Association pour la participation des entreprises françaises à l'harmonisation comptable internationale

Mouvement des Entreprises de France
MEDEF

The Chairman of the IASB
IFRS Foundation,
30 Cannon Street,
London EC4M 6XH,
United Kingdom.

10 April, 2017

Dear Mr. Hoogervorst,

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

We welcome the opportunity to respond to the invitation for comments on the Exposure Draft ED/2017/1 Annual Improvements to IFRS Standards 2015-2017 Cycle (the ED).

Responses to the individual questions raised are given in the Appendix to this letter, but the major points we have to make are in respect of the proposed amendments to IAS 28, as follows:

a) We do not agree with the proposal to make the long-term interest subject to the impairment requirements of both IFRS 9 and IAS 28. We consider that it is preferable from both a conceptual and practical standpoint to treat all the elements that are, in substance, part of the net investment, as a whole unit for the purposes of the absorption of equity-accounted losses and of impairment and apply IAS 28.

b) We think that, even if the Board were to go ahead with the limited amendments proposed, these are insufficient to clarify the issues raised with the IFRS Interpretations Committee, and that further explanation and illustration is required.

The setting of a mandatory application date of 1 January 2019, with earlier application permitted, would facilitate entities' implementation of these changes.

If you require any further information about the points raised, please do not hesitate to ask.

Yours sincerely,

ACTEO	AFEP	MEDEF
Patrice MARTEAU Chairman	François SOULMAGNON Director General	Agnès LEPINAY Director of economic and financial affairs

Appendix

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.**

Although the proposed amendments to IAS 12 will go some of the way towards eliminating the perceived diversity in treatment, we think that they do not fully address the request for clarity about where to recognise the income-tax consequences of payments on financial instruments classified as equity. We understand that the Board states that judgement should be exercised in determining whether such payments are distributions (dividends), but we think that reliance solely on the definition of dividends laid out in IFRS 9 is insufficient and that this will not completely eliminate sources of diversity.

We agree with the proposal for retrospective application with earlier application permitted.

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

Although the amendments proposed to paragraph 14 are reasonable, we do not think that the proposals deal with the issue comprehensively enough. We think that mixed messages are provided in the standard, on the one hand, by paragraph IAS 23.15, which requires the use of judgement as to what is included in the calculation of the weighted-average borrowing cost that is appropriate to the circumstances, and, on the other hand, by paragraph IAS 23.BC24, which states that all outstanding borrowings (other than those made specifically to obtain a qualifying asset) must be used in determining the capitalisation rate. In our view, the prevailing principles should be that the cost base of all qualifying assets should include an allocation of borrowing costs, and that the capitalisation rate should include all relevant borrowing costs but not all possible borrowing costs of the group.

As an example, take a group which has genuinely separate, independent financing "silos" on a regional basis. Its Brazilian subsidiary takes out dedicated and subsidised financing for the construction of a factory. When construction is complete there are no other qualifying assets in the group's South America financing pool but the loan will still be outstanding for a number of years. Qualifying assets are under construction in the Africa financing region. Following the logic of paragraph 15, the group would exclude the borrowing costs of the South America zone, including those of the dedicated borrowings which are now considered to be general borrowings, from the weighted-average capitalisation rates to be used in Africa. However, a strict reading of paragraph BC24 might lead to the conclusion that these costs should be taken into the capitalisation rates for Africa.

We do not think that this is appropriate and, if the Board agrees, this should be made clear in the proposed amendments. Indeed, we think that the emphasis provided in the US GAAP equivalent of paragraph IAS 23.15 may be a better way of posing the principle:

"Accordingly, judgment will be required to make a selection of borrowings that best accomplishes that objective in the circumstances. For example, in some circumstances, it will be appropriate to include all borrowings of the parent company and its consolidated subsidiaries; for some multinational enterprises, it may be appropriate for each foreign subsidiary to use an average of the rates applicable to its own borrowings. However, the use of judgment in determining capitalization rates shall not circumvent the requirement that a capitalization rate be applied to all capitalized expenditures for a qualifying asset to the extent that interest cost has been incurred during an accounting period."

We agree with the Board's proposal to require prospective application for this amendment (as expressed in paragraph 28A).

