Project **IAS 28 *Investments in Associates***
Topic **Impairment of investments in associates**

Introduction

Objective of this paper

1. The objective of this paper is to document the staff's analysis and recommendation. The staff will ask the IFRIC whether it agrees with the staff recommendation that impairment testing of investments in associates should be performed for the consolidated financial statements in accordance with IAS 36 *Impairments* and for the separate financial statements of the investor in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*. As such, this paper:

    (a) provides background information on this issue;

    (b) analyses the issue within the context of IFRSs;

    (c) discusses the staff recommendation; and

    (d) asks the IFRIC whether it agrees with the staff recommendations.

Background information

2. In March 2009, the staff received a request to add to the IFRIC agenda an issue regarding the potentially conflicting guidance in IAS 28 *Investments in Associates*, IAS 36 and IAS 39 when performing an impairment test of investments in associates. The request noted different impairment models (IAS 36 vs IAS 39) are used for impairment testing of investments in associates in the consolidated financial statements vs the separate financial statements of the investor. A copy of the agenda request has been included as Appendix A.

Analysis, recommendations and questions for the IFRIC

Consolidated financial statements

3. IAS 28 provides guidance on the accounting for investments in associates in the group consolidated financial statements. One aspect of that accounting for investments in associates is the potential recognition of an impairment loss in the investment.

4. Paragraphs 31-33 of IAS 28 state:

> **Impairment losses**
>
> After application of the equity method, including recognising the associate's losses in accordance with paragraph 29, the investor applies the requirements of IAS 39 to determine whether it is necessary to recognise any additional impairment loss with respect to the investor's net investment in the associate.
>
> The investor also applies the requirements of IAS 39 to determine whether any additional impairment loss is recognised with respect to the investor's interest in the associate that does not constitute part of the net investment and the amount of that impairment loss.
>
> Because goodwill included in the carrying amount of an investment in an associate is not separately recognised, it is not tested for impairment separately by applying the requirements for impairment testing goodwill in IAS 36 *Impairment of Assets*. Instead, the entire carrying amount of the investment is tested under IAS 36 for impairment, by comparing its recoverable amount (higher of value in use and fair value less costs to sell) with its carrying amount, whenever application of the requirements in IAS 39 indicates that the investment may be impaired…

5. In the staff's opinion, the references to IAS 39 requirements refer to paragraphs 58-62 of IAS 39 that provide guidance on *when* an entity assesses an investment in an associate for impairment and *what* is included as 'objective evidence' detailed in paragraph 59 of that Standard.

6. Once an entity determines there is objective evidence of an impairment in an investment in an associate, paragraph 33 of IAS 28 (included in paragraph 3 above) provides explicit guidance that "the entire carrying amount of the investment is tested under IAS 36 for impairment".

Question 1 – Consolidated financial statements
Does the IFRIC agree that, for the consolidated financial statements, impairment losses on investments in associates should be determined in

accordance with IAS 36 whenever application of the requirements in IAS 39 indicates that the investment may be impaired?

Separate financial statements

7. IAS 27 provides guidance, in part, on the accounting for investments in associates presented in the separate financial statements of the investor. Paragraph BC66 of IAS 27 states (emphasis added):

> Although the equity method would provide users with some profit and loss information similar to that obtained from consolidation, the Board noted that such information is reflected in the investor's economic entity financial statements and does not need to be provided to the users of its separate financial statements. <u>For separate statements, the focus is upon the performance of the assets as investments. The Board concluded that separate financial statements prepared using either the fair value method in accordance with IAS 39 or the cost method would be relevant.</u> Using the fair value method in accordance with IAS 39 would provide a measure of the economic value of the investments. Using the cost method can result in relevant information, depending on the purpose of preparing the separate financial statements. For example, they may be needed only by particular parties to determine the dividend income from subsidiaries.

8. In the staff's opinion, the paragraph BC66 of IAS 27 clearly explains the Board's intent that, in the separate financial statements of the investor, investments in associates should be accounted for as financial instrument. With the 2003 revisions and 2008 amendments to IAS 27, the Board specified the two allowable accounting models are either the cost method or fair value through profit or loss. Both allowed accounting models are detailed in IAS 39, the applicable standard for financial instruments.

9. If an investor elects to account, in its separate financial statements, for its investment in an associate at fair value through profit or loss, all increases and decreases in the fair value of the investment will be recorded in the statement of comprehensive income at each reporting date, as required by paragraph 55(a) of IAS 39. Therefore, an impairment test will not be necessary.

10. If an investor elects to account, in its separate financial statements, for its investment in an associate at cost, for impairment testing purposes, the investor applies paragraphs 58-62 and 66 of IAS 39.

