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STAFF PAPER

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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 6937

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Introduction

1. At its meetings in September and November 2015, the IFRS Interpretations Committee ('the Interpretations Committee') discussed an issue relating to the interaction between IFRS 9 *Financial Instruments* and IAS 28 *Investments in Associates and Joint Ventures*. Specifically, the issue relates to whether an entity applies IFRS 9, IAS 28 or a combination of both Standards in measuring long-term interests in an associate or a joint venture that, in substance, form part of the 'net investment' in the associate or joint venture, but to which the equity method is not applied (hereafter, referred to as 'long-term interests'). The question relates mainly to impairment.

2. At those meetings, the Interpretations Committee discussed various ways in which the requirements could be interpreted, noting the following:

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

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

(c) in the view of the Interpretations Committee members, the scope exception in paragraph 2.1(a) of IFRS 9 regarding interests in associates and joint ventures is not clear in this respect.

Consequently, depending on which alternative interpretation it chose to pursue, the Interpretations Committee concluded that an amendment to IFRS Standards may be required to clarify the issue.

3. However, after discussing the issue at those meetings, the Interpretations Committee did not reach a consensus on which alternative to propose as an amendment. Consequently, the Interpretations Committee decided to consult the International Accounting Standards Board ('the Board') about whether the scope exception in paragraph 2.1(a) of IFRS 9 is intended to apply to such long-term interests.

4. The Board discussed the issue at its meetings in December 2015 and February 2016. The Board specifically considered the following with respect to the issue:

(a) whether the scope exception in paragraph 2.1(a) of IFRS 9 applies to long-term interests in an associate or a joint venture; and

(b) if such long-term interests are not excluded from the scope of IFRS 9, how the requirements in IFRS 9 and IAS 28 interact.

5. At its meeting in February 2016, the Board agreed with the staff analysis of the accounting for long-term interests when applying IFRS Standards, as described in paragraph 63 of this paper.

6. Subsequently, the Interpretations Committee discussed the issue at its March 2016 meeting. During the discussion, the Interpretations Committee raised some further questions about the accounting for long-term interests, specifically relating to the interaction between the measurement requirements in IFRS 9 and the loss allocation and impairment requirements in IAS 28.

7. The purpose of this paper is to analyse the issue, focussing in particular on the concerns raised at the March 2016 Interpretations Committee's meeting.

8. Since the March 2016 Interpretations Committee's meeting, we received an unsolicited comment letter, which is attached as Appendix C to this paper.

Structure of this paper

9. The paper is structured as follows:

   (a) background;

   (b) staff analysis;

   (c) assessment against the Interpretations Committee's agenda criteria;

   (d) staff conclusion and recommendation;

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

   (f) Appendix B—Example illustrating the accounting for long-term interests applying View B; and

   (g) Appendix C—Unsolicited comment letter received after the March 2016 Interpretations Committee's meeting.

Background

Issue raised

10. 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 further explains this scope exception as follows:

> IFRS 9 *Financial Instruments* does not apply to interests in associates and joint ventures that are accounted for using the equity method. […]

11. Paragraph 38 of IAS 28 requires that when an entity allocates its share of losses of an associate or a joint venture to the carrying amount of its investment in that associate or joint venture, the entity should allocate such losses to both:

    (a) interests that it accounts for using the equity method; and

    (b) long-term interests that, in substance, form part of the net investment.

12. In this respect, paragraph 38 states the following (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. [….]

13. Paragraphs 40 and 41A–43 of IAS 28 then go on to explain that this net investment is subject to impairment testing. More precisely:

    (a) an entity is first required to assess whether there is any objective evidence that the net investment is impaired, by considering the indicators included in paragraphs 41A–41C of IAS 28. These indicators were largely transferred from IAS 39 *Financial Instruments: Recognition and Measurement* as part of the development of IFRS 9.

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

14. In the light of these requirements in IFRS 9 and IAS 28, the submitter asked whether paragraph 2.1(a) of IFRS 9 should be interpreted to exclude long-term interests from the scope of IFRS 9, in particular the impairment requirements of that Standard. In other words, the submitter asked whether an entity assesses long-term interests for impairment by applying only the requirements in IAS 28, only those in IFRS 9, or a combination of the requirements in both Standards.

