STAFF PAPER

December 2015

IASB Meeting

Project	**IFRS 9 *Financial Instruments* and IAS 28 *Investments in Associates and Joint Ventures*—Measurement of long-term interests**
Paper topic	Measurement of interests in associates and joint ventures that, in substance, form part of the net investment

CONTACT(S) Takashi Yamagami tyamagami@ifrs.org +44 (0)20 7246 6410

Introduction

1. At its meetings in September and November 2015, the IFRS Interpretations Committee ('the Interpretations Committee') discussed an issue related to the interaction between IFRS 9 *Financial Instruments* and IAS 28 *Investments in Associates and Joint Ventures*. Specifically, the issue relates to whether the measurement of long-term interests in associates and joint ventures that, in substance, form part of the 'net investment' ('the long-term interest'), in particular relating to impairment, should be governed by IFRS 9, IAS 28 or a combination of both.

2. In those meetings, the Interpretations Committee discussed various alternatives that are seen in practice, and noted that:

   (a) the feedback received from the outreach indicated that there are divergent views on how to account for the impairment of the long-term interests and that the issue is widespread;

   (b) the key difference arising from the alternatives is whether the long-term interests are subject to the IFRS 9 impairment requirements; and

   (c) the scope exception in IFRS 9 is not clear in this respect.

Consequently, the Interpretations Committee considered that an amendment to IFRS would be required to clarify the issue.

3. However, after discussing the issue at two of its meetings, the Interpretations Committee did not reach a consensus on which alternative should be followed as an amendment. Consequently, the Interpretations Committee decided to consult the IASB about whether and how the IASB would expect the scope exception in IFRS 9 to apply to such long-term interests.

4. The purpose of this paper is to:

   (a) provide a description of the issue and a summary of the Interpretations Committee’s discussions; and

   (b) ask the IASB for its view on whether its expectation of the applicability of the scope exception in IFRS 9 to the long-term interests would be consistent with the view recommended by us.

Summary of staff recommendation

5. If the IASB understands the scope exception in IFRS 9 to mean that the long-term interest is subject to the entire requirements of IFRS 9, including the impairment requirements, we recommend that the IASB should ask the Interpretations Committee to develop a narrow-scope amendment to IAS 28, in line with the view under which such a long-term interest:

   (a) is accounted for in accordance with IFRS 9 in its entirety, including the impairment requirements of IFRS 9;

   (b) is subject to the allocation of the share of losses of an investee in accordance with IAS 28; and

   (c) is assessed for impairment as part of the net investment using the guidance that is included in IAS 28.

Structure of this paper

6. This paper is structured as follows:

(a) background (paragraphs 7–21);

(b) a summary of the staff analysis and the Interpretations Committee's discussions (paragraphs 22–49);

(c) staff analysis and recommendation (paragraphs 50–63);

(d) questions for the IASB;

(e) Appendix A—Extracts from IFRSs; and

(f) Appendix B—Relevant extracts from Agenda Paper 5 presented at the Interpretations Committee meeting in November 2015.

Background

Issue raised

7. Paragraph 2.1(a) of IFRS 9 states that interests in associates and joint ventures that are accounted for in accordance with IAS 28 are excluded from the scope of IFRS 9. Paragraph 14 of IAS 28 explains this scope exception, which states:

> IFRS 9 *Financial Instruments* does not apply to interests in associates and joint ventures that are accounted for using the equity method. When instruments containing potential voting rights in substance currently give access to the returns associated with an ownership interest in an associate or a joint venture, the instruments are not subject to IFRS 9. In all other cases, instruments containing potential voting rights in an associate or a joint venture are accounted for in accordance with IFRS 9.

8. Paragraph 38 of IAS 28 requires that the base to which a share of investees' losses is allocated includes not only interests in the investees that are measured using the equity method, but also other long-term interests that, in substance, form part of the net investment. In this respect, paragraph 38 states (emphasis added):

> If an entity's share of losses of an associate or a joint venture equals or exceeds its interest in the associate or

> joint venture, the entity discontinues recognising its share of further losses. The interest in an associate or a joint venture is the carrying amount of the investment in the associate or joint venture determined using the equity method *together with any long-term interests that, in substance, form part of the entity's net investment in the associate or joint venture. For example, an item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, an extension of the entity's investment in that associate or joint venture*. Such items may include preference shares and long-term receivables or loans, but do not include trade receivables, trade payables or any long-term receivables for which adequate collateral exists, such as secured loans. [….]

9. Paragraphs 40 and 41C–43 of IAS 28 go on to explain that this net investment is subject to an impairment testing in accordance with IAS 28. More precisely:

   (a) first, an entity is required to assess whether there is any objective evidence that the net investment is impaired by applying the indicators and guidance included in paragraphs 41A–41C, which were largely transferred from IAS 39 *Financial Instruments: Recognition and Measurement*; and

   (b) second, if this assessment indicates that the net investment is impaired, then the entity is required to measure the impairment by applying the impairment guidance included in IAS 36 *Impairment of Assets*.

10. In the light of these requirements in IFRS 9 and IAS 28, the submitter asked whether the scope exception in IFRS 9 should be interpreted to include the long-term interests, in particular within the context of the impairment requirements. In other words, should the long-term interest be tested for impairment by applying only the requirements in IAS 28 and not those in IFRS 9 as well?