Question 2 – Separate financial statements

Does the IFRIC agree that, for the separate financial statements of the investor, impairment losses on investments in associates should be determined in accordance with IAS 39?

Staff recommendation

11. In the staff's opinion, given the different purposes of consolidated financial statements and separate financial statements (as detailed by the Board in BC66 of IAS 27 included in paragraph 7 above), different impairment models (IAS 36 and IAS 39) is appropriate.

12. Based on the explicit guidance provided in IAS 28 and other IFRSs, in the staff's opinion, IFRSs already provide relevant guidance and the staff does not expect divergent interpretations in practice. Therefore, the staff recommends that the IFRIC not add this issue to its agenda.

13. Proposed wording for the tentative agenda decision is set out in Appendix B.

Question 3
Does the IFRIC agree with the staff's recommendation not to add this issue to its agenda? If not, how does the IFRIC recommend the staff to proceed? Does the IFRIC have any comments on the proposed wording for the tentative agenda decision?

Alternative recommendations

14. As stated earlier in this paper, in the staff's opinion, IFRSs already provide relevant guidance and the staff does not expect divergent interpretations in practice; however, if the IFRIC does not agree, the staff provide two alternative recommendations:

    (a) the staff could incorporate this issue into the analysis to be presented to the Board as part of its redeliberation process on the comments received on the exposure draft ED 10 *Consolidated Financial Statements* that includes a question requesting comments on whether the Board should consider a separate project on IAS 28; or

    (b) the staff could present this issue to the Board for their consideration for potential inclusion in the exposure draft of proposed Improvements to IFRSs to be published in August 2009.

Appendix A – IFRIC Agenda Request

Staff overview

A1. The staff received the following IFRIC agenda request. All information has been copied without modification by the staff.

Agenda request

Submission summary/ cover note

With regard to issue pertaining to IAS 28 as you share the same view that the existence of two standards dealing with impairment would produce different impairment numbers in consolidated and separate financial statements. I don't agree that if an entity carries an investment in associate in its separate financial statements at cost has to look at IAS 39 for impairment; rather they should follow the IAS 36 for potential impairment. Further its my view and depends whether IFRIC share the same that IAS 39 should only be consulted, as in case of equity accounted impairment, only for assessment of impairment indicator both for separate (either at cost or IAS 39) and consolidated and follow the requirement of IAS 36 for detailed calculation of impairment so as to ensure consistency of results in both consolidated as well as separate financial statements.

Submission

The issue

IAS 28- Investment in Associates allows an investor to account for such investment in its separate financial statements using cost or IAS 39 (i.e. Fair value) model. The issue is, if an entity account for such an investments using IAS 39 in its separate financial statements then how entity should assess the impairment in such investments. IAS 28 only provide guidance on impairment related to equity accounted associates and not provide explicit requirement with regard to assessment of impairment of associates accounted for in its separate financial statements using IAS 39 model. This would create different in assessment criteria whereby associates in separate financial statements assessed for impairment using IAS 39 principles and when it comes for consolidated financial statements it assess under IAS 36 for potential impairment. Since both standards have different testing criteria for impairment, it would result in different impairment number result in reporting inconsistency. As per IAS 39 if there is significant or prolonged decline in fair value below cost an equity investment is considered to be impaired whereas IAS 36 compare carrying amount of entire investments to its recoverable amount (i.e. higher of fair value less cost to sell and value in use). Since IAS 39 follow one measure most entities end up recording impairment in separate financial statements whereas it might not record any impairment in consolidated financial statements.

Current practice

Some entities following IAS 36 for both financial statements (i.e. for consolidated and separate) so as to produce consistent result and disclosing it as their policy, while other following IAS 36 for consolidated financial statements and IAS 39 for separate financial statements for investments carried at fair value as per the IAS 39 while entities carrying investments in associates at cost in separate financial statements were recognizing impairment as per IAS 36.

Reasons for the IFRIC to address the issue

Because of wider application of the standard across jurisdiction and apparent inconsistency created through application of both standards, I think IFRIC should establish clear guidance that will ensure consistency in application of the standard. The above issue is also equally prominent in IAS 27 so single guidance will serve the dual purpose i.e. for both associates and subsidiary.

While developing guidance I would appreciate if IFRIC provide any insight why Board has allowed alternative measurement in separate financial statements. I think Board should restrict the application of IAS 39 where the associates or subsidiary held for trading purpose rather as an strategic investment, that is how the inconsistency would best resolved.

[Appendix B has been omitted from this Observer note]