IFRS

STAFF PAPER

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IFRS Interpretations Committee Meeting

Project	**New items for initial consideration**
Paper topic	IFRS 9 *Financial Instruments* and IAS 28 *Investments in Associates and Joint Ventures*—Impairment of long-term interests

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This paper has been prepared for discussion at a public meeting of the IFRS Interpretations Committee. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination. Decisions made by the IFRS Interpretations Committee are reported in IFRIC *Update*. The approval of a final Interpretation by the Board is reported in IASB *Update*.

Introduction

1. The IFRS Interpretations Committee ('the Interpretations Committee') has received a request related to the interaction between IFRS 9 *Financial Instruments* (2014) and IAS 28 *Investments in Associates and Joint Ventures* (2011).

2. The issue relates to whether the measurement of long-term interests in associates and joint ventures, in particular relating to impairment, should be governed by IFRS 9, IAS 28 or a combination of both.

3. The objective of this agenda paper is to provide the Interpretations Committee with a summary of the issue, along with the staff's research, analysis and recommendation.

4. The submission is reproduced in full in Appendix C to this agenda paper.

Structure of the agenda paper

5. This paper is organised as follows:

   (a) Background information;

   (b) Summary of outreach conducted;

   (c) Staff analysis;

   (d) Assessment against the Interpretations Committee's agenda criteria;

   (e) Staff recommendation;

   (f) Questions for the Interpretations Committee;

   (g) Appendix A—Proposed wording for the tentative agenda decision;

   (h) Appendix B—Additional extracts from IFRSs;

   (i) Appendix C—Submission.

Background Information

The issue

6. 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.

7. Paragraph 38 of IAS 28 provides examples of items that are considered to constitute long-term interests in associates or joint ventures and notes that they form part of the 'net investment' in an associate or joint venture for the purposes of allocating an entity's share of losses of an associate or joint venture:

> **38** 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. [….] *[emphasis added]*

8. Paragraph 40 of IAS 28 goes on to require an entity to determine whether there is any objective evidence that its 'net investment' in the associate or joint venture is impaired. Where such evidence is identified, paragraph 42 of IAS 28 requires the 'entire carrying amount of the investment' be tested for impairment in accordance with IAS 36 *Impairment of Assets* as a single asset.

9. The submitter presents an example of a long-term interest that is in the form of an interest-bearing loan that would meet the definition of a financial instrument. The question raised is whether the scope exemption from IFRS 9 referred to in paragraph 6 should be interpreted to include such a long-term interest (in particular within the context of the impairment requirements), which would otherwise be wholly within the scope of IFRS 9.

10. The submitter believes that the requirements are unclear and considers that there is already diversity in practice under IAS 39 *Financial Instruments: Recognition and Measurement*, but that this had hitherto not been perceived as a significant issue, because of the similarity of the impairment models in IAS 28/IAS 36 and IAS 39. However, with the new expected credit loss model under IFRS 9, the submitter thinks that the impact is likely to be larger.

11. Four views relating to this issue are presented by the submitter and are summarised below.

View A—Entirely within the scope of IFRS 9 (subject to an IAS 28.38 overlay)

12. 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 overruled only by paragraph 38 of IAS 28 in the context of allocating an entity's share of losses of an associate or joint venture.

13. The long-term interest would not be accounted for using the equity method because it does not represent an investment in ordinary shares (ownership interest).

View B—Entirely in the scope of IFRS 9 (subject to an IAS 28.38 overlay) and also within scope of IAS 28/36 for impairment

14. This view is identical to View A, except that in addition to the overlay of paragraph 38 of IAS 28, the long-term interest must be further tested for

impairment under IAS 36, in accordance with the requirements of paragraph 42 of IAS 28, if the entity has identified objective evidence that the 'net investment' in the associate or joint venture is impaired. Consequently, the long-term interest would be within the scope of both IFRS 9 and IAS 28/36 for impairment purposes.

View C—Entirely within the scope of IAS 28

15. Because of the wording in paragraph 38 of IAS 28 that a long-term interest is, in substance, an extension of the entity's investment in an associate, it would be accounted for in the same way as the investment in the associate. In other words, it would be accounted for using the equity method and would be subject to the impairment requirements of IAS 28/IAS 36.

View D—Within the scope of IFRS 9 for classification and measurement purposes but excluded from the scope of IFRS 9's impairment requirements (subject to an IAS 28.38 overlay)

16. Proponents of this view believe that the long-term interest should be accounted for in accordance with IFRS 9, except for the purposes of the impairment requirements (and subject to the overlay of paragraph 38 of IAS 28 regarding the allocation of the investor's share of losses in an associate or joint venture).
17. In their view, the long-term interests are part of the 'entire carrying amount of the investment', which in accordance with paragraph 42 of IAS 28 must be tested for impairment in accordance with IAS 36 as a single asset if the entity has identified objective evidence that the 'net investment' in the associate or joint venture is impaired.

