary, but non-urgent, amendments to IFRS Standards that will not be included as part of another major project. The ED proposed the following amendments:

Issue	IFRS Standard	Subject of amendments
1	IAS 12 *Income Taxes*	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.
2	IAS 23 *Borrowing Costs*	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.
3	IAS 28 *Investments in Associates and Joint Ventures*	To clarify that an entity is required to apply IFRS 9 *Financial Instruments*, 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.

Further details are available on the EFRAG website.

EFRAG's draft comment letter

EFRAG published a draft comment letter on the proposals on 2 February 2017. In the draft comment letter, EFRAG broadly agreed with most of the proposals in the ED, but was concerned that amending IAS 12 without providing guidance on how to determine whether payments are distributions of profits might not lead to a significant improvement in consistent application compared to the current situation.

Moreover, EFRAG recommended that the IASB should include an example or other guidance illustrating the application of the proposed amendments to IAS 28.

Lastly, whilst EFRAG understood the benefits from aligning the effective date of the amendments to IAS 28 with the effective date of IFRS 9, EFRAG expressed its concerns about the short time period between the expected date of issuing the amendments and the proposed effective date of 1 January 2018, and hence, proposed an effective date of 1 January 2019, with earlier application permitted.

Comments received from constituents

EFRAG received fifteen comment letters from constituents. These comment letters are available on the EFRAG website.

The comment letters came from national standard setters, associations of preparers, listed companies, accounting organisations and a regulator.

Two respondents agreed overall with all proposed amendments in the ED without providing detail. The remainder of the analysis relates to the respondents who provided more detail.

Proposed amendments to IAS 12

Most of the respondents broadly agreed with EFRAG's tentative position that the IASB clarify that the requirements in paragraph 52B of IAS 12 apply to all income tax consequences of dividends and not only to the circumstances described in paragraph 52A of IAS 12.

Almost half of the respondents explicitly supported EFRAG's concerns that pursuing the narrow-scope amendments to 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. Most of the remaining respondents were silent.

Some respondents disagreed with the proposed amendment, as they thought that the issue was broader than the scope of an Annual Improvement and should be considered under a more general approach, which would specify the underlying principles to determine when tax effects have to be presented in equity or profit or loss.

Proposed amendments to IAS 23

Most respondents agreed with EFRAG's tentative support for the proposed amendments to IAS 23.

Proposed amendments to IAS 28

EFRAG received mixed views on the proposed amendments to IAS 28. Slightly more than half of the respondents were in agreement with EFRAG's view that an entity applies IFRS 9, including its impairment requirements, to long-term interests, that in substance form part of the net investment in an associate or joint venture, to which the equity method is not applied.

Some respondents disagreed with EFRAG's view, because they considered that long-term interests that form part of the net investment in an associate or joint venture should either be measured (including impairment) based on IAS 28, or at least should only be assessed for impairment based on IAS 28.

Irrespective of whether they agreed or disagreed with the proposed amendments, many respondents explicitly agreed with EFRAG that an example or other guidance is necessary to improve the clarifying nature of these amendments.

Some respondents raised additional issues including:

(a) the IASB should define what might be considered 'long-term interest' that forms part of the net investment of an associate or joint venture;

(b) there is a lack of guidance in IAS 28 on how to allocate impairment of the net investment as a whole to the different components of the net investment (i.e. the investment accounted for using the equity method and long-term interests);

(c) there may be similar issues in the separate financial statements of a parent entity, if the parent entity measures its investments in subsidiaries at cost or using the equity method in accordance with IAS 27 *Separate Financial Statements*; and

(d) there may be similar issues in the separate financial statements of an entity, if the entity measures its investments in associates or joint ventures at cost in accordance with IAS 27.

Lastly, EFRAG received mixed views on its proposal to suggest an effective date of 1 January 2019, with earlier application permitted.

EFRAG's proposed final comment letter

EFRAG issued its final comment letter on 19 April 2017.

Proposed amendments to IAS 12

Based on the input received from respondents, EFRAG maintained its general agreement with the proposed amendments to IAS 12.

Based on similar comments received from almost half of the respondents, EFRAG decided to maintain in the final comment letter, its concern 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.

Proposed amendments to IAS 23

Considering the support received from respondents, EFRAG maintained its initial support for the amendments to IAS 23.