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

We do not agree with the proposed amendments. We do not think that the proposed amendments will result in a consistent, holistic approach to the accounting for such interests, nor are they sufficient to resolve the underlying issues that we think are behind the request for clarification that the IFRS Interpretations Committee has worked on.

When the Board modified IAS 28 to ensure that certain interests would absorb equity-accounted losses (apparently as an anti-abuse measure), it created the concept of a long-term interest which is in substance part of the net investment in an equity-accounted investment. The resulting unit of account now seems to be called into question by the proposed amendments. We think that the Board should now take the time to examine all the aspects of the notion of equity accounting as a whole and avoid proceeding by proposing piecemeal changes which have the effect of blurring the concepts on which the accounting is actually based.

We accept that from a purely technical point of view today the long-term interests which absorb equity-accounted losses are not explicitly excluded from the scope of IAS 39 (or IFRS 9 in the future). However, should one infer automatically from this that one should apply to such interests the same impairment approach as for all other financial assets and deny the specific nature of such interests that the Board recognised when it decided to allocate the equity-accounted losses to them. We therefore think that it would be more logical at this stage either not to finalise this amendment or to exclude such interests from the impairment provisions of IFRS 9 in order to deal with them in a way consistent with that of the equity-accounted investment to which they are attached.

We repeat the points made in ACTEO's letter to Mr. Hoogervorst following the Board's discussion of this issue at its March 2016 meeting:

> Firstly, to be considered to be, in substance, part of the net investment, long-term interests should be items for which settlement is neither planned nor likely to occur in the foreseeable future. We therefore wonder how this characteristic should be considered in the IAS 39 impairment model (and that of the forthcoming IFRS 9). One may conclude that the absence of settlement, especially when the JV or associates make losses, will lead systematically to an

impairment. In this case, long-term interests would never be able to absorb the JV or associate losses of the period in excess of the equity interest.

Secondly, as soon as a long-term investment begins to absorb losses of the period, should one not consider that, in practice, it is accounted for using the equity method (even though it is true that all the equity-accounting mechanisms are not applied to it)? We believe that one should be consistent in the approach and reflect the holistic situation of the net investment of which the long-term interests form part. For this reason, in order to allow long-term interests to absorb losses, we believe they should first absorb the equity-accounted losses of the period and then be tested within the entire investment for impairment. We therefore ask the Board to reconsider its conclusions and to further explore view D as developed in the Agenda Paper which proposed that "long-term interests are within the scope of IFRS 9 for classification and measurement purposes, excluding impairment (and are subject to the loss allocation requirements in paragraph 38 of IAS 28). In addition, these interests are also subject to the impairment requirements in paragraphs 40-43 of IAS 28."

We think that interests (as defined in paragraph IAS 28.38) in an associate or joint venture should be subject to the impairment requirements of IAS 28 alone. Setting aside the confusion introduced by the premature reference to IFRS 9 in paragraph 14 of current IAS 28, our understanding of the current text (paragraph 40 and foll.) is that once the equity method has been applied, the entire net investment is reviewed for impairment using, by incorporation, the impairment indicators ("triggers") of IAS 39 but testing for impairment using the IAS 36 recoverable-amount approach. This appears to us to be a logical and consistent approach which is straight-forward to apply and would be equally effective even if IFRS 9's recognition and measurement approaches, but not the impairment provisions, were incorporated. In contrast, the proposal to apply the measurement and impairment approaches of IFRS 9, followed by the allocation of equity-method losses, a second review for impairment triggers (as laid out in paragraphs 41A-41C of the future IAS 28, but which are essentially those of IAS 39) and finally the recoverable-amount impairment measurement approach appears to be both inconsistent and complicated.

Notwithstanding the above objections, we think that even with the proposed amendments further clarification would need to be provided in order to enable stakeholders to understand how the articulation 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 is also required 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, 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…" needs to be explained to make this clearer.

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 agree with the analysis of EFRAG and others that the short period between exposure and the proposed effective date of 1 January 2018 leaves little time for entities to analyse and implement the changes. We think that a mandatory effective date of 1 January 2019, with earlier application permitted to allow entities to take advantage of the transition relief available under IFRS 9, would be more helpful to entities.