Summary of outreach conducted

18. In order to gather information about the issue described in the submission, we sent requests to 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. IFRS 9 is not yet mandatory, and so we expect experience of this issue to be limited. We therefore asked about the understanding of the requirements of IAS 28 and IFRS 9 in respect of this issue. In addition, we asked respondents about their experience under the existing requirements of IAS 39. Specifically we asked:

    (a) what do you understand the requirements of IAS 28 and IFRS 9 to require for the issue presented above, and based on your knowledge, what is the common understanding in your jurisdiction / practice? ie

    (i) whether the impairment of 'long-term interests' in associates and joint ventures should be governed by IFRS 9, IAS 28 or a combination of both

    (b) your rationale behind this accounting treatment. In particular, please could you explain whether you consider long-term interests to be part of the 'entire carrying amount of the investment' for the purposes of impairment; and

    (c) whether you consider that diversity in practice is likely to develop and how prevalent you envisage this issue will become upon initial application of IFRS 9. If you have already observed diversity in the accounting treatment under the existing requirements of IAS 39, please include this information in your response.

19. The views received represent informal opinions and do not reflect the formal views of those organisations.

20. We received 11 responses from national standard-setters who had sought the views of their constituents. The geographical breakdown for the responses received is as follows:

Geographical region	**Number of respondents**
Asia	3
Europe	5
Americas	1
Oceania	2
Africa	0
Total respondents	**11**

21. We also received responses from 6 accounting firms and 2 securities regulators. Both securities regulators had sought the views of individual national regulators across various jurisdictions.

22. The feedback received can be summarised as follows:

    (a) the majority of respondents noted that the requirements were unclear and consequently many respondents noted 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; and

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

23. Among the arguments put forward in support of View A were:

(a) paragraph 38 of IAS 28 only scopes in long-term interests in the context of the allocation of losses;

(b) the scope exemption in paragraph 2.1(a) of IFRS 9 only relates to ordinary shares making up the investment;

(c) 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; and

(d) 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—ie the expected loss model in IFRS 9 versus the incurred loss model in IAS 36. Likewise, it would be confusing for the accounting for long-term interests to be governed by a combination of IFRS 9 and IAS 28 (ie IFRS 9 for classification and measurement but IAS 28 for impairment).

24. Proponents of View B noted the following points:

(a) 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; and

(b) a literal reading 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.

25. The main argument in support of View C was 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. A few respondents were of the opinion that the consequential amendments made to IAS 28 as a result of IFRS 9 supported this view.

26. Furthermore, one accounting firm noted a concern regarding the classification of the long-term interest under IFRS 9; ie whether it would be classified as fair value through profit and loss because it did not meet the 'solely payments of principal and interest' test. Consequently, this respondent noted that there is a preference for the long-term interest to be considered as quasi-equity and to be wholly within the scope of IAS 28, ie View C.

27. The main argument against View C was that because the long-term interest in the example provided was a financial instrument, it would have to be within the scope of IFRS 9.

28. A number of arguments were put forward in support of View D:

    (a) 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;

    (b) the IFRS 9 impairment requirements would be inconsistent with the indicators for impairment set out in paragraphs 41A-41C of IAS 28;

    (c) the general equity method refers to 'investment' rather than 'net investment';

    (d) it is not clear how the equity method would be applied to a long-term interest in the form of a loan; and

    (e) 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.

29. In addition to the above, another respondent noted that in their experience, View D was the most prevalent view at present and, based on their understanding that IASB did not intend to change the treatment of long-term interests by virtue of the consequential amendments made to IAS 28 when IFRS 9 was issued, it is appropriate to maintain this view.

Staff analysis

31. The submitter describes a long-term interest in the form of an interest-bearing loan that would otherwise be within the scope of IFRS 9 for classification and measurement purposes, including impairment.

32. Consequently, the analysis that follows assumes that the long-term interest:

    (a) is a debt instrument that meets the criteria for classification as amortised cost in accordance with paragraph 4.1.2 of IFRS 9; and

    (b) is not an instrument that contains potential voting rights that in substance currently give the holder access to the returns associated with an ownership interest in an associate or a joint venture.

33. In order to address the question raised by the submitter, we will first set out the relevant accounting requirements of IFRS 9 and IAS 28. We will then analyse:

    (a) whether, and to what extent, the long-term interest is within the scope of IFRS 9; and

    (b) whether, and to what extent, the long-term interest is within the scope of IAS 28.

34. Having completed the analysis above, we will set out our view as to whether the accounting treatment of long-term interests should be governed by IAS 28, IFRS 9 or a combination of both.