11. The submitter believes that the requirements are unclear and considers that there is already diversity in practice under IAS 39, but that this had not been perceived

as a significant issue, because of the similarity of the impairment models in IAS 28/IAS 36 and IAS 39. However, now that there is the new expected credit loss model under IFRS 9, the submitter thinks that the impact is likely to be larger.

Views identified

12. The submitter identified the following four views that are seen in practice:
    (a) View A—entirely within the scope of IFRS 9 (subject to a loss allocation in accordance with IAS 28);
    (b) View B—entirely within the scope of IFRS 9 (subject to a loss allocation in accordance with IAS 28) and also within the scope of IAS 28 for impairment;
    (c) View C—entirely within the scope of IAS 28 and not within the scope of IFRS 9; and
    (d) View D—within the scope of IFRS 9 for classification and measurement purposes, excluding the impairment (subject to a loss allocation in accordance with IAS 28), and within the scope of IAS 28 for impairment.

13. The applicability of the requirements of IAS 28 and IFRS 9 with respect to the long-term interests under each view can be summarised as follows.

Views	IAS 28 impairment	IFRS 9 impairment	IAS 28 loss allocation	Other IFRS 9 requirements
A		○	○	○
B	○	○	○	○
C	○		○	
D	○		○	○

View A—entirely within the scope of IFRS 9 (subject to a loss allocation in accordance with IAS 28)

14. The proponents of this view believe that the scope exclusion from IFRS 9 applies only to the investment in ordinary shares that is accounted for using the equity method. The long-term interests are financial instruments and as such they are

wholly within the scope of IFRS 9 from a classification, measurement and impairment perspective. The IFRS 9 requirements are overridden only by paragraph 38 of IAS 28 within the context of allocating an entity's share of losses of an associate or joint venture.

15. They would also argue that IAS 36 does not contain any specific reference to how long-term interests in the form of a loan would be treated for impairment purposes. In addition, they think that it would seem contradictory for the long-term interests to be within the scope of the impairment requirements of both Standards when the impairment models are so different.

View B—entirely within the scope of IFRS 9 (subject to a loss allocation in accordance with IAS 28) and also within the scope of IAS 28 for impairment

16. The proponents of this view believe that while the long-term interest is within the scope of IFRS 9 and should not be accounted for using the equity method, it also forms part of the carrying amount of the investment for the purposes of impairment in accordance with IAS 28; consequently, the impairment requirements of that Standard must also be applied.

17. In addition, they think that the wording of the Standards would lead to the conclusion that long-term interests were within the scope of both IFRS 9 and IAS 28/IAS 36 for impairment.

View C—entirely within the scope of IAS 28 and not within the scope of IFRS 9

18. The proponents of this view believe that where a long-term interest is in substance part of the 'net investment', it is akin to an equity interest and it would therefore be more appropriate to account for it in the same way as the equity investment.

View D—within the scope of IFRS 9 for classification and measurement purposes, excluding the impairment (subject to a loss allocation in accordance with IAS 28), and within the scope of IAS 28 for impairment

19. Proponents of this view believe the IFRS 9 impairment requirements would be inconsistent with the indicators for impairment set out in paragraphs 41A-41C of IAS 28. They also think that applying the IFRS 9 impairment requirements to a long-term interest would be challenging, for example, switching from 12-month to lifetime expected credit losses and the calculation of shortfalls when payments are not planned for the foreseeable future.

20. They would also point out that paragraph 41 of IAS 28 refers to other long-term interests that are not part of the 'net investment', noting that they are within the scope of IFRS 9 for the purposes of impairment. This implies that those interests that do form part of the 'net investment' are not within the scope of IFRS 9 for impairment purposes.

Summary of the outreach results[1]

21. The feedback received on the outreach can be summarised as follows:

    (a) a majority of the respondents noted that the requirements were unclear and, therefore, they thought that some or all of the views provided by the submitter were possible;

    (b) opinions were also varied regarding whether the long-term interest should form part of the carrying amount of the investment for the purposes of impairment in accordance with IAS 28; and

    (c) many respondents noted that they had either observed existing diversity in practice in accordance with IAS 39 or expected it to arise in the future upon application of IFRS 9.

[1] For details, see Agenda Paper 10 for the Interpretations Committee's meeting in September 2015. The outreach was conducted with members of the International Forum of Accounting Standard-Setters, securities regulators, and the global IFRS technical teams of the international networks of the large accounting firms.

Summary of the staff analysis and the Interpretations Committee's discussions[2]

On the basis of the current wording

Summary of staff analysis

22. When we initially performed our analysis, we based it on the current wording of IAS 28 and IFRS 9.[3] As a result of the analysis, we noted that:

    (a) the long-term interests would be within the scope of IFRS 9. This is because the scope exception in paragraph 2.1(a) of IFRS 9, when read together with paragraph 14 of IAS 28 (which explains the IFRS 9 scope exclusion) indicates that it is only those interests that are measured using the equity method to which the scope exception of IFRS 9 applies.[4]

    (b) the long-term interests are subject to the allocation of losses and the impairment test, in accordance with the guidance in IAS 28 and IAS 36, because IAS 28 is clear that the long-term interests constitute part of the net investment that is subject to these requirements. We also noted that the impairment guidance in IAS 28 had not been changed as a result of the consequential amendment to IAS 28 when IFRS 9 was issued. This is because we noted that:

        (i) before IFRS 9 was issued, IAS 28 had referred to IAS 39 for the indicators of the impairment with respect to the net investment; and

        (ii) the indicators of impairment in IAS 28 (paragraphs 41A–41C of IAS 28) that were amended as a result of the issue of IFRS 9 were largely the same as the impairment indicators that had been previously contained in paragraphs 59–61 of IAS 39.