Proposed amendments to IAS 28

Considering the input from respondents and for the reasons explained in the draft comment letter, EFRAG decided to retain its initial tentative position, as it considers this is consistent with an acceptable interpretation of IFRS Standards, is a practical way to address the issue and does not require extensive changes.

However, EFRAG noted the following issues raised by respondents and decided to reflect them in its final comment letter among the issues that needed to be considered by the IASB it its equity method research project:

(a) defining what might be considered 'long-term interest' that forms part of the net investment of an associate and joint venture;

(b) the appropriate treatment when the long-term interest is managed together with the equity interest as a single package;

(c) the lack of guidance in IAS 28 on how to allocate the impairment of the net investment as a whole to the different components of the net investment (i.e. the investment accounted for using the equity method and long-term interests);

(d) similar issues in the separate financial statements of a parent entity, if the parent entity measures its investments in subsidiaries at cost or using the equity method in accordance with IAS 27; and

(e) similar issues in the separate financial statements of an entity, if the entity measures its investments in associates or joint ventures at cost in accordance with IAS 27.

Moreover, considering the mixed views on its proposal to suggest an effective date of 1 January 2019, with earlier application permitted, EFRAG maintained its support for providing a later effective date, with earlier application permitted. Assuming that the endorsement process is not complete by 1 January 2018, EFRAG also recommended to its final comment letter that the IASB provide transition provisions that address this issue.

Detailed analysis of issues, comments received and changes made to EFRAG's final comment letter

EFRAG's tentative views expressed in the draft comment letter and constituents' comments

Proposed amendments to IAS 12

Proposals in the ED

The ED clarified that the requirements in paragraph 52B (now proposed as paragraph 58A) of IAS 12 apply not just in the circumstances described in paragraph 52A of IAS 12, but to all income tax consequences of dividends.

EFRAG's tentative position

Whilst EFRAG agreed with the proposed amendments to IAS 12, EFRAG expressed its concerns 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.

Constituents' comments

The proposed amendment

Two respondents did not specifically comment on the proposed amendments to IAS 12.

Most of the remaining eleven respondents broadly agreed with EFRAG's tentative position that the IASB clarify that the requirements in paragraph 52B apply to all income tax consequences of dividends and not only to the circumstances described in paragraph 52A of IAS 12.

Seven respondents explicitly supported EFRAG's concerns that pursuing the narrow-scope amendments to IAS 12 without providing guidance on

EFRAG's response to constituents' comments

Proposed EFRAG final position

Based on the input received from respondents, EFRAG maintained its agreement with the proposed amendments to IAS 12.

Based on similar comments received from almost half of the respondents, EFRAG decided to maintain its concern 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.

EFRAG did not agree with the comment that guidance on the classification of dividends cannot be given by the IASB through a separate project, as there are many cases where the substance of a transaction is different from its legal form.

EFRAG also did not agree that the specific amendments went beyond the remit of an Annual Improvement, as it was a very narrow clarification of the applicability of the requirements in paragraph 52B (now proposed as paragraph 58A) of IAS 12.

EFRAG did not observe a general request for prospective application of the amendments.

EFRAG did not observe a general request for clarifying the wording of paragraph 58A.

EFRAG's tentative views expressed in the draft comment letter and constituents' comments

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.

One respondent disagreed with EFRAG's concerns on the basis that providing guidance on the classification of dividends was a legal issue, and as such, the IASB was not the appropriate body to provide related guidance. The other respondents remained silent on that.

One respondent did not agree with EFRAG's position. In the respondent's view, the proposed modification to IAS 12 was broader than the scope of an Annual Improvement. This respondent thought that the proposed amendments did not specify the underlying principles to determine when tax effects have to be presented in equity or profit or loss and other types of tax reductions triggered by costs such as tax-deductible interest payments and costs of issuing equity instruments raise similar questions. Therefore, the respondent suggested the proposed amendments are not limited to the situation where dividends are distributed, but be considered under a more general approach, notably as regards the conceptual elements permitting to determine when tax effects shall be reflected to profit or loss or to equity.

One respondent although fully supporting EFRAG's concerns, noted the possibility of unintended consequences, as the proposed amendments were more extensive than a clarification and went beyond the Annual Improvements process remit. This respondent also noted that it was possible that the amendments result in significant additional cost and effort if reporting entities have to analyse in detail the economic sources that generated the income available for payments to the holders of the financial instruments.

EFRAG's response to constituents' comments

EFRAG also did not observe widespread agreement that the amendments went beyond the remit of the Annual Improvements or resulted in significant additional costs.