Relevant accounting requirements

35. Paragraph 2.1(a) of IFRS 9 excludes from its scope interests in associates and joint ventures that are accounted for in accordance with IAS 28:

> **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.* […]

36. Paragraph 14 of IAS 28 provides further guidance regarding interests in associates and joint ventures that are outside the scope of IFRS 9:

> **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. *[emphasis added]*

37. Paragraph 3 of IAS 28 describes the equity method as follows:

> **3** The *equity method* is a method of accounting whereby the **investment** is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investor's share of the investee's net assets. The investor's profit or

> loss includes its share of the investee's profit or loss and the investor's other comprehensive income includes its share of the investee's other comprehensive income. *[emphasis added]*

38. Paragraph 38 of IAS 28 contains specific examples of items that are considered to constitute long-term interests in an associate or joint venture that in substance form part of the entity's 'net investment' in the associate or joint venture. Furthermore, this paragraph notes the distinction between long-term interests such as long-term receivables and 'other interests' such as trade receivables or secured loans:

> **38** 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.** Losses recognised using the equity method in excess of the entity's investment in ordinary shares are applied to the other components of the entity's

> interest in an associate or a joint venture in the reverse order of their seniority (ie priority in liquidation). *[emphasis added]*

39. The requirements relating to impairment losses for associates and joint ventures are set out in paragraphs 40-43 of IAS 28 (Appendix B reproduces paragraphs 40-43 of IAS 28 in their entirety):

    (a) paragraphs 40 and 41A-43 of IAS 28 contain the impairment requirements pertaining to the 'net investment' in the associate or joint venture:

    > **40** After application of the equity method, including recognising the associate's or joint venture's losses in accordance with paragraph 38, the entity applies paragraphs 41A–41C to determine **whether there is any objective evidence that its net investment in the associate or joint venture is impaired.**
    >
    > [….]
    >
    > **41A** The **net investment** in an associate or joint venture is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment [….]
    >
    > [….]
    >
    > **42** Because goodwill that forms part of the carrying amount of the net investment in an associate or a joint venture 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 for impairment in accordance with IAS 36 as a single**

> **asset**, by comparing its recoverable amount (higher of value in use and fair value less costs to sell) with its carrying amount whenever application of paragraphs 41A–41C indicates that the net investment may be impaired. [….] **In determining the value in use of the net investment**, an entity estimates: [….]
>
> [….]
>
> *[emphasis added]*

(b) paragraph 41 of IAS 28 contains the impairment requirements pertaining to 'other interests'[1] in the associate or joint venture that are in the scope of IFRS 9 and that do not constitute part of the 'net investment':

> **41** The entity applies the impairment requirements in IFRS 9 to its other interests in the associate or joint venture that are in the scope of IFRS 9 and that do not constitute part of the net investment.

[1] As noted in paragraph 38 of IAS 28, 'other interests' would be items such as trade receivables and secured loans—ie interests other than long-term interests (which in substance form part of the 'net investment').

Is the long-term interest within the scope of IFRS 9?

40. In accordance with paragraph 2.1(a) of IFRS 9 and paragraph 14 of IAS 28, in order for a long-term interest in an associate or joint venture to be outside the scope of IFRS 9 an entity would need to conclude that it is part of the interests in the associate or joint venture that are accounted for using the equity method.

41. In order to determine whether the long-term interest should be considered to be part of the interests in the associate or joint venture that are accounted for using the equity method, we refer to paragraph 38 of IAS 28. This paragraph highlights that there are two distinct elements to an interest in an associate or joint venture, which together make up the 'net investment' in the associate or joint venture: ie, the carrying amount of the investment determined using the equity method together with any long-term interests that in substance form part of the 'net investment'.

42. We note that only the first element, the carrying amount of the investment, is described as being determined using the equity method, whereas the Standard is silent on the accounting for the second element, the long-term interests. We think that this implies that the long-term interests, while considered to be part of the overall 'net investment' in the associate or joint venture, are not subject to the equity method.

43. This is also consistent with the definition of the equity method set out in paragraph 3 of IAS 28, which refers to the equity method within the context of the 'investment' in the associate or joint venture rather than the 'net investment'.

44. On the basis of the analysis above, we are of the view that while the long-term interests form part the 'net investment' in an associate or joint venture, they are nevertheless distinct from the investment in the associate or joint venture and should not be accounted for using the equity method.

45. Consequently, we do not think that the long-term interest is part of the interests in the associate or joint venture that are accounted for using the equity method. Therefore, we think that the scope exemption set out in paragraph 2.1(a) of IFRS 9 does not apply and that the long-term interest is, prima facie within the scope of IFRS 9.

46. However, because long-term interests are specifically referenced in IAS 28, we also think it is necessary to consider whether and to what extent the requirements of that Standard also apply.

What are the implications of IAS 28's specific reference to long-term interests?