15. The submitter is of the view that the requirements are unclear. The submitter observes that there is already diversity in practice applying IAS 39; however, this has not been perceived to be a significant issue because of the similarity of the impairment models in IAS 28/IAS 36 and IAS 39. With the introduction of an expected credit loss model in IFRS 9, the submitter thinks that the effects of the diversity are likely to be more significant.

Views identified

16. The submitter identified the following four views as to how to interpret the requirements:

(a) View A—long-term interests are entirely within the scope of IFRS 9 (and are subject to the loss allocation requirements in paragraph 38 of IAS 28);

(b) View B—long-term interests are entirely within the scope of IFRS 9 (and are subject to the loss allocation requirements in paragraph 38 of IAS 28). In addition, these interests are also subject to the impairment requirements in paragraphs 40 and 41A–43 of IAS 28;

(c) View C—long-term interests are entirely within the scope of IAS 28, and are not within the scope of IFRS 9; and

(d) View D—long-term interests are within the scope of IFRS 9 for classification and measurement purposes, excluding impairment (and are subject to the loss allocation requirements in paragraph 38 of IAS 28). In

addition, these interests are also subject to the impairment requirements in paragraphs 40 and 41A–43 of IAS 28.

Summary of feedback from outreach activities as reported in September 2015[1]

17. The feedback received from our outreach activities can be summarised as follows:

    (a) a majority of the respondents thought that the requirements are unclear and, thus, that some or all of the views provided by the submitter are possible;

    (b) opinions were varied regarding whether long-term interests form part of the carrying amount of the net investment in an associate or a joint venture for the purposes of impairment applying IAS 28; and

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

Staff analysis

18. This section is divided into the following sub-sections:

    (a) some background information about the development of relevant requirements in IAS 28 and IFRS 9;

    (b) a summary of the staff's analysis in support of View B based on existing requirements. This includes an explanation as to why we do not support Views A, C and D;

    (c) an illustration of the accounting for long-term interests applying View B; and

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[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 large accounting firms.

(d) the staff's views on concerns raised about the potential outcome of applying View B.

Background information about the development of relevant requirements in IAS 28 and IFRS 9

What types of interests are long-term interests?

19. IAS 28 refers to three types of financial interests that an investor might have in an associate or a joint venture, which we have categorised as follows:

    (a) Category 1—investments in the associate or joint venture that an entity accounts for using the equity method (ie those interests to which only IAS 28 applies);

    (b) Category 2—financial interests that do not form part of the net investment in the associate or joint venture (ie those interests to which only IFRS 9 applies); and

    (c) Category 3—financial interests that form part of the net investment but to which the equity method is not applied (ie what this paper and IAS 28 refers to as long-term interests). As described in paragraph 39 of this paper, we think that both IFRS 9 and IAS 28 apply to these long-term interests.

20. IAS 28 provides little information about the types of interests that are included within each category. Depending on the type of interest, an entity may need to apply more or less judgement in determining within which category the interest is included. For example, for investments in ordinary shares, it is likely to be relatively straight-forward to conclude that the equity method is applied, and thus that the investment is included in Category 1. Similarly, it is likely to be relatively straight-forward to conclude that trade receivables or loans with fixed repayment terms (such as a 10-year senior bond) are not part of the net investment in the associate or joint venture, and thus that those instruments are included in Category 2. However, determining those interests that are considered to be long-term interests, within Category 3, may require more judgement.

When were long-term interests introduced within IAS 28?

21. IAS 28 first referred to 'long-term interests' after the Board made amendments to IAS 28 in 2003—ie the Board created what is referred to in paragraph 19 of this paper as Category 3 interests in 2003 when it amended IAS 28. That amendment expanded the scope of interests subject to the allocation of losses and impairment requirements in IAS 28 to include long-term interests. In this regard, paragraphs BCZ39–40 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.

The issuance of IFRS 9

22. The Board did not change how the requirements in IAS 28 interact with the financial instruments requirements when it issued IFRS 9, ie the scope exception in IAS 39 relating to interests in associates and joint ventures was carried forward unchanged to IFRS 9.

23. In addition, we note that the expected credit loss impairment model in IFRS 9 is part of, and interlinked with, amortised cost accounting in IFRS 9. For example, how interest revenue is calculated depends on whether the related financial asset is credit-impaired. Consequently, we think that an entity could not apply amortised cost accounting in IFRS 9 without also applying the impairment requirements in that Standard.