EFRAG accordingly decided not to include such comments in its comment letter.

EFRAG's tentative views expressed in the draft comment letter and constituents' comments	EFRAG's response to constituents' comments
One respondent observed that the wording of paragraph 58A needed to clarified, as it was difficult to understand it without reading the Basis for Conclusions. *Effective date and transition* One respondent noted it did not support retrospective application, as the proposed amendments could give rise to considerable costs for little or no benefit. Two respondents suggested that the effective date on the proposed amendments to IAS 12 should be the same as the one proposed for amendments to IAS 28. One of them added that all the three proposed narrow-scope amendments have the same effective date, as this would simplify work for preparers.	

EFRAG's tentative views expressed in the draft comment letter and constituents' comments

Proposed Amendments to IAS 23

Proposals in the ED

Paragraph 14 of IAS 23 specifies how to determine the amount of borrowing costs eligible for capitalisation when an entity borrows funds generally and uses them to obtain a qualifying asset. The ED amended that paragraph 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.

EFRAG's tentative position

EFRAG agreed with the proposed amendments to IAS 23.

Constituents' comments

Proposed amendments

Three respondents did not specifically comment on the proposed amendments to IAS 23.

All remaining respondents agreed with EFRAG's tentative position.

One respondent noted that the drafting of the proposed amendments did not make it entirely clear that, when a qualifying asset is ready for its intended use or sale, any outstanding borrowings made specifically to acquire that asset are treated as part of the funds it has borrowed generally. Therefore, the respondent suggested that the IASB explicitly state this.

EFRAG's response to constituents' comments

Proposed EFRAG final position

Considering the support received from respondents, EFRAG maintained its initial support for the amendments.

EFRAG did not observe a general request for clarity on the wording of the amendments. EFRAG accordingly decided not to include such a comment in its letter to the IASB.

EFRAG did not consider that the ED was unclear on the prospective application of the proposed amendments (paragraph 28A states 'An entity shall apply those amendments to borrowing costs incurred on or after the beginning of the first annual period beginning on or after [date]') . Consequently, EFRAG decided not to address this issue in its final comment letter.

Moreover, EFRAG decided not to comment on paragraph 15 of IAS 23, as this was unrelated to the proposed amendments and would need to be the subject of a separate consultation.

EFRAG's tentative views expressed in the draft comment letter and constituents' comments	EFRAG's response to constituents' comments
One respondent suggested that the IASB clarify paragraph 15 of IAS 23, as they have observed diversity in practice. *Effective date and transition* One respondent, although agreeing with the proposed prospective application of the amendment, noted that this was not clear in the ED. One respondent suggested that the effective date on the proposed amendments to IAS 23 should be the same as the one proposed for amendments to IAS 28.	

EFRAG's tentative views expressed in the draft comment letter and constituents' comments

Proposed amendments to IAS 28

Proposals in the ED

The ED clarified 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's tentative position

EFRAG supported the IASB's decision to address the issue before IFRS 9 becomes effective. EFRAG generally agreed with the proposed amendments to IAS 28. Although we acknowledged that applying two different impairment requirements could create confusion and additional costs to preparers, given that the IASB had decided to defer consideration of the equity method of accounting, the most appropriate solution would be to apply the impairment requirements of both IFRS 9 and IAS 28 to these long-term interests.

However, as there was an overlap between the requirements of IFRS 9 and IAS 28 to long-term interests, EFRAG considered that the IASB should include an example or similar guidance illustrating the application of the proposed amendments.

EFRAG also observed that there are no specific requirements in IAS 28 on how to allocate impairment of the net investment as a whole to the different components of the net investment (i.e. the investment accounted for using the equity method and long-term interests) and would welcome guidance thereon. EFRAG noted that this issue could not be resolved within the Annual Improvements process and would require an

EFRAG's response to constituents' comments

Proposed EFRAG final position

The proposed amendments

EFRAG noted that respondents were split on the amendments to IAS 28. Slightly more than half of the respondents were in agreement with EFRAG's view. For the reasons explained in the draft comment letter, EFRAG decided to retain its initial tentative position, as it considers they codify an acceptable interpretation of the existing requirements of IFRS Standards, are a practical way to address the issue, and do not involve extensive changes.

EFRAG supports the arguments raised that more guidance is needed on the application of the proposed solution and included this request in its comment letter.