---

[2] Our full analysis can be found in Agenda Paper 10 and Agenda Paper 5 for the Interpretations Committee's meetings in September and November 2015 respectively.

[3] The staff analysis and the Interpretations Committee's discussions focussed on financial instruments that are measured at amortised cost. This is because it was the assumption included in the original submission and that type of financial instrument would need more clarification compared to financial instruments measured at fair value.

[4] We are of the view that the long-term interests are not considered to be interests that are measured using the equity method, because not all of the requirements for the equity method of accounting apply to these long-term interests.

(c) we considered that the more specific requirements within IAS 28 relating to the impairment of the net investment should take precedence and, therefore, the impairment requirements of IFRS 9 would not apply to the long-term interests.

Consequently, we concluded that the current wording of IAS 28 and IFRS 9 would lead to View D.

Summary of the Interpretations Committee's discussion

23. The Interpretations Committee largely agreed with our analysis and there was a fair amount of support for View D. In reaching this conclusion, the Interpretations Committee noted that:

(a) it would be counterintuitive to apply two different impairment requirements to the same financial instrument (ie the long-term interest); and

(b) in determining which of the two different requirements should apply, the more specific requirements should take precedence.

24. The Interpretations Committee also noted that one could interpret the IFRS 9 requirements to mean that they apply to the long-term interest in its entirety, including the impairment requirements, because IFRS 9 does not specifically exclude such long-term interests from its scope.

25. Consequently, at its September 2015 meeting, the Interpretations Committee considered that a clarification would be required to address the issue and that such a clarification would require a narrow-scope amendment to IFRS instead of an annual improvement, given the magnitude of the potential financial impacts of this issue.

Interaction issues that would arise under View D between the requirements in IAS 28 and those in IFRS 9

26. The Interpretations Committee thought that an amendment to clarify the issue in line with View D would also have to address interaction issues that would arise

under that view between the requirements in IAS 28 and those in IFRS 9, particularly those relating to the recognition of interest income under IFRS 9.

27. A tension in this interaction arises because the expected credit loss impairment model in IFRS 9 is part of, and interlinked with, the amortised cost accounting in IFRS 9. More specifically in accordance with IFRS 9:

    (a) measurement of interest income and impairment both use:

        (i) contractual cash flows associated with financial instruments; and

        (ii) an original effective interest rate.

    (b) an amortised cost of a financial asset reflects, among other things, any adjustments for any loss allowance; and

    (c) for financial assets other than purchased or originated credit-impaired financial assets, interest income is calculated on the basis of the gross carrying amount until the financial instruments become credit-impaired, at which stage interest income is calculated on the basis of the amortised cost.

28. In contrast, inputs used in IAS 36 for measuring impairments are different from those in IFRS 9:

    (a) the recoverable amount is used as an amount to be compared with the carrying amount of an asset, which is the higher of the fair value less costs of disposal and value in use; and

    (b) if value in use is used, the discount rate could be a risk-free rate if the risk is reflected in cash flows.

29. Similarly, the amount of allocation of equity method losses under IAS 28 is not based on the inputs used for measurement under IFRS 9.

30. Because of this interaction issue that would arise under View D, the Interpretations Committee thought that this issue should also be addressed by an amendment.

An alternative to View D

Summary of staff analysis

31. As summarised in the previous section, at its meeting in September 2015, a majority of the Interpretations Committee members showed its support for View D and considered that an amendment to IFRS would be required to clarify the issue as well as the interaction issue that would arise under that View.

32. After analysing the issue further with the focus on the interaction issue, we decided to explore another alternative because:

    (a) we understood the Interpretations Committee's discussions and observations in September 2015 to mean that:

        (i) its support for View D was on the basis of the current wording in IAS 28 and IFRS 9, and not necessarily on the basis that View D would produce the most useful information; and

        (ii) an amendment in line with that view was conditional on whether the interaction between the IAS 28 and IFRS 9 requirements would work under that view.

    (b) even though we attempted to come up with a possible proposal to deal with the interaction issue that would arise under View D as described above, we found it very difficult, if indeed it would prove to be possible at all, to find a reconciliation between the requirements in IAS 28 and those in IFRS 9. This was mainly because under View D the long-term interest would not be subject to the impairment requirements of IFRS 9, while the recognition of interest income under IFRS 9 would be affected by the application of the impairment requirements of IFRS 9.

    (c) we considered that if the issue were to be clarified through an amendment, instead of an interpretation, such an amendment would not need to be limited to an interpretation of what the current Standards say, which might not be consistent with the IASB's expectation of the outcome of the application of IFRS 9.