47. As noted above, paragraph 38 of IAS 28 specifically refers to long-term interests such as long-term receivables or preference shares and distinguishes them from 'other interests' such as trade receivables or secured loans. It goes on to note that long-term interests are considered to form part of the 'net investment' in the associate or joint venture for the purposes of allocating an entity's share of losses of an associate or joint venture. Consequently, we consider that long-term interests are within the scope of IAS 28 within the context of the allocation of losses.

48. After the allocation of losses in accordance with paragraph 38 of IAS 28, we note that an entity must then apply the impairment requirements of IAS 28.

49. The requirements relating to impairment losses for associates and joint ventures are set out in paragraphs 40-43 of IAS 28. We note that there are two distinct sets of requirements within these paragraphs:

(a) paragraphs 40 and 41A-43 of IAS 28 contain the impairment requirements pertaining to the 'net investment' in the associate or joint venture; and

(b) paragraph 41 of IAS 28 contains the impairment requirements pertaining to 'other interests' in the associate or joint venture that are within the scope of IFRS 9 and that do not constitute part of the 'net investment'.

50. These requirements are further analysed below.

Requirements pertaining to the 'net investment'

51. Paragraph 40 of IAS 28 requires that after application of the equity method (including applying the provisions of paragraph 38 of IAS 28) an entity must determine whether there is objective evidence that its 'net investment' in the associate or joint venture is impaired, by using the impairment indicators set out in paragraphs 41A-41C of IAS 28.

52. Where it is identified that there is objective evidence that the 'net investment' is impaired, paragraph 42 of IAS 28 states that the 'entire carrying amount of the investment' should then be tested for impairment in accordance with IAS 36 as a single asset.

53. Because paragraph 38 of IAS 28 has already noted that long-term interests are considered to form part of the 'net investment' in the associate or joint venture, it then follows that these long-term interests should also form part of the 'net investment', which is required to be assessed for objective evidence of impairment in accordance with paragraph 40 of IAS 28.

54. Furthermore, we consider that the reference to the 'entire carrying amount of the investment' in paragraph 42 of IAS 28 should to taken to mean the entire carrying amount of the 'net investment' on the basis that:

    (a) the 'net investment' is the item that paragraph 40 of IAS 28 requires to be assessed for objective evidence impairment in accordance with paragraphs 41A-41C of IAS 28; and

    (b) paragraph 42 of IAS 28 goes on to explain different methods of calculating the value in use of the 'net investment' where there is evidence that the 'net investment' is impaired.

55. We note that before IFRS 9 was issued, IAS 28 required an entity to apply the requirements of IAS 39 in determining whether the 'net investment' was impaired. IFRS 9 amended IAS 28 by removing the cross-reference to IAS 39 and instead listing indicators of impairment in the main text of the Standard (paragraphs 41A-41C of IAS 28). These indicators are largely the same as the incurred loss impairment indicators that were previously contained in paragraphs 59-61 of IAS 39 (this guidance is reproduced in Appendix B) and consequently, we do not consider that the guidance has been changed as a result of the consequential amendment to IAS 28.

Requirements pertaining to the 'other interests'

56. Paragraph 41 of IAS 28 sets out the impairment requirements in respect of 'other interests' in the associate or joint venture that are in the scope of IFRS 9 but that do not constitute part of the 'net investment'.

57. As noted in paragraph 39(b), 'other interests' in the associate of joint venture that do not constitute part of the net investment could be trade receivables or secured loans.

58. Having analysed the impairment requirements of IAS 28 as set out above, we consider that:

    (a) for interests that form part of the 'net investment', ie long-term interests, an entity should apply the impairment requirements pertaining to the 'net investment' as set out in paragraphs 40 and 41A-43 of IAS 28 instead of the requirements of IFRS 9; and

    (b) for 'other interests' that do not form part of the 'net investment' an entity should apply the impairment requirements set out in paragraph 41 of IAS 28—ie the requirements of IFRS 9.

Conclusion

59. Based on the analysis set out in paragraphs 40-58, we are of the view that the accounting for long-term interests is governed by a combination of IFRS 9 and IAS 28. Specifically, we consider that long-term interests are:

    (a) within the scope of IFRS 9 for the purposes of classification and measurement (excluding impairment); and

    (b) within the scope of IAS 28 for the purposes of the allocation of losses in accordance with paragraph 38 of IAS 28 and also for the impairment requirements pertaining to the 'net investment' set out in paragraphs 40 and 41A-43 of IAS 28.

60. We acknowledge that IFRS 9 does not specifically exclude long-term interests from the scope of the impairment requirements. However, we consider that the more specific requirements within IAS 28 pertaining to the impairment of the 'net investment' (which in accordance with paragraph 38 of IAS 28 includes long-term interests) should take precedence. Furthermore, we do not consider that long-term

interests should be within the scope of two different sets of impairment requirements.