EFRAG also considered that a number of issues raised by respondents in relation to long-term interests should be considered more broadly in the IASB's research project on the equity method and included this request in its comment letter. These issues are:

(a) where the long-term interest is managed together with the equity interest as a single package. As mentioned in the draft comment letter, should long-term interests be scoped out of IFRS 9, there would be no basis for classifying and measuring them. As 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), it would be necessary to develop

EFRAG's tentative views expressed in the draft comment letter and constituents' comments

amendment to IAS 28. EFRAG observed that the necessary clarity can be addressed in the IASB's equity method project.

In its draft comment letter, EFRAG acknowledged that, in some cases, the long-term interest was managed together with the equity interest as a single package. Some commentators therefore argue that the long-term interest should be accounted for in the same way as the equity investment. However, EFRAG acknowledged that, should long-term interests be scoped out of IFRS 9, there would be no basis for classifying and measuring them. As IAS 28's guidance on the equity method did not address the accounting for long-term interests (apart from the guidance on loss allocation and impairment), it would be necessary to develop new guidance on their measurement if they were to be scoped out of IFRS 9.

Regarding the effective date, EFRAG considered that the IASB should propose an effective date of 1 January 2019, with earlier application permitted due to the short time period between the expected date of issuing the amendments to IAS 28 and the IASB's proposed effective date.

Constituents' comments

The proposed amendment

One respondent did not specifically comment on the proposed amendments to IAS 28.

The remaining twelve respondents had mixed views on this issue. Seven of them broadly agreed with EFRAG's view that IFRS 9, including its impairment requirements, applies to long-term interests that form part of the net investment, to which the equity method is not applied.

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new guidance on their measurement if they were to be scoped out of IFRS 9.

(b) the need for a review of IAS 28's guidance on what constitutes a 'long-term interest that forms part of the net investment of the associate or joint venture'.

(c) the lack of guidance in IAS 28 on how to allocate the 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 long-term interests).

(d) the issue addressed in the ED may also arise in the separate financial statements of a parent entity, if the parent entity measures its investments in subsidiaries using the equity method or at cost in accordance with IAS 27.

(e) the issue may also arise in the separate financial statements of an entity, if the entity measures its investments in associates or joint ventures at cost in accordance with IAS 27.

Lastly, EFRAG did not agree with one respondent's comment related to possibility of double counting of impairment losses, if the IFRS 9 impairment test precedes the allocation of losses of paragraph 38 of IAS 28. Therefore, EFRAG decided not to amend its final comment letter to this respect.

Effective date and transition

EFRAG noted that respondents were split on the proposed effective date of the amendments to IAS 28. As noted in its draft comment letter, EFRAG understands the benefits from aligning the effective date of the amendments with the effective date of IFRS 9. If an entity first applies

EFRAG's tentative views expressed in the draft comment letter and constituents' comments

Three respondents disagreed with the proposed amendment:

(a) Two of them considered that long-term interests that form part of the net investment in an associate or joint venture should be assessed for impairment based on the requirements in IAS 28. One of these respondents noted that the IASB might have to define what elements form part of the relevant long-term interests, but paragraph 38 of IAS 28 already provided a good basis and this should therefore be possible within a relatively short period of time.

(b) The other respondent considered that long-term interests should be managed with the equity interest as a single package and suggested that a consistent approach be investigated by the IASB as regards long-term net investment impairments (analogising with the accounting treatment proposed in IAS 21, paragraph 32 for exchange differences arising on a monetary item that forms part of a reporting entity's net investment). It was also noted that applying the expected loss model to such transactions was complex and debatable both for conceptual reasons and practical difficulties. The respondent finally noted, that this amendment was not a mere clarification to IFRS Standards, as the issue was related to the equity method topic and raised additional application issues. Hence, the amendments should be part of a wider project.

Two respondents, who did not explicitly agree or disagree with the proposed amendments, and one respondent who broadly agreed with the proposed amendments, raised the following concerns:

(a) The amendments highlighted that there is an issue related to the definition of the unit of account when an investor holds both long-term interests and an equity investment in an investee;

EFRAG's response to constituents' comments

the amendments in 2018, it would be able to use the transition reliefs in IFRS 9. However, EFRAG is concerned that the short time from issuance of the final standard until the application date of IFRS 9 will create difficulties for all jurisdictions with a translation or endorsement process, including the European Union, and it is highly unlikely that such processes can be finalised by 1 January 2018 in all jurisdictions.