33. In exploring an alternative view, we noted the following:[5]

    (a) any amendment should be made through a narrow-scope amendment instead of the research project on the equity method of accounting (‘the Research Project’), because the Research Project would be unlikely to result in an amendment to IAS 28 before IFRS 9 becomes effective. Considering the potential financial impacts of this issue, we thought that it was important that a clarification should be made before IFRS 9 becomes effective, to prevent diversity in practice with respect to this issue;

    (b) an amendment should not consider possible changes to the composition of the net investment and/or financial instruments that are accounted for using the equity method, because such changes would be too broad for a narrow-scope amendment;

    (c) the IFRS 9 impairment requirements should apply to the long-term interests, because we did not think that applying only the allocation of losses and impairments under IAS 28 instead of the impairment requirements of IFRS 9 will provide better information to users with respect to the long-term interest; and

    (d) two levels of impairment testing with respect to the long-term interest are not in themselves an issue, but we understand them to exist to serve different purposes.

34. Taking into considerations the points above, we developed an alternative view under which the long-term interest:

    (a) is accounted for in accordance with IFRS 9 in its entirety, including the impairment requirements of IFRS 9;

    (b) is subject to the allocation of the share of losses of an investee in accordance with IAS 28; and

    (c) is assessed for impairment as part of the net investment using the guidance that is included in IAS 28.

[5] Our detailed analysis relating to the alternative view that is presented at the Interpretations Committee meeting in November 2015 is included in Appendix B— Relevant extracts from Agenda Paper 5 presented at the Interpretations Committee meeting in November 2015.

35. We noted that this alternative also creates interaction considerations between the requirements in IAS 28 and those in IFRS 9, because the long-term interest is within the scope of both Standards for (a part of) the measurement requirements.

36. We considered that because under this view the long-term interest is accounted for in its entirety in accordance with IFRS 9, the logical steps would be:

    (a) first, account for the long-term interests in accordance with IFRS 9, including the impairment; and

    (b) second, bring into the amount of the 'net investment' the carrying value of the long-term interests reflecting the impairment recognised under IFRS 9, if any.

37. If there is any allocation of losses and/or impairments under IAS 28 to the long-term interest, an entity would not take it into account in recognising interest income on the long-term interest in accordance with IFRS 9. We are of the view that the interaction under this alternative view works better than the one under View D, because the requirements in IFRS 9 are kept intact, which means that the benefits of IFRS 9 are retained.

38. We also noted that under this alternative view the long-term interest is subject to two different methods of impairment testing and that one of the arguments in support for View D instead of View B was that the application of impairment requirements in different Standards to the same item is counterintuitive. However, we understand that this is not the case with respect to the issue, because we understand that these impairment requirements under IAS 28 and IFRS 9 apply to different units of account:[6]

---

[6] We note that a similar situation to this already exists in other Standards. For example,

(a) Under IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, non-current assets that are not within the measurement requirements of that Standard are first measured in accordance with applicable Standards, including the impairment requirements. Then, the carrying amount of those non-current assets become part of a disposal group, which is measured at the lower of its fair value less costs of disposal and its carrying value.

(b) Under IAS 36, assets that constitute the cash-generating unit to which goodwill has been allocated should be tested for impairment before the unit containing the goodwill is tested for impairment, if they are tested for impairment at the same time.

(a) under IFRS 9, the unit of account is the long-term interest; and

(b) under IAS 28, the unit of account is the 'net investment', which includes the long-term interest.

39. We noted that this different level of impairment testing would be necessary with respect to the long-term interest merely to ensure that an entity records adequate losses and impairments in relation to its investments in the associate.

40. We think that this is consistent with the rationale for the amendment that was made to IAS 28 in 2003, which expanded the scope of financial interests that are subject to the allocation of losses and impairment under IAS 28 to include the long-term interests because of a concern relating to structuring opportunities for investors. In this regard, paragraphs BCZ 39–40 of IAS 28 state:

> BCZ39 The Board decided that the base to be reduced to zero should be broader than residual equity interests and should also include other non-equity interests that are in substance part of the net investment in the associate or joint venture, such as long-term receivables. Therefore, the Board decided to withdraw SIC-20.
>
> BCZ40 The Board also noted that if non-equity investments are not included in the base to be reduced to zero, an entity could restructure its investment to fund the majority in non-equity investments to avoid recognising the losses of the associate or joint venture under the equity method.

41. Based on our analysis as summarised above, in November 2015, we proposed to the Interpretations Committee that it should pursue an amendment in line with the alternative view instead of View D.

42. In addition, we thought that such an amendment could and should be made by providing clarifications only to IAS 28 because we thought that:

(a) the IASB should avoid amending IFRS 9, if possible, during the endorsement process of IFRS 9;

(b) paragraph 2.1(a) of IFRS 9, read together with paragraph 14 of IAS 28, makes it clear that IFRS 9 does not apply to interests in associates and joint ventures that are accounted for using the equity method;

(c) if it is not sufficiently clear that the long-term interests that form part of the ‘net investment’ are not considered to be interests accounted for using the equity method, a clarification can be made to IAS 28; and

(d) additional guidance relating to the interaction between the requirements in IAS 28 and IFRS 9 under the alternative view can be made in IAS 28.

Summary of the Interpretations Committee’s discussion

43. In response to our new proposal, the Interpretations Committee’s views were mixed. While nearly half of the Interpretations Committee’s members preferred the alternative view to View D, some members supported View D.

44. Those who were in favour of the alternative view noted that:

(a) the long-term interest should be accounted for by applying IFRS 9, including the impairment requirements, because it meets the definition of a financial instrument; and

(b) interest income would be recognised in accordance with IFRS 9.

