
Dear Hans,


We disagree with the proposed amendments to IAS 28 regarding long-term interests in an associate or joint venture. We believe that applying current IAS 28 requirements regarding allocation of losses and impairment is sufficient to prevent from any overstatement of the carrying amount of the net investment in the associate or joint venture. Adding first an IFRS 9 impairment layer could lead to an undue understatement of the carrying amount of the investment (compared to its recoverable amount), and counterintuitive effects if the IFRS 9 impairment loss occurs after the carrying amount of the net investment is reduced to zero through the share of losses allocation.

We also have reservations regarding the proposed amendments to IAS 12: the proposed amendments do not answer the question that was initially raised to the IFRS Interpretations Committee, and do not help identifying payments to equity instruments holders that are in substance distribution of profits.
Our detailed comments to the questions raised in the Exposure Draft are set out in the Appendix.

Please do not hesitate to contact us should you want to discuss any aspect of our comment letter.

Yours sincerely,

Michel Barbet-Massin  
*Head of Financial Reporting Technical Support*
Appendix

**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?*

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

We have some reservations on the proposed amendments.

While we agree with this partial reorganisation of the text of IAS 12 (moving paragraph 52B to a new paragraph 58A after paragraph 58 seems logical, as it enables to regroup dispositions on classification issues), we think that these amendments:

- do not answer the question raised in the initial submission;

- do not bring any clarification on how judgement should be exercised to determine whether payments to equity instruments holders are distributions of profits (ie dividends) or not.

In our view, the lack of guidance in this area is the main reason why diversity exists in practice when accounting for the tax effects of payments on equity instruments such as perpetual bonds.

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**Proposed amendments to IAS 23 Borrowing Costs:**

We agree with the proposed amendments.

However, regarding transitional provisions, we recommend that the wording be amended as follows to avoid any misunderstanding on how to apply these transitional provisions in case of an early application (new text underlined):

“[Draft] *Annual Improvements to IFRS Standards 2015–2017 Cycle*, issued in [month], amended paragraph 14. An entity shall apply those amendments prospectively to borrowing costs incurred on or after the beginning of the first annual period to which beginning on or after [date to be decided after exposure] date of first application.”
Proposed amendments to IAS 28 Investments in Associates and Joint Ventures:

We do not agree with the Board’s proposal to clarify that IFRS 9 impairment provisions apply to long-term interests that, in substance, form part of the entity’s net investment un an associate of joint venture (“LTI”), in addition to IAS 28 requirements regarding allocation of losses and impairment.

As a general rule, the objective of impairing assets is to make sure their carrying amount is not overstated. We consider that accounting for these LTI in accordance with IAS 28 alone, without any IFRS 9 impairment layer, should be sufficient to achieve this objective. Indeed, IAS 28.40 already contains requirements for impairing the net investment in Associates and Joint Ventures (meaning the sum of the equity method investment and LTIs that, in substance, form part of the entity’s net investment) whenever its recoverable amount is lower than its carrying amount.

IAS 28.38 does not deal with the risk of understating LTI carrying amount, and its application could lead to the carrying amount of the net investment being lower than its recoverable amount, due to the accounting for the share of losses that exceed the equity accounted investment. Adding, on top of these requirements, an additional “layer” of impairment according to IFRS 9 could lead to having two “layers” of losses co-existing simultaneously, ie:

- the IAS 28.38 allocation of losses that exceed the equity accounted investment;
- and IFRS 9 Chapter 5.5. impairment expense based on expected credit losses.

As a result, the risk of understating the carrying amount of the net investment below its recoverable amount would be even higher than it already is when applying IAS 28 alone.

Furthermore, we fear that this several layers’ approach could have some counterintuitive or unexpected consequences on the financial statements especially when the impairment loss under IFRS 9 becomes important because of a significant credit risk deterioration while the carrying amount of the investment has been significantly reduced through the losses allocation in accordance with IAS28.38.

To illustrate this point, please consider a simplified example below:

- Assumptions:
  - The net investment of Investor in entity A amounts to CU 300, of which CU 100 accounted for according to the equity method;
  - The IFRS 9 expected loss impairment model applied to the LTI in entity A leads to an insignificant impairment loss at investment date;
  - During the first 3 years following the investment, entity A generates losses, and the Investor share of these losses attributable to the equity method investment of the investor amounts to CU 350. This is in line with the initial forecasts. Therefore,
entity A’s rating is not modified and no additional impairment under IFRS 9 is recognized;

- During Year 4, in which Entity A is expected to make profits, a new loss is recognized by Entity A (Investor’s share CU 150). Therefore, Investor reassesses the repayment capacity of Entity A and concludes that according to IFRS 9, an impairment loss of CU120 is required.

- Accounting consequences at the end of Y4:

  - At the end of Y3, the carrying amount of the total net investment in Entity A is zero, since Investor’s accumulated share of losses (CU 350) exceeds the initial investment (CU 300);
  - According to the proposed amendment, Investor recognizes an IFRS 9 impairment loss on the LTI (CU 120);
  - Since the carrying amount of the total net investment cannot be negative, a reversal of the previously recognized share of losses is necessary. Therefore, Investor recognizes a profit of CU 120 on the “Share of the profit or loss of associates and joint ventures accounted for using the equity method” line item.

Recognising this profit in the statement of profit or loss (even if an impairment loss has been recognized at the same time) seems difficult to explain in a period when the investee continues to generate losses.

Should the IASB decide to pursue with the amendment as proposed, we do not consider that the wording proposed in the Exposure Draft brings sufficient clarity. In particular:

- Given that this is probably not intuitive for quite a number of users of IFRS financial statements that some instruments might be subject to multiple impairment requirements (i.e. IFRS 9 and IAS 28), we suggest clarifying directly in the new paragraph 14A (and not only in the introductory remark or in the basis for conclusions) that IFRS 9 impairment requirements would also apply. We would suggest the following wording alternative (with changes compared to the ED’s text underlined):

  “An entity also applies IFRS 9 (including the impairment requirements of this standard) to other financial instruments in an associate or joint venture to which the equity method is not applied. These include financial instruments that are long-term interests that, in substance, form part of the entity’s net investment in an associate or joint venture (see paragraph 38).”

- We also suggest including an explanation (or an illustrative example) of the order of applying the different requirements in these two standards, similarly to what was done in the May 2016 IFRIC Update.
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?

Should the IASB proceed with the amendment as proposed, we agree with (a) aligning the effective date of the proposed amendments with the effective date of IFRS 9, and (b) with having transition requirements that are aligned with those of IFRS 9 / IFRS 4.