Therefore, in its final comment letter, EFRAG maintained its support for providing a later effective date, with earlier application permitted. EFRAG also recommended to its final comment letter that the IASB and provide transition provisions for entities that will not be able to apply the amendments at the same time they apply IFRS 9.

EFRAG did not include in its final comment letter any other comment related to the proposed effective date, as EFRAG considers that paragraphs 45E and 45F of the ED are sufficient in this respect.

EFRAG's tentative views expressed in the draft comment letter and constituents' comments	EFRAG's response to constituents' comments
(b) The amendments focused on entities who have investments accounted for under the equity method and at the same time have long-term interests on these entities. However, the respondents believe that there is a similar issue, where an entity has equity investments in associates or joint ventures accounted for at cost in the separate financial statements and at the same time has long-term interests in these entities; and (c) Respondents generally noted that the issue was more frequent in the separate financial statements of a parent entity who had investments in subsidiaries accounted for either under the equity method or at cost in accordance with IAS 27. The bright line dividing a long-term interest from an equity investment was very thin in such cases. One of them considered that in such cases, the long-term interest and the equity investment should be managed together as a single package, and hence, accounted for in the same way as the equity investment, i.e. scoped out of IFRS 9. Respondents generally suggested the IASB consider the issue more broadly and develop a principle to distinguish between long-term interests. Although agreeing with the proposed amendments, one respondent noted that the dual application of IFRS 9 and IAS 28 to long-term interests may lead to unnecessary confusion and complexity. In this respect, this respondent suggested that the IASB consider the potential consequences and possibly include long-term interests wholly in only one standard. One respondent questioned whether in applying the proposed amendments to IAS 28, the IFRS 9 impairment test should precede the	

EFRAG's tentative views expressed in the draft comment letter and constituents' comments	**EFRAG's response to constituents' comments**
allocation of losses required by paragraph 38 of IAS 28, as this might result in double counting of impairment losses. Irrespective of whether they agreed or disagreed with the proposed amendments, seven respondents explicitly agreed with EFRAG that an example or guidance is necessary to improve the clarifying nature of the amendments. *Effective date and transition* Five respondents did not specifically respond on the proposed effective date. From the remaining eight respondents, three agreed with EFRAG's tentative position that the IASB should propose an effective date of 1 January 2019, with earlier application permitted. The remaining five agreed with the IASB's proposed effective date of 1 January 2018, due to the importance of aligning it with the effective date of IFRS 9. Lastly, one respondent noted that the application date specified in paragraph 45E of the ED should include a specific exemption for entities that have the option under the recent Amendments to IFRS 4 *Insurance Contracts* to delay the initial application of IFRS 9.	

Appendix 1: List of respondents

Table 1: List of respondents

Name of constituent[1]	***Country***	***Type / Category***
Accounting Standards Committee of Germany (ASCG)	Germany	National Standard Setter
Association of Accounting Technicians (AAT)	United Kingdom	Accounting Organisation
Swedish Enterprise Accounting Group (SEAG)	Sweden	Association of Preparers
Dutch Accounting Standards Board (DASB)	Netherlands	National Standard Setter
ENEL SpA	Italy	Preparer
Autorité des Normes Comptables (ANC)	France	National Standard Setter
The Institute of Chartered Accountants in England and Whales (ICAEW)	United Kingdom	Accounting Organisation
UK Financial Reporting Council (FRC)	United Kingdom	National Standard Setter
Association of German Banks	Germany	Association of Preparers
Organismo Italiano di Contabilità (OIC)	Italy	National Standard Setter
BusinessEurope	Europe	Association of Preparers
Ferrovie dello Stato Italiane SpA	Italy	Preparer
European Securities and Markets Authority (ESMA)	Europe	Regulator
Instituto de Contabilidad y Auditoría de Cuentas (ICAC)	Spain	National Standard Setter
The Norwegian Accounting Standards Board (NASB)	Norway	National Standard Setter

[1] Respondents whose comment letters were considered by the EFRAG Board before finalisation of the comment letter.

Appendix 2: Summary - respondents by country and by type

Table 2: Total respondents by country and by type

Respondent by country:		***Respondent by type:***	
Germany	2	National Standard Setters	7
United Kingdom	3	Accounting Organisations	2
Sweden	1	Associations of Preparers	3
Netherlands	1	Preparers	2
Italy	3	Regulators	1
France	1		
Norway	1		
Spain	1		
Europe	2		
	15		15