Assessment against the Interpretations Committee's agenda criteria

61. We have assessed this issue against the agenda criteria of the current *Due Process Handbook*:

Paragraph 5.16 states that the Interpretations Committee should address issues:	Agenda criteria satisfied?
that have widespread effect and have, or are expected to have, a material effect on those affected;	Many respondents had observed this issue and confirmed that views on the appropriate treatment were divergent.
where financial reporting would be improved through the elimination, or reduction, of diverse reporting methods; and	Diverse views were presented and consequently financial reporting would be improved if this issue were clarified. However, we consider that there is sufficient guidance in existing IFRSs for us to conclude that this could be done by way of an agenda decision that sets out the staff analysis.
that can be resolved efficiently within the confines of existing IFRSs and the *Conceptual Framework for Financial Reporting*.	See above—could be resolved by way of an agenda decision.

Paragraph 5.16 states that the Interpretations Committee should address issues:	Agenda criteria satisfied?
In addition:	
Can the Interpretations Committee address this issue in an efficient manner (paragraph 5.17)?	See above—could be resolved by way of an agenda decision.
The solution developed should be effective for a reasonable time period. (paragraph 5.21)	See above—could be resolved by way of an agenda decision.

Staff recommendation

62. We acknowledge that the results of the outreach indicate that there are divergent views regarding the interaction of IFRS 9 and IAS 28 within the context of accounting for long-term investments.

63. However, as set out in the staff analysis, we think that the appropriate accounting treatment can be deduced from existing IFRSs without the need for further guidance. Consequently, we think that the Interpretations Committee's agenda criteria are not met.

64. Consequently, we recommend that the Interpretations Committee should not take this issue onto its agenda.

Questions for the Interpretations Committee

Questions for the Interpretations Committee
1. Does the Interpretations Committee agree with the staff's recommendation as set out in paragraphs 62-64? 2. Does the Interpretations Committee agree with the proposed wording for the tentative agenda decision set out in Appendix A?

Appendix A—Proposed wording for tentative agenda decision

A1. We propose the following wording for the tentative agenda decision:

Impairment of long-term interests in associates and joint ventures

The IFRS Interpretations Committee ('the Interpretations Committee') received a request related to the interaction between IFRS 9 *Financial Instruments* (2014) and IAS 28 *Investments in Associates and Joint Ventures* (2011).

The issue relates to whether the measurement, in particular relating to impairment, of long-term interests in associates and joint ventures that in substance form part of the 'net investment' in the associate or joint venture should be governed by IFRS 9, IAS 28 or a combination of both.

For the purposes of the analysis, the Interpretations Committee considered a long-term interest that is an interest-bearing loan that would meet the criteria for classification as amortised cost in accordance with paragraph 4.1.2 of IFRS 9.

The Interpretations Committee observed that the accounting for such a long-term interest should be governed by a combination of IFRS 9 and IAS 28. Specifically, they considered that the long-term interest is:

- within the scope of IFRS 9 for the purposes of classification and measurement (excluding impairment); and
- within the scope of IAS 28 for the purposes of the allocation of losses in accordance with paragraph 38 of IAS 28 and also for the purposes of the impairment requirements pertaining to the 'net investment' set out in paragraphs 40 and 41A-43 of IAS 28.

In drawing this conclusion, the Interpretations Committee noted the following:

- in accordance with paragraph 2.1(a) of IFRS 9 and paragraph 14 of IAS 28, in order for the long-term interest to be outside the scope of IFRS 9, it would have to be considered part of the interests in the associate or joint venture that are accounted for using the equity method;
- paragraph 38 of IAS 28 distinguishes between two elements of an interest in an associate or joint venture (namely the carrying amount of the investment together with any long-term interests that in substance form part of the 'net investment' in the associate or joint venture) and notes that only the first element, the carrying amount of the investment, is described as being determined using the equity method;
- paragraph 38 of IAS 28 makes an explicit reference to long-term interests, stating that they should be considered to form part of the 'net investment' in the associate or joint venture for the purposes of the allocation of losses; and
- paragraphs 40 and 41A-43 of IAS 28 contain specific requirements pertaining to the impairment of the 'net investment' in the associate of joint venture

The Interpretations Committee noted that while IFRS 9 does not specifically exclude long-term interests from the scope of the impairment requirements, they are specifically included within the scope of IAS 28 by virtue of paragraph 38 of IAS 28.

The Interpretations Committee acknowledged that the feedback received from the outreach indicated that there were divergent views on how to account for impairment of long-term interests. However, the Interpretations Committee considered that in the light of its analysis of the existing IFRS requirements, an amendment to IFRS 9 or an interpretation was not necessary and consequently [decided] not to add the issue to its agenda.