Summary of staff analysis in support of View B based on existing requirements

24. Consistently with our position in previous papers, we think that the application of existing requirements results in View B. In this section, we summarise the analysis that we presented at the March 2016 meeting. We also explain why we think that Views A, C and D are inconsistent with existing requirements.

Summary of our rationale for View B[2]

25. On the basis of the wording of the requirements in IFRS 9 and IAS 28, we think that the requirements in IFRS 9, including those relating to impairment, apply to long-term interests in an associate or a joint venture to which the equity method is not applied. In other words, the scope exception in paragraph 2.1(a) of IFRS 9 does not apply to such long-term interests. This is because we think:

    (a) The scope exception in paragraph 2.1(a) of IFRS 9 applies only to interests in an associate or a joint venture that an entity accounts for using the equity method. In our view, this is consistent with the clarification provided in paragraph 14 of IAS 28, which states that 'IFRS 9 *Financial Instruments* does not apply to interests in associates and joint ventures that are accounted for using the equity method'.

    (b) Interests, described as 'long-term interests' in IAS 28, are not accounted for using the equity method. Although long-term interests are subject to one part of the equity method procedures (ie the allocation of losses), we do not consider this to mean that an entity accounts for such long-term interests using the equity method. This is because, as described in paragraphs 3 and 10 of IAS 28, applying the equity method involves much more than merely allocating losses. We think that this interpretation is consistent with the requirements in paragraph 38 of IAS 28 (reproduced in paragraph 12 of this paper). That paragraph explains that the interest in an

[2] Our full analysis can be found in Agenda Paper 15 for the March 2016 Interpretations Committee's meeting.

associate or a joint venture subject to the allocation of losses is the investment accounted for using the equity method *together with* long-term interests that form part of the net investment.

Why we think Views A, C and D are inconsistent with existing requirements

View A

26. View A is the same as View B, except that in applying View A long-term interests would not be subject to the impairment requirements in IAS 28.

27. Proponents of this view note that IAS 36, which IAS 28 requires an entity to apply in testing the net investment for impairment, does not contain any specific reference to the treatment of long-term interests for impairment purposes. In addition, proponents of this view think that it would seem contradictory for long-term interests to be within the scope of the impairment requirements in both IFRS 9 and IAS 28, especially when the impairment models are so different.

28. We think that View A is not consistent with the requirements in IAS 28, because paragraphs 40 and 41A–42 of IAS 28 refer to the 'net investment' for the purpose of the impairment requirements in IAS 28. Because paragraph 38 of IAS 28 states that long-term interests are considered to form part of the 'net investment' in the associate or joint venture for the purpose of allocating losses, we think that it then follows that those long-term interests also form part of the 'net investment' for the purpose of impairment testing.

View C

29. Applying View C, an entity accounts for long-term interests by applying only IAS 28. In other words, applying this view, none of the requirements in IFRS 9 would apply to such interests.

30. Proponents of this view argue that, when long-term interests are in substance part of the 'net investment', they are akin to an equity interest and it would, therefore,

be more appropriate to account for them in the same way as an equity investment in an associate (ie using the equity method).

31. We think that View C is not consistent with existing requirements. This is because, as discussed in paragraph 25 of this paper, we think that long-term interests are not excluded from the scope of IFRS 9.

32. Furthermore, paragraph 38 of IAS 28 (reproduced in paragraph 12) identifies 'long-term interests' separately from the 'investment in the associate or joint venture determined using the equity method'. As noted in paragraph 21 of this paper, the inclusion of long-term interests within the allocation of losses and impairment requirements in IAS 28 resulted from an amendment made in 2003. We think that, in making that amendment:

    (a) the Board intended to include long-term interests within the scope of IAS 28 only for the purpose of allocating losses and impairment; and

    (b) the Board did not intend that amendment to override or change the requirements that had always been applicable to such long-term interests (ie the requirements in IAS 32 and IAS 39 at that time).

View D

33. View D is the same as View B, except that in applying View D long-term interests would not be subject to the impairment requirements in IFRS 9. Accordingly, applying View D, an entity would account for long-term interests applying all of the requirements in IFRS 9, except those relating to impairment.

34. Proponents of this view think that 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 long-term interests would be challenging; for example, switching from 12-month to lifetime expected credit losses and the calculation of expected cash shortfalls when settlement of such long-term interests are not planned for the foreseeable future.