45. In contrast, those who supported View D thought that:

(a) the long-term interest is, in substance, an extension of the entity’s investments in associates and, therefore, should be accounted for as equity;

(b) the implications of the alternative view on the accounting for the long-term interest under paragraph 32 of IAS 21 *The Effects of Changes in Foreign Exchange Rates* should be explored.[7] This is because it seems odd that on the one hand the long-term interest is treated like equity (for foreign exchange translation purposes) and on the other hand it is treated like any other financial instrument under IFRS 9; and

[7] Paragraphs 15 and 32 of IAS 21 require exchange differences arising from an entity’s net investment in a foreign operation to be initially recognised in other comprehensive income in its consolidated financial statements.

(c) View D would be more practical because an entity would not have to apply two different impairment requirements for the same financial instruments.

46. Other comments made by the Interpretations Committee include:

(a) whichever view is taken (ie either View D or the alternative view), the information provided would not be useful when a share of losses is allocated to the long-term interests. This is because the allocation of losses under IAS 28 may not represent the economic reality of an entity's investments in associates, because the absorption of losses in accordance with paragraph 38 of IAS 28 would not always be consistent with the entity's contractual obligations to absorb losses. Instead, investors would find information about the fair value of the financial instruments that are included in the net investment more useful.

(b) a broader consideration should be given with respect to what should or should not be included in the net investment. However, such a consideration would not be suitable for a narrow-scope amendment, but should be considered as part of the Research Project.

The next step

47. After discussing the issue at its meetings in September and November 2015, the Interpretations Committee did not reach a consensus on which view to pursue as a possible amendment.

48. Some members thought that even if the Interpretations Committee does not reach a consensus on a view, it should at least publish an agenda decision so that it can rule out some of the four views that are seen in practice and that it thought would not be appropriate. This is because they thought that such an agenda decision would to some extent contribute to a reduction of diversity in practice.

49. However, because of the magnitude of the potential financial impacts of this issue, the Interpretations Committee thought that before pursuing such an agenda decision it should consult the IASB about whether and how the IASB would expect the scope exception in IFRS 9 to apply to such long-term interests. The

Interpretations Committee thought that feedback from the IASB would help it to decide what further work it should undertake, if any, including whether to develop a proposal for a narrow-scope amendment.

Staff analysis and recommendation

Overall direction of the project

50. We think that there are two alternatives that the IASB can consider with respect to this issue, as follows:

    (a) the IASB could ask the Interpretations Committee to pursue an agenda decision that rules out any of the four views that the Interpretations Committee thinks would not be appropriate, but leaves open the decisions of whether the long-term interest is subject to the impairment requirements of IFRS 9. This would be the case if, for example, the IASB thought that this issue should be considered as part of the Research Project; or

    (b) the IASB could ask the Interpretations Committee to develop a narrow-scope amendment that clarifies the issue in line with the IASB's expectation of the applicability of the scope exception to the long-term interest (ie whether the impairment requirements of IFRS 9 apply to the long-term interest).

51. With respect to the first alternative, we note that there are potential benefits associated with addressing this issue through the Research Project, which could include:

    (a) Any amendment in relation to this issue that would come out of the Research Project could be based on, and therefore, be consistent with, any new revised objectives in relation to the equity method of accounting.

    (b) There would be fewer burdens on stakeholders, especially on preparers, because amendments relating to IAS 28 that would come out of the Research Project would be published at the same time. Consequently, the amendments would have the same effective dates, which might not be the case if the amendments were published separately at different times.

52. However, we are of the view that the issue should be addressed through a narrow-scope amendment. This is because we think that:

(a) it is important that a clarification should be made with respect to this issue before IFRS 9 becomes effective, which is in 2018; and

(b) any amendment that would come out of the Research Project could take several years.

53. We think that a clarification should be made before IFRS 9 becomes effective because, without a clarification, we think that there would be diversity in which Views A–D would be applied and that this could have significant financial impacts.

54. In addition, even if these views are narrowed down to fewer than four views as a result of an agenda decision, if the question relating to whether the long-term interest is subject to the IFRS 9 impairment requirements was still not answered, we expect that financial results of entities could be different. We also think that this issue could be pervasive once IFRS 9 becomes effective, because the issue is relevant not only in a situation in which the investee is making losses, but also in a situation in which the investee is profitable.

55. Consequently, we think that the IASB should not transfer this issue to the Research Project.

56. With respect to the second alternative, an amendment would depend on the IASB’s expectation of the applicability of the scope exception of IFRS 9 to the long-term interest, but consistently with our proposal to the Interpretations Committee at its meeting in November 2015, we think that the alternative view would be better than View D, because:

(a) the long-term interests meet the definition of financial instruments, and therefore, they should be treated in the same way as any other financial instruments, except for those specifically excluded from the scope of IFRS 9.

(b) we consider that the interaction between the requirements in IAS 28 and those in IFRS 9 under the alternative view would work better than the interaction under View D, because, under the alternative view, the IFRS 9 requirements are kept intact.

