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Global Mindset, Asian Insights

2 May 2017

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sirs,

RESPONSE TO EXPOSURE DRAFT – ANNUAL IMPROVEMENTS TO IFRS STANDARDS 2015-2017 CYCLE ("ED")

ISCA sought views from its members on the above ED through a one-month public consultation and from the ISCA Financial Reporting Committee which includes experienced technical accounting professionals from large accounting firms.

We support IASB's aim to clarify application of IFRS through minor amendments via the annual improvement project. However, we have our reservations on the proposed amendments to IAS 23 *Borrowing Costs* and IAS 28 *Investments in Associates and Joint Ventures*. These amendments might create unnecessary confusion and complexity in their application in practice. In addition, we are of the view that the proposed amendments to IAS 28 should be deferred and re-considered in light of IASB's research project on financial instruments with characteristics of equity.

Our detailed comments and responses to the questions in the ED are set out below.

Question 1
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?

IAS 12 *Income Taxes*

<u>Income tax consequences of payments on financial instruments classified as equity</u>

We agree with the intention of the proposed amendment as it provided clarity to the application of the requirement in paragraph 52B of IAS 12. However, the amendment does not address the fundamental issue of whether payments are distributions of profits (i.e. dividends) or are other distributions to owners/shareholders. We note that in paragraph BC5 of the ED, IASB shared that an entity should apply judgment in the determination of whether payments on financial instruments classified as equity are distributions of profits. In addition, we acknowledge the reasons in paragraph BC 6 for the exclusion of requirements on how to determine whether payments on financial instruments classified as equity are distributions of profits. However, this would not be helpful to the preparers in the application of this amendment and therefore would not reduce diversity in practice. We suggest IASB to re-consider providing guidance on the determination of whether payments on financial instruments classified as equity are distributions of profits separately.

In addition, the sentence "The income tax consequences of dividends are linked more directly to past transactions or events than to distributions to owners" is ambiguous and could be interpreted differently. This sentence could be made clearer by explaining that the "past transactions or events" are those that generated distributable profits as described in paragraph BC2(b).

We also propose IASB to define the term "dividends" within the body of IAS 12 as this term can be interpreted differently in the context of legal requirements in various jurisdictions. We note that the term "dividends" has been used in paragraph 52A as payments made out from net profit or retained earnings. In the Basis for Conclusion of the ED, paragraph BC2(a) states that "IFRS 9 *Financial Instruments* defines dividends as distribution of profits to holders of equity instruments in proportion to their holdings of a particular class of capital". Furthermore, paragraph BC5 states that "Rather, an entity would exercise judgment in determining whether payments on such instruments are distribution of profits (i.e. dividends)." If IASB intended for the dividends to be read as distribution of profits, this should be included in proposed paragraph 58A.

IAS 23 Borrowing Costs

Borrowing costs eligible for capitalisation

We are concerned with the proposed amendments to IAS 23 paragraph 14 that includes the existing requirement in paragraph 22 on the cessation of capitalisation of borrowing costs whereby "an entity ceases capitalising borrowing costs when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete". We note that a qualifying asset is defined as an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. With the introduction of the concept of satisfaction of performance obligations as control is transferred under IFRS 15 *Revenue from Contracts with Customers,* there is uncertainty on how to apply IAS 23 paragraph 22 when (or as) control passes continuously to the customer. In view of the above, we propose for IASB to relook at the definition of a qualifying asset in IAS 23 and provide clarity on its application in the context of IFRS 15.

IAS 28 Investments in Associates and Joint Ventures

Long-term interests in an associate or joint ventures

We do not agree with the proposed amendment whereby any long-term interests are subjected to both impairment requirements under IFRS 9 and the allocation of losses under

IAS 28. The application of the proposed requirements would be challenging for certain debt instruments with equity features. One example of such instruments commonly seen in Singapore market are non-commercial loans given by the investors to an associate or a joint venture which are interest-free and not expected to be repaid in the foreseeable future. These loans could in-substance be part of the investors' net investment in associates and joint ventures. If such loans are long-term interests in the scope of IFRS 9, an effective interest rate is required to be "imputed" for the fair value of these interests at initial recognition. Further, future cash shortfall will need to be estimated under the expected credit loss model in IFRS 9. These would pose practical challenges considering the equity-like nature of these loans. We propose long-term interests to be scoped out of IFRS 9 and only subjected to allocation of losses under IAS 28 as this would better reflect the substance of such interests being part of the equity investment.

On a related note, IASB has an existing research project on financial instruments with characteristics of equity. This project is expected to provide more guidance on the accounting for such instruments. Therefore, we propose IASB to re-consider this amendment in light of the IASB's research project on financial instruments with characteristics of equity.

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?

As shared in our response provided to Question 1, the proposed amendments to IAS 28 could result in practical application challenges. Notwithstanding the need for alignment with the effective date for IFRS 9, we are of the view that they should be re-considered and deferred until the completion of IASB's research project on financial instruments with characteristics of equity. Pending further debate on the accounting classification of such instruments, we recommend such instruments be subjected only to the allocation of losses under IAS 28 as this would better reflect the substance of such instruments being part of the equity investment.

Should you require any further clarification, please feel free to contact Ms Lim Ju May, Deputy Director, Technical Advisory and Professional Standards, or Ms Jezz Chew, Senior Manager, Technical Advisory and Professional Standards, from ISCA via email at jumay.lim@isca.org.sg or jezz.chew@isca.org.sg respectively.

Yours faithfully,

Titus Kuan
Director
Technical Advisory, Professional Standards and Learning & Development