35. They also point out that paragraph 41 of IAS 28 refers to other interests in the associate or joint venture that are not part of the 'net investment', noting that those other interests are within the scope of IFRS 9 for the purposes of impairment. In their view, this implies that those interests that form part of the 'net investment' are not within the scope of IFRS 9 for impairment purposes.

36. We think that View D is not consistent with existing requirements. This is because, in our view:

    (a) the scope exception in paragraph 2.1(a) of IFRS 9[3] cannot be read to require an entity to apply only some of the measurement requirements in IFRS 9 to long-term interests, but not all. If that had been the Board's intention, then the Board would have had to state that explicitly within the requirements of IFRS 9 or IAS 28.

    (b) the Board's intentions in this respect are confirmed in how the measurement requirements relating to the amortised cost accounting in IFRS 9 interact with each other. As noted in paragraph 23 of this paper, the expected credit loss impairment model in IFRS 9 is part of, and interlinked with, amortised cost accounting in IFRS 9.

    (c) the impairment requirements in IFRS 9 and IAS 28 are not necessarily inconsistent. Applying View B, long-term interests are subject to two different methods of impairment testing. However, we note that this does not mean that the same asset is tested for impairment in two different ways. This is because the impairment requirements in each Standard apply to different units of account:

[3] Paragraph 2.1(a) of IFRS 9 states: '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*. […]'

(i) applying IFRS 9, the unit of account is the long-term interests; and

(ii) applying IAS 28, the unit of account is the 'net investment', of which any long-term interests are only a part.

Summary

37. On the basis of our analysis, we are of the view that View B is consistent with the existing requirements in IFRS Standards. Views A, C and D are inconsistent with those requirements.

38. The Board agreed with our analysis regarding View B at its February 2016 meeting.

Question 1 for the Interpretations Committee
1. Does the Interpretations Committee agree with the staff analysis that the existing requirements in IFRS Standards result in View B?

Illustration of the accounting for long-term interests applying View B

39. Applying View B, an entity would account for long-term interests in an associate or a joint venture as follows:

(a) the entity would account for the long-term interests applying IFRS 9, including the impairment requirements in IFRS 9;

(b) in allocating any losses of the associate or joint venture, the entity would include the carrying amount of those long-term interests (determined applying IFRS 9) as part of the net investment to which the losses are allocated; and

(c) the entity would then assess the net investment for impairment by applying the requirements in paragraphs 40 and 41A-43 of IAS 28.

40. If the entity allocates losses or recognises impairment applying IAS 28 as a result of steps (b) and (c) in paragraph 39, we think that the entity would ignore those losses or that impairment when it accounts for long-term interests applying

IFRS 9 in subsequent periods, including when recognising interest revenue on such interests.

41. The paragraphs that follow illustrate the accounting for long-term interests applying the steps described in paragraphs 39–40.[4] The main assumptions used for this purpose are as follows:

(a) Investor has the following types of interests in Associate:

(i) ordinary shares representing a 40 per cent ownership interest in Associate to which Investor applies the equity method (Equity Method interest);

(ii) preference shares that form part of the net investment in Associate and that are measured at fair value through profit or loss ('FVPL') applying IFRS 9 (Preference Share interest); and

(iii) a long-term loan that forms part of the net investment in Associate and that is measured at amortised cost applying IFRS 9 (Loan interest). The effective interest rate of the Loan interest is 5 per cent.

(b) The following table shows at the end of periods 2 and 3 the carrying amount of the Equity Method interest applying IAS 28, and the Preference Share and Loan interests applying IFRS 9 (but before applying IAS 28):

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[4] The illustration included in the main body of the paper covers only Period 3 of the example. Appendix B to this paper illustrates this example for Periods 1-6. Appendix B also includes a full list of assumptions made within the example.
We have not illustrated step (c) in paragraph 39—IAS 28 impairment—for two main reasons. First, we think that illustrating the allocation of losses to two types of long-term interests over a number of periods (when the associate has profits in some periods and losses in others) best addresses the concerns raised at the March 2016 Interpretations Committee's meeting and discussed in the next section of the paper. Second, we think that it would be rare (if ever) that an entity would recognise an IAS 28 impairment loss relating to long-term interests, especially if losses have been allocated to those long-term interests applying step (b) in paragraph 39 of this paper. If an entity recognises an IAS 28 impairment loss, then we think it would typically relate to the investment in the associate or joint venture accounted for using the equity method. We did not see any benefit in illustrating an IAS 28 impairment loss that relates to the investment accounted for using the equity method.