Appendix B—Additional Extracts from IFRSs

A2. Additional extracts from IAS 28 and IAS 39

IAS 28: Investments in Associates and Joint Ventures (2011)

Impairment losses

40 After application of the equity method, including recognising the associate's or joint venture's losses in accordance with paragraph 38, the entity applies paragraphs 41A–41C to determine whether there is any objective evidence that its net investment in the associate or joint venture is impaired.

41 The entity applies the impairment requirements in IFRS 9 to its other interests in the associate or joint venture that are in the scope of IFRS 9 and that do not constitute part of the net investment.

41A The net investment in an associate or joint venture is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the net investment (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows from the net investment that can be reliably estimated. It may not be possible to identify a single, discrete event that caused the impairment. Rather the combined effect of several events may have caused the impairment. Losses expected as a result of future events, no matter how likely, are not recognised. Objective evidence that the net investment is impaired includes observable data that

comes to the attention of the entity about the following loss events:

(a) significant financial difficulty of the associate or joint venture;

(b) a breach of contract, such as a default or delinquency in payments by the associate or joint venture;

(c) the entity, for economic or legal reasons relating to its associate's or joint venture's financial difficulty, granting to the associate or joint venture a concession that the entity would not otherwise consider;

(d) it becoming probable that the associate or joint venture will enter bankruptcy or other financial reorganisation; or

(e) the disappearance of an active market for the net investment because of financial difficulties of the associate or joint venture.

41B The disappearance of an active market because the associate's or joint venture's equity or financial instruments are no longer publicly traded is not evidence of impairment. A downgrade of an associate's or joint venture's credit rating or a decline in the fair value of the associate or joint venture, is not of itself, evidence of impairment, although it may be evidence of impairment when considered with other available information.

41C In addition to the types of events in paragraph 41A, objective evidence of impairment for the net investment in the equity instruments of the associate or joint venture includes information about significant changes with an adverse effect that have taken place in the technological,

market, economic or legal environment in which the associate or joint venture operates, and indicates that the cost of the investment in the equity instrument may not be recovered. A significant or prolonged decline in the fair value of an investment in an equity instrument below its cost is also objective evidence of impairment.

42 Because goodwill that forms part of the carrying amount of the net investment in an associate or a joint venture 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 for impairment in accordance with IAS 36 as a single asset, by comparing its recoverable amount (higher of value in use and fair value less costs to sell) with its carrying amount whenever application of paragraphs 41A–41C indicates that the net investment may be impaired. An impairment loss recognised in those circumstances is not allocated to any asset, including goodwill, that forms part of the carrying amount of the net investment in the associate or joint venture. Accordingly, any reversal of that impairment loss is recognised in accordance with IAS 36 to the extent that the recoverable amount of the net investment subsequently increases. In determining the value in use of the net investment, an entity estimates:

(a) its share of the present value of the estimated future cash flows expected to be generated by the associate or joint venture, including the cash flows from the operations

of the associate or joint venture and the proceeds from the ultimate disposal of the investment; or

(b) the present value of the estimated future cash flows expected to arise from dividends to be received from the investment and from its ultimate disposal.

Using appropriate assumptions, both methods give the same result.

43 The recoverable amount of an investment in an associate or a joint venture shall be assessed for each associate or joint venture, unless the associate or joint venture does not generate cash inflows from continuing use that are largely independent of those from other assets of the entity.

IAS 39: Financial Instruments - Recognition and Measurement (2013)

59 A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. It may not be possible to identify a single, discrete event that caused the impairment. Rather the combined effect of several events may have caused the impairment. Losses expected as a result of future events, no matter how likely, are not recognised. Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the

attention of the holder of the asset about the following loss events:

(a) significant financial difficulty of the issuer or obligor;

(b) a breach of contract, such as a default or delinquency in interest or principal payments;

(c) the lender, for economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider;

(d) it becoming probable that the borrower will enter bankruptcy or other financial reorganisation;

(e) the disappearance of an active market for that financial asset because of financial difficulties; or

(f) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including:

(i) adverse changes in the payment status of borrowers in the group (eg an increased number of delayed payments or an increased number of credit card borrowers who have reached their credit limit and are paying the minimum monthly amount); or

(ii) national or local economic conditions that correlate with defaults on the assets in the group (eg an increase in the unemployment rate in the geographical area of the borrowers, a decrease in property prices for mortgages in

the relevant area, a decrease in oil prices for loan assets to oil producers, or adverse changes in industry conditions that affect the borrowers in the group).

60 The disappearance of an active market because an entity's financial instruments are no longer publicly traded is not evidence of impairment. A downgrade of an entity's credit rating is not, of itself, evidence of impairment, although it may be evidence of impairment when considered with other available information. A decline in the fair value of a financial asset below its cost or amortised cost is not necessarily evidence of impairment (for example, a decline in the fair value of an investment in a debt instrument that results from an increase in the risk-free interest rate).