(c) we question some of the concerns expressed by the Interpretations Committee over View B:

   (i) While we agree that the net investment is treated like equity, we are of the view that this alone is not sufficient to justify exclusion from the IFRS 9 impairment requirements of the long-term interest in the net investment. We do not think that applying only the loss allocation and impairment requirements of IAS 28 instead of the impairment requirements of IFRS 9 will provide better information to users with respect to the long-term interest. In addition, we think that an amendment should not consider the aspect of foreign currency translation for the long-term interest because we think that this would be too broad for a narrow-scope amendment to deal with. In other words, we think that any foreign exchange differences arising from the long-term interest should continue to be recognised in other comprehensive income in an entity's consolidated financial statements in accordance with paragraphs 15 and 32 of IAS 21.

   (ii) With respect to the application of two different impairment requirements, as discussed in paragraphs 38–40, we think that these impairment requirements apply to different units of account for different reasons (ie IFRS 9 impairment to the long-term interest, and IAS 28/IAS 36 impairment to the net investment). Consequently, we are of the view that two levels of impairment testing with respect to the long-term interest are themselves not an issue, because they exist to serve different purposes.

57. Consequently, if the IASB understands the scope exception in IFRS 9 to mean that the long-term interest is subject to the entire requirements of IFRS 9, including the impairment requirements, we recommend that the IASB should ask

the Interpretations Committee to develop a narrow-scope amendment to IAS 28 in line with the alternative view.

The IASB's expectation about the scope exception in IFRS 9

58. Paragraph 2.1(a) of IFRS 9 excludes interests in associates and joint ventures that are accounted for in accordance with IAS 28 from the scope of that Standard. Paragraph 14 of IAS 28 explains that this scope exception applies to interests in associates and joint ventures that are accounted for using the equity method.

59. However, because paragraphs 40 and 41A–43 of IAS 28 set out the impairment requirement for the net investment in associates and joint ventures, which includes not only the interests that are accounted for using the equity method, but also other long-term interest, the question is raised of whether the long-term interest is subject to the impairment requirement of only IAS 28 as part of the net investment, or the impairment requirements of both IAS 28 and IFRS 9.

60. After discussing the issue, the Interpretations Committee did not reach a consensus on how the issue should be clarified. Consequently, the Interpretations Committee asked that we consult the IASB about whether and how it would expect the scope exception in IFRS 9 to apply to such long-term interests in associates and joint ventures. In other words, does the IASB expect an entity to account for the long-term interest:

    (a) in accordance with the entire requirements of IFRS 9, including the impairment requirements of that Standard; or
    (b) only in respect of parts of IFRS 9 (ie excluding the impairment requirements of IFRS 9)?

61. The Interpretations Committee thought that the IASB's conclusion on this question would help it to decide what further work it should undertake, if any, including whether to develop a proposal for a narrow-scope amendment.

62. In our view, accounting requirements consistent with (a) in paragraph 60 would be preferable because those accounting requirements would result in retaining the entire IFRS 9 requirements, which means that recognition of interest income

could be accounted for consistently with the requirements of IFRS 9. We note that if the impairment requirements of IFRS 9 did not apply to the long-term interests, a narrow-scope amendment would also have to provide guidance on how to recognise interest income that could be different from those in IFRS 9.

Summary of staff recommendation

63. If the IASB understands the scope exception in IFRS 9 to mean that the long-term interest is subject to the entire requirements of IFRS 9, including the impairment requirements, we recommend that the IASB should ask the Interpretations Committee to develop a narrow-scope amendment to IAS 28, in line with the view under which such a long-term interest:

    (a) is accounted for in accordance with IFRS 9 in its entirety, including the impairment requirements of IFRS 9;

    (b) is subject to the allocation of the share of losses of an investee in accordance with IAS 28; and

    (c) is assessed for impairment as part of the net investment using the guidance that is included in IAS 28.

Questions for the IASB

Questions for the IASB
1. Does the IASB have any questions about the issue and the Interpretations Committee's discussions?
2. Does the IASB expect an entity to apply the entire IFRS 9 requirements, including the impairment requirements, to the long-term interest?
3. If the answer to Question 3 is yes, does the IASB agree with the staff recommendation that it should ask the Interpretations Committee to develop a narrow-scope amendment in line with that expectation?

Appendix A—Extracts from IFRSs

A1. The following are extracts from IFRS 9 and IAS 28 relating to the scope of interests that are accounted for in accordance with IAS 28.

IFRS 9: Financial Instruments

> 2.1 This Standard shall be applied by all entities to all types of financial instruments except:
>
> (a) those interests in subsidiaries, associates and joint ventures that are accounted for in accordance with IFRS 10 *Consolidated Financial Statements*, IAS 27 *Separate Financial Statements* or IAS 28 *Investments in Associates and Joint Ventures*. However, in some cases, IFRS 10, IAS 27 or IAS 28 require or permit an entity to account for an interest in a subsidiary, associate or joint venture in accordance with some or all of the requirements of this Standard. Entities shall also apply this Standard to derivatives on an interest in a subsidiary, associate or joint venture unless the derivative meets the definition of an equity instrument of the entity in IAS 32 *Financial Instruments: Presentation*.

IAS 28: Investments in Associates and Joint Ventures

> 14 IFRS 9 *Financial Instruments* does not apply to interests in associates and joint ventures that are accounted for using the equity method. When instruments containing potential voting rights in substance currently give access to the returns associated with an ownership interest in an associate or a joint venture, the instruments are not subject to IFRS 9. In all other cases, instruments containing potential voting rights in an associate or a joint venture are accounted for in accordance with IFRS 9.