At the end of \ Carrying amount of interest	Equity Method applying IAS 28	Preference Share applying IFRS 9 (fair value)	Loan applying IFRS 9[5] (amortised cost)
Period 2	CU140	CU90	CU70
Period 3	-	CU50	CU50

(c) Associate's net loss during period 3 is CU500.

42. Applying the step in paragraph 39(a), Investor first measures the Preference Share and Loan interests applying IFRS 9. Consequently, in Period 3 it recognises the following:

DR. Profit or loss	CU40	
CR. Preference Share interest		CU40
To recognise the change in fair value (CU50-CU90)		
DR. Profit or loss	CU20	
CR. Loan loss allowance (Loan interest)		CU20
To recognise an increase in loan loss allowance of CU20		
DR. Interest receivable	CU5	
CR. Interest revenue		CU5
*To recognise interest revenue on Loan interest (CU100 gross carrying amount * 5% effective interest rate)*		

43. Applying the step in paragraph 39(b), Investor then allocates its share of Associate's losses in the order specified in paragraph 38 of IAS 28 (ie in the reverse order of seniority). Consequently, it recognises the following:

DR. Equity method loss	CU200	
CR. Equity Method interest		CU140
CR. Preference Share interest		CU50
CR. Loan interest		CU10
*To recognise Investor's share of Associate's losses (CU500 * 40%)*		

44. At the end of Period 3, the carrying amount of the net investment in Associate is CU40—after allocating losses, the Equity Method interest is zero, the Preference Share interest is zero and the Loan interest is CU40.

[5] These amounts are shown net of loan loss allowances.

Concerns raised about the potential outcome of applying View B

45. At its meeting in March 2016, Interpretations Committee members raised some concerns about the potential outcome of applying View B. Those concerns can be summarised as follows:

    (a) Double counting of losses—Does the application of both IFRS 9 and IAS 28 to long-term interests lead to double counting of losses?

    (b) Impairment—how does the expected credit loss model in IFRS 9 work for long-term interests with no planned settlement?

    (c) Presentation—how does an entity present different types of interests in an associate or a joint venture?

Does the application of both IFRS 9 and IAS 28 to long-term interests lead to double counting of losses?

46. Some Interpretations Committee members raised concerns about applying both the impairment requirements in IFRS 9 to long-term interests and the loss allocation and impairment requirements in IAS 28 to the net investment (which includes long-term interests). In particular, concerns were raised that the application of both sets of requirements would lead to the recognition of losses twice on the same asset. This is because some think that losses recognised by applying the expected credit loss impairment requirements in IFRS 9 already reflect future losses to be incurred by an associate. Some Interpretation Committee members also questioned whether it is appropriate to write down the carrying amount of long-term interests below their measurement applying IFRS 9, particularly if those instruments are measured at fair value. As illustrated in the example in paragraphs 41-43 of this paper, applying View B, it is possible that the carrying amount of long-term interests is written down below their measurement applying IFRS 9.

47. In our view, the application of View B does not result in the recognition of losses twice. The IFRS 9 impairment requirements and the loss allocation requirements in IAS 28 have different measurement objectives, which are independent of each

other. Applying the IFRS 9 impairment requirements, an entity measures expected cash shortfalls arising from a particular financial instrument. Those requirements focus only on expected cash flows associated with particular financial instruments. In contrast, the IAS 28 allocation of an associate or a joint venture's profit or loss focusses on the results of operations of the associate or joint venture during the relevant reporting period. The objective of an investor recognising its proportionate share of the associate or joint venture's profit or loss is not directly to adjust the carrying amount of the net investment to the amount expected to be recovered—instead, it is a means of the investor reflecting its interests in the operations of the associate or joint venture because of its 'special' relationship with the associate or joint venture (ie one of significant influence or joint control). The impairment requirements in IAS 28 could be viewed as having a similar objective to the impairment requirements in IFRS 9—nonetheless, as noted in paragraph 36(c) of this paper, those respective impairment requirements are applied to different units of account. Also, as previously mentioned, we think that, in applying the IAS 28 impairment requirements, it would be rare that an entity would recognise any impairment relating to long-term interests already measured applying IFRS 9.

