EXPOSURE DRAFT 2017/1

ANNUAL IMPROVEMENTS TO IFRSs 2015 – 2017 CYCLE

INTERNATIONAL FINANCIAL REPORTING BULLETIN 2017/04

Summary

On 12 January 2017, the International Accounting and Standards Board (IASB) published Exposure Draft 2017/1 *Annual Improvements to IFRSs 2015 – 2017 Cycle* (the ED).

The ED proposes amendments to three standards:

Standard	Amendments relate to
IAS 12 *Income Taxes*	– Clarification of the income tax consequences of dividends.
IAS 23 *Borrowing Costs*	– Clarification of which borrowing costs qualify for capitalisation.
IAS 28 *Investments in Associates and Joint Ventures*	– Clarification of the application of IFRS 9 *Financial Instruments* to long-term interests in associates or joint ventures.

STATUS
Exposure Draft

EFFECTIVE DATE
To be confirmed

ACCOUNTING IMPACT
May be significant

IAS 12 *Income Taxes*

Paragraph 52A of IAS 12 *Income Taxes* notes that in some jurisdictions income taxes are payable at a higher or lower rate if part or all of the net profit or retained earnings is paid out as a dividend to equity shareholders. It also notes that in some jurisdictions income tax may be refundable or payable if part or all of the net profit is distributed to shareholders. Paragraph 52B goes on to note that the income tax effects of those dividends are more directly linked to past transactions or events than to the dividends and hence should be accounted for in profit or loss. However, it is not clear whether the requirement to account for the tax effects in profit or loss applies only in certain circumstances or more generally to all payments on equity instruments.

The proposed amendment clarifies that the requirement to recognise the tax consequences of dividends in profit or loss applies when the dividend is being paid out of profits recognised in the income statement. Therefore, tax consequences of other dividends should be recognised:

- in other comprehensive income to the extent that the dividend is being paid out of net gains originally recognised in other comprehensive income; or
- in equity to the extent the dividend is being paid from reserves arising from transactions originally recognised directly in equity.

Therefore, entities in jurisdictions where paying a dividend has an income tax consequence will need a system or policy for determining the transactions which gave rise to the reserve(s) from which a dividend has been paid.

The ED does not propose an effective date for the proposed amendment, but does propose that, when effective, it should apply on a fully retrospective basis.

IAS 23 *Borrowing Costs*

Paragraph 14 of IAS 23 *Borrowing Costs* 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. Specifically it requires a capitalisation rate to be applied to general borrowings, calculated as the weighted average of the borrowing costs applicable to the entity's borrowings that are outstanding during the period. General borrowings exclude borrowings made specifically for the purpose of obtaining a qualifying asset.

The IASB proposes to amend that paragraph to clarify that when borrowings have been made specifically for the purpose of obtaining a qualifying asset, those borrowings are required to be included in the pool of general borrowings for the purposes of calculating the capitalisation rate once the qualifying asset is ready for its intended use. The IASB felt IAS 23.14 as currently drafted could be misinterpreted to exclude from general borrowings any amounts that were originally borrowed specifically.

The ED does not propose an effective date for the proposed amendment, but does propose that, when effective, it should apply prospectively and not retrospectively. This is because the development of some qualifying assets currently in use may have been completed many years ago. Therefore, the IASB concluded that the costs of gathering the information required to apply the proposed amendment retrospectively may exceed the potential benefits.

IAS 28 *Investments in Associates and Joint Ventures*

An investor's net investment in an associate or joint venture may be held through one or more instruments (e.g. an equity interest in ordinary shares together with other long term interests such as preference shares and loans). IAS 28 *Investments in Associates and Joint Ventures* requires the equity method to be applied to equity interests. It also requires losses in excess of the equity interest to be attributed to long-term interests that in substance form part of the net investment (note that this is not the equity method as it excludes a share of amounts recorded in OCI and equity), with the net investment also being subject to the impairment requirements in IAS 28. IAS 28.41 notes that the impairment requirements in IFRS 9 apply to interests that do not form part of the net investment. The scope of IFRS 9 *Financial Instruments* excludes interests in associates and joint ventures that are accounted for in accordance with IAS 28.

The IASB noted that these requirements in IAS 28 and IFRS 9 have resulted in some considering that it is not clear whether long term interests are excluded from the scope of IFRS 9, either in their entirety or only in respect of the IFRS 9 expected credit loss impairment requirements.

The proposed amendments to IAS 28 therefore clarify that an entity is required to apply IFRS 9 to long-term interests in an associate or joint venture to which the equity method is not applied.

The consequences of the amendments would be that, when assessing an entity's total net interest in an associate, it is necessary to apply IFRS 9's expected credit loss model to those interests within the scope of IFRS 9 (such as long-term loans) independently of (and before) attributing losses and considering whether there is a need to impair the carrying amount of the net investment in an associate or joint venture in accordance with IAS 28.

It would therefore be inappropriate to conclude that no impairment provision needs to be recognised on a loan to an investee because the carrying amount of that loan and the investment in shares are in aggregate less than the aggregate recoverable amount of the interests in the investee.

The ED proposes an effective date for the proposed amendment of periods beginning on or after 1 January 2018, so as to align with the effective date of IFRS 9. The ED also proposes that the amendment should apply retrospectively. However, where an entity is applying the cumulative catch-up approach when it first applies IFRS 9 and is therefore not restating comparative information, it would be permitted to apply the requirements of IAS 39 *Financial Instruments Recognition and Measurement* to comparatives when determining the impairment provision for long term interests in associates and joint ventures.

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