Appendix B—Relevant extracts from Agenda Paper 5 presented at the Interpretations Committee meeting in November 2015

Is there a better alternative than View D?[8]

21. We note that if an amendment were to be proposed, instead of an interpretation, it would not need to be limited to an interpretation of what the current Standards say. In this regard, in analysing other alternatives, we considered the following:

    (a) how to make an amendment;

    (b) scope of the 'net investment', and equity method accounting;

    (c) application of IFRS 9 impairment requirements to the long-term interest;

    (d) interaction of the requirements in IAS 28 and IFRS 9 under an alternative view; and

    (e) what Standard(s) to amend;

How to make an amendment

22. Considering that this issue partly relates to accounting requirements of IAS 28 and that the Research Project is in progress, there are two possible ways to address an issue; that is, either through:

    (a) a narrow-scope amendment; or

    (b) the Research Project.

23. When we consulted the IASB members at various meetings in October 2015 to inform them of the discussion held by the Interpretations Committee, in which we did not ask them to make any decisions, some IASB members thought that this issue should be referred to the Research Project, while other IASB members thought that this issue should be addressed through a separate narrow-scope amendment.

24. Potential benefits associated with addressing this issue through the Research Project could include:

---

[8] The analysis included in this section assumes that the long-term interests included in the 'net investment' meets the criteria for classification as amortised cost financial instruments in accordance with IFRS 9.

(a) Any amendment in relation to this issue that would come out of the Research Project could be based on, and therefore be consistent with, any new revised objectives in relation to the equity method of accounting.

(b) There would be fewer burdens on stakeholders, especially on preparers, because amendments relating to IAS 28 that would come out of the Research Project would be published at the same time. Consequently, the amendments would have the same effective dates, which might not be the case if the amendments were published separately at different times.

25. Despite these potential benefits, we are of the view that the issue should be addressed through a narrow-scope amendment. This is because we think that:

(a) it is important that a clarification should be made with respect to this issue before IFRS 9 becomes effective, which is in 2018; and

(b) any amendment that would come out of the Research Project could take many years.

26. We think that a clarification should be made before IFRS 9 becomes effective because without a clarification, we think that there would be diversity in which any of the Views A–D would be applied and that this could have significant financial impacts.

27. With respect to items included in the Research Project, we are aware that the area of impairment of associates is being considered in the Research Project in the short term, but there is currently no plan to address the issue with a short-term amendment. Consequently, we think that anything that would come out of the Research Project would not be likely to be published before IFRS 9 becomes effective.

28. On the basis of this analysis, we recommend that an amendment should be pursued through a narrow-scope amendment.

Scope of the 'net investment', and equity method accounting

29. We note that the issue originally arose mainly because the long-term interest is included in the 'net investment' for the purpose of allocation of losses and

impairment under IAS 28. In other words, if the long-term interests had not been included in the 'net investment', this issue would not have arisen.

30. We think that an amendment could consider the broader question of whether the long-term interests should stay in the 'net investment', and/or whether the long-term interests should be included in the population of financial instruments that are accounted for using the equity method.

31. However, we think that these broader considerations should not be pursued through a narrow-scope amendment, because they touch on fundamental aspects of the equity method of accounting. We think that a broader question like this is better placed in the Research Project.

32. As we recommended in the previous section, we think that an amendment should be made through a narrow-scope amendment. Consequently, we are of the view that the amendment should not consider possible changes to the composition of the 'net investment' and/or financial instruments that are accounted for using the equity method.

Should the long-term interest be excluded from the IFRS 9 impairment?

33. Under View D, the impairment requirements in IFRS 9 do not apply to the long-term interest. But is this appropriate?

34. We note that the benefits of the new impairment model in IFRS 9 include the fact that it is:

    (a) a more forward-looking model that requires entities to consider a wide range of information. Consequently, it is more responsive to changes in credit risk and responds to concerns raised during the financial crisis about the delayed recognition of losses under the IAS 39 impairment model; and

    (b) a single impairment model for all the financial instruments to which the impairment requirements apply, which reduces complexity of multiple impairment models which existed under IAS 39.

35. We note that the only difference between the long-term interests in the 'net investment' and other financial instruments that are within the scope of IFRS 9 is that the former is included within the scope for the purpose of allocation of losses

and impairments under IAS 28. We are of the view that this difference alone is not sufficient to justify exclusion of the long-term interests from the IFRS 9 impairment requirements, because the allocation of losses and impairments under IAS 28 cannot be a substitute for the impairment requirements in IFRS 9.

36. First, IFRS 9 switched the impairment model from the incurred loss model to the expected credit loss model, but allocation of losses and assessment for impairments under IAS 28 is generally based on the incurred loss model.

37. Second, we think that the requirements relating to allocation of losses and impairments under IAS 28 are not designed to override measurement requirements that are included in other Standards. Instead, we think that they are merely a mechanism to ensure that sufficient losses are recognised with respect to the interests in the associates.

38. With respect to the second point above, we understand that the revisions to IAS 28 in 2003 expanded the scope of financial interests that are subject to the allocation of losses and impairment under IAS 28 to include the long-term interests because of a concern relating to structuring opportunities for investors. In this regard, paragraphs BCZ 39–40 of IAS 28 state:

> BCZ39 The Board decided that the base to be reduced to zero should be broader than residual equity interests and should also include other non-equity interests that are in substance part of the net investment in the associate or joint venture, such as long-term receivables. Therefore, the Board decided to withdraw SIC-20.
>
> BCZ40 The Board also noted that if non-equity investments are not included in the base to be reduced to zero, an entity could restructure its investment to fund the majority in non-equity investments to avoid recognising the losses of the associate or joint venture under the equity method.