61 In addition to the types of events in paragraph 59, objective evidence of impairment for an investment in an equity instrument includes information about significant changes with an adverse effect that have taken place in the technological, market, economic or legal environment in which the issuer operates, and indicates that the cost of the investment in the equity instrument may not be recovered. A significant or prolonged decline in the fair value of an investment in an equity instrument below its cost is also objective evidence of impairment.

Appendix C—Original submission received

A3. We reproduce below the submission that we received. We have deleted details that would identify the submitter of this request.

Potential Interpretations Committee Agenda Item Request

This letter describes an issue that we believe should be added to the agenda of the IFRS Interpretations Committee, potentially as an annual improvement clarification. We have included a summary of the issue, alternative views and an assessment of the issue against the Interpretations Committee criteria.

The issue

Following the application of IFRS 9 (2014), will the measurement (including impairment) of long-term interests' in associates and joint ventures be governed by IFRS 9, IAS 28 or both?

In this context, a long-term interest is a loan or other debt instrument that in substance forms part of the net investment in an associate or joint venture — e.g. an interest-bearing long-term loan with no fixed repayment terms for which settlement is neither planned nor likely to occur in the foreseeable future. Long-term interests exclude trade receivables, trade payables and any long-term receivables for which adequate collateral exists — e.g. secured loans.

Long-term interests are mentioned in IAS 28.38 in the context of allocating an entity's share of losses of an associate after the investment in ordinary shares has been reduced to nil. IAS 28.42 requires the 'entire carrying amount of the investment' to be tested for impairment in accordance with IAS 36 as a single asset. 'Entire carrying amount of the investment' is not defined anywhere so it is not clear whether this includes any long-term interests.

Long-term interests meet the definition of financial instruments because they represent a contractual right to receive cash or another financial asset for the holder and a contractual obligation to deliver cash or another financial asset for the issuer, even though there may be no explicit repayment terms.

The scope exemption in IFRS 9 refers to interests in associates and joint ventures that are accounted for under IAS 28 (IFRS 9.2.1(a)). It is not clear what is meant by 'interests in associates and joint ventures' and whether it includes long-term interests that in substance form part of the net investment in the associate or joint venture. It is also not clear whether 'accounted for' in this context is referring to the equity method in IAS 28 or also to the impairment requirements in IAS 28 (which incidentally fall under the general heading 'Application of the equity method').

This brings into question the interaction between IFRS 9 and IAS 28 for these long-term interests and which standard's requirements apply, particularly in relation to impairment.

Current practice

We believe that there is currently diversity in practice under IAS 39 in analysing whether and to what extent the measurement of these long-term interests is governed by IAS 28 or IAS 39, but that this has not been perceived as a significant issue because of the similarity between the impairment models in IAS 28 and IAS 39. However, the impact of this question is likely to be larger when 1FRS 9 (2014) is applied because of its new expected credit loss impairment model. We believe that the Interpretations Committee should consider the issue because the potential outcomes (measurement under IAS 28/IAS 36 vs measurement under IFRS 9) could have a significant effect on financial statements, and consistency in this area is desirable.

Here we outline different interpretations of which we are aware.

View 1a: Entirely in the scope of IFRS 9 (subject to an IAS 28.38 overlay)

Proponents of this view believe that these long-term interests do not fall under the scope exclusion from 'FRS 9 and that the scope exclusion applies only to the investment in ordinary shares that is equity accounted. The measurement requirements in IFRS 9 are overruled only by the requirement in lAS 28.38 to recognise an equity-accounted investee's losses against the investor's other long-term interests that in substance form part of the investment. However, the long-term interests are financial instruments and remain entirely in the scope of FRS 9. Under this approach, the classification, measurement and impairment would be based on IFRS 9.

The long-term interest would not be equity accounted because it does not represent an investment in ordinary shares (ownership interest). IAS 28.38 distinguishes investments in an associate

determined using the equity method from long-term interests that in substance form part of the net investment in the associate.

View 1b: Entirely in the scope of IFRS 9 but subject to an IAS 28.38 overlay and also in scope of IAS 28/36 for impairment

This view is identical to View la except that the impairment model under IFRS 9 is first applied to the loan and then it is further tested under IAS 36 to comply with the requirement of IAS 28.41that the entire carrying amount of the investment be tested for impairment under IAS 36. The impairment calculations under the different standards provide different results.

View 2: Entirely in the scope of IAS 28

Due to the wording in IAS 28.38 that a long-term interest is, in substance, an extension of an entity's investment in an associate, it would be accounted for in the same way as the investment in the associate i.e. equity accounted and subject to impairment requirements under IAS 28/IAS36.