39. We understand from this that:

(a) the long-term interests are included in the 'net investment' so as to ensure that entities would recognise adequate losses that are allocable to the entities' investment in the associate, and only for that purpose; and

(b) consequently, the long-term interests should be accounted for in all respects, including impairment, in accordance with the applicable Standard, which in this case is IFRS 9.

40. On the basis of the analysis, we are of the view that allocation of losses and impairments under IAS 28, which occurs only once the loss occurs, cannot be a substitute for the impairment requirements in IFRS 9, which adopts the expected credit loss model. Consequently, we are of the view that the IFRS 9 impairment requirements should apply to the long-term interests.

Interaction of the requirements in IAS 28 and IFRS 9 under an alternative view

41. On the basis of our conclusions in the previous sections, an alternative view would be consistent with View B. Under this View, accounting consequences would be:

(a) the long-term interests are accounted for in accordance with IFRS 9 in their entirety, including the impairment requirements.

(b) as part of the net investment, the long-term interests are subject to allocation of share of losses of an investee; and

(c) as part of the net investment, the long-term interests are assessed for impairment using the indicators that are included in IAS 28.

42. We understand that this alternative also creates interaction considerations between the requirements in IAS 28 and IFRS 9, because the long-term interest is within the scope of both Standards for (a part of) the measurement requirements.

43. Because under this view the long-term interests are accounted for in their entirety in accordance with IFRS 9, the logical steps would be:

(a) first, account for the long-term interests in accordance with IFRS 9, including the impairment; and

(b) second, bring into the amount of the 'net investment' the carrying value of the long-term interests reflecting the impairment recognised under IFRS 9, if any.

44. If there is any allocation of losses and/or impairments under IAS 28 to the long-term interest, entities would treat those losses and/or impairments as an allowance, so that they do not affect the carrying amount of the long-term interests for the measurement purposes of IFRS 9.

45. We are of the view that the interaction under this alternative works better than the one under View D, because the requirements in IFRS 9 are kept intact, which means that the benefits of IFRS 9 are retained.

46. We are aware that under this alternative view the long-term interests are subject to two different methods of impairment testing. Some may argue that application of impairment requirements in different Standards to the same item is counterintuitive. However, we understand that this is not the case with respect to the issue, because these impairment requirements under IAS 28 and IFRS 9 apply to different units of account:

(a) under IFRS 9, the unit of account is the long-term interest; and

(b) under IAS 28, the unit of account is the 'net investment', which includes the long-term interest.

47. We note that this different layer of impairment testing would be necessary with respect to the long-term interests merely to ensure that entities record adequate losses and impairments in relation to their investments in the associate.

48. In addition, we note that a similar situation to this already exists in other Standards. For example:

(a) Under IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, non-current assets that are not within the measurement requirements of that Standard are first measured in accordance with applicable Standards, including the impairment requirements. Then, the carrying amount of those non-current assets become part of a disposal group, which is measured at the lower of its fair value less costs of disposal and its carrying value.

(b) Under IAS 36, assets that constitute the cash-generating unit to which goodwill has been allocated should be tested for impairment before the unit containing the goodwill is tested for impairment, if they are tested for impairment at the same time.

49. On the basis of this analysis, we are of the view that:

(a) the interaction between the requirements of IAS 28 and IFRS 9 under the alternative view would work better than the one under View D; and

(b) two layers of impairment testing with respect to the long-term interest themselves are not an issue, and instead they are consistent with the measurement objective of both IAS 28 and IFRS 9.

50. Consequently, we recommend pursuing the alternative view, instead of View D.

What Standard(s) to amend

51. We note that an amendment required depends on which View to be followed.

52. We also note that the IASB should avoid amending IFRS 9, if possible, during the endorsement process of IFRS 9.

53. If the Interpretations Committee agrees with our view that the alternative view should be pursued, we think that an amendment in line with that view can be made by providing clarifications only to IAS 28. We hold this view because:

(a) paragraph 2.1(a) of IFRS 9, read together with paragraph 14 of IAS 28, makes it clear that IFRS 9 does not apply to interests in associates and joint ventures that are accounted for using the equity method.

(b) if it is not sufficiently clear that the long-term interests that form part of the 'net investment' are not included in the interests accounted for using the equity method, a clarification can be made to IAS 28.

(c) additional guidance relating to the interaction analysed in paragraphs 41–49 can be made in IAS 28.

54. Consequently, if the Interpretations Committee agrees with the alternative view, we recommend that an amendment should be made only to IAS 28.

Summary

55. A summary of our analysis is that:

(a) any amendment should be made through a narrow-scope amendment, instead of via the Research Project;

(b) an amendment should not consider possible changes to the composition of the ‘net investment’ and/or financial instruments that are accounted for using the equity method;

(c) the IFRS 9 impairment requirements should apply to the long-term interests;

(d) the interaction between the requirements in IAS 28 and IFRS 9 under the alternative view would work better than the one under View D;

(e) consequently, the alternative view should be pursued, instead of View D; and

(f) the amendment should be made only to IAS 28.