View 3: In the scope of IFRS 9 for classification and measurement purposes but excluded from the scope of IFRS 9's impairment requirements (subject to an IAS 28.38 overlay)

Before IFRS 9 (2014), IAS 28.40 referred to IAS 39 to determine if it was necessary to recognise any additional impairment loss with respect to a net investment in the associate, and IAS 28.42 specifically required IAS 36 to be applied for measuring the impairment on the entire carrying amount of the investment. IFRS 9 (2014) then made consequential amendments to IAS 28.40 such that the determination of whether there is any objective evidence of impairment is made under IAS 28.41A—C and there is no reference to IFRS 9. IAS 28.41A refers to impairment indicators of a net investment in an associate, mentions incurred losses and specifically says that losses expected as a result of future events, no matter how likely, are not recognised. These impairment indicators are more aligned with an incurred loss model and are inconsistent with IFRS 9's expected loss model. Proponents of this view therefore believe that the impairment methodology/calculation for the entire net investment should therefore be under IAS 36 and not IFRS 9.

IAS 28.41C specifically uses the term 'net investment in the equity instruments of the associate or joint venture' when referring to such instruments alone; this implies that the term 'net investment in an associate' in IAS 28.41A has a wider meaning that includes the long-term interests.

It follows that the 'entire carrying amount of the investment' that is tested for impairment under IAS 36 per IAS 28.42 would include the long-term interests forming part of the net investment.

Therefore, only one standard — i.e. IAS 36 — would apply for impairment. This is supported by IAS 28.BCZ46, in which the Board states that an impairment loss on an investment in an associate is recognised in accordance with IAS 36, rather than in accordance with IAS 39.

IAS 28 does not otherwise address the classification of the long-term interest or initial and subsequent measurement of the long-term interest. The scope of 'FRS 9 only excludes interests in associates that are accounted for under IAS 28. Proponents of this view believe that the long-term interest should be accounted for under IAS 28 only when allocating the investor's share of losses in an associate and when calculating impairment. Other aspects of accounting for the long-term interest therefore follows IFRS 9.

Under this view the long-term interest would be classified and measured under IFRS 9, except that IFRS 9's impairment requirements will not apply. The measurement basis depends on the measurement category under IFRS 9. If the long-term interest is subsequently measured at amortised cost, then interest will continue to be recognised using the effective interest method.

Reasons for the Interpretations Committee to address the issues

a) Is the issue widespread and practical? Yes. We believe that interest-bearing long-term loans to associates with no fixed repayment terms for which settlement is neither planned nor likely to occur in the foreseeable future are common in many group structures.

b) Does the issue involve significantly divergent interpretations? Yes. Depending on the interpretation applied, the decision on how to account for the long-term interest could have a significant effect on an entity's financial statements.

c) Would financial reporting be improved through elimination of the diversity? Yes. The comparability of financial statements would be improved if entities applied the same financial reporting standards to account for the long-term interests.

d) Is the issue sufficiently narrow? Yes. It is concerned with specific concepts in IAS 28.

e) If the issue relates to a current or planned IASB project, is there a pressing need for guidance sooner than would be expected from the IASB project? The issue does not relate to a current or planned IASB project.

Appendix A

Illustrative example: Entity Y early adopts IFRS 9 (2014). Entity Y has a 25% holding in the ordinary equity shares of Entity X, an associate, which is accounted for under the equity method in Y's consolidated financial statements. The carrying amount of this investment is CU150,000 at the reporting date. Entity Y also granted a 5% interest-bearing loan of CU100,000 to Entity X three years ago. The loan has a stated original maturity of twenty years and may be extended for further periods of ten years by mutual agreement. Settlement of the loan is neither planned nor likely to occur in the foreseeable future. The gross carrying amount of the loan is CU100,000 and the effective interest rate is 5% a year.

Note: this example considers only the impairment of the loan.

Scenario 1: If Entity Y applies the indicators in IAS 28.41A—C, then there is no objective evidence that its net investment in the associate is impaired.

If the loan is accounted for under IFRS 9 for impairment purposes, then Entity Y assesses that there has not been a significant increase in credit risk since initial recognition. The loss allowance, based on 12-month expected credit losses, is CU500.

Scenario 2: If Entity Y applies the indicators in 1AS 28.41A—C, then there is no objective evidence that its net investment in the associate is impaired.

If the loan is accounted for under IFRS 9 for impairment purposes, then Entity Y assesses that there has been a significant increase in credit risk since initial recognition. There is a significant increase in the risk of default occurring over the expected life of the loan, although no loss events or missed payments have occurred. The loss allowance, based on lifetime expected credit losses, is CU15,000.

The following table illustrates the impairment loss on the loan under the alternative views for each scenario.

	View 1a	View 1b	View 2	View 3
Scenario 1	CU500	CU500	CU0	CU0
Scenario 2	CU15,000	CU15,000	CU0	CU0