48. Furthermore, even if there might be to some extent an overlap in the recognition of losses arising from the IFRS 9 impairment requirements and the loss allocation requirements in IAS 28, it would be very difficult, if not impossible, to separate the effects of losses from different sources and eliminate what might be viewed as 'overlapping' losses. We note that the potential overlap in the recognition of losses is not limited to long-term interests, but can apply equally to an interest in an associate or a joint venture that (a) does not form part of the net investment and (b) is measured at amortised cost applying IFRS 9 (ie a Category 2 interest measured at amortised cost as described in paragraph 19 of this paper). This is because such an interest is also subject to the expected credit loss impairment requirements in IFRS 9.

49. Having said that, we acknowledge the concern about the usefulness of the information that arises if the carrying amount of long-term interests is reduced

below their measurement applying IFRS 9. Again, using the example in paragraphs 41-43 of this paper, some may question whether it is useful to report a carrying amount for the Preference Share interest of CU0 at the end of Period 3 when the fair value of that interest on that date is CU50.

50. In our view, this concern is directly related to, and a consequence of, the amendment that the Board made to IAS 28 in 2003 regarding the allocation of losses and impairment (discussed in paragraph 21 of this paper). In addition, that same concern could be raised about the investment accounted for using the equity method. In the example in paragraphs 41-43 of this paper, the Equity Method investment has a carrying amount of CU0 at the end of Period 3. It may well be the case that, on that date, the 40 per cent interest in the ordinary shares of Associate has a value that is significantly greater than CU0, which is not reflected in the financial statements of Investor.

51. If the Board were to address these concerns (ie the potential double count of losses and the usefulness of information), then we think that the Board would need to amend IAS 28 so that long-term interests would be within the scope of either IFRS 9 or IAS 28, and not both. However, we think that any such amendment would not be a narrow-scope amendment:

    (a) If an amendment were made to IAS 28 so that long-term interests are only within the scope of IFRS 9, it would change the population of interests in an associate or a joint venture to which an entity allocates losses. This would effectively reverse the amendment that the Board made to IAS 28 in 2003.

    (b) If an amendment were made to IAS 28 so that long-term interests are only within the scope of IAS 28 (ie if an entity were to apply the equity method to long-term interests), it would change the population of financial instruments to which IFRS 9 applies.

52. Before proposing either of these amendments, we think that we would need to undertake research to determine whether either of the amendments would actually solve an identified problem, without creating new problems. There would also

appear to be strong links between this question and any research work being done on the equity method. Accordingly, we think that any consideration would need to be part of a research project and possibly linked to future research work on the equity method.

Impairment—how does the expected credit loss model in IFRS 9 work for long-term interests with no planned settlement?

53. Applying View B, long-term interests are subject to all of the requirements in IFRS 9, including its impairment requirements. Some have raised a concern about how to apply such impairment requirements to financial instruments whose settlement is neither planned nor likely to occur in the foreseeable future. We understand that this concern arises because of the possible difficulty in estimating expected cash shortfalls over the expected life of such financial instruments.

54. Nonetheless, we note that such a concern is not limited to long-term interests. This is because IFRS 9 envisages application of amortised cost accounting, including the impairment requirements in IFRS 9, to financial instruments that are similar in nature to such long-term interests.

55. Instrument H included in paragraph B4.1.13 of IFRS 9 is a perpetual instrument. That paragraph states that the fact that Instrument H is perpetual does not in itself mean that the contractual cash flows are not solely payments of principal and interest on the principal amount outstanding. In other words, this instrument may pass the condition relating to cash flow characteristics of financial instruments, as described in paragraph 4.1.2(b) of IFRS 9 ('SPPI test'). Consequently, it may be measured at amortised cost. If that is the case, then it becomes subject to the impairment requirements of IFRS 9.

56. We see a similarity between long-term interests and perpetual instruments, in that a holder of those instruments does not expect their settlement in the foreseeable future. In our view, the concern about the application of the impairment requirements in IFRS 9 to long-term interests applies equally to perpetual instruments. We think that it is not our objective within the context of this particular issue to consider how to apply the impairment requirements in IFRS 9

to particular types of financial instruments. Consequently, we think that the Interpretations Committee should not pursue this concern further as part of this issue.

57. It's worthwhile noting that, if long-term interests fail the SPPI test, this concern would not arise because those long-term interests would then be measured at FVPL.

Presentation—how does an entity present different types of interests in an associate or a joint venture?

58. With respect to the presentation of long-term interests, a concern was raised in particular when an entity allocates losses to such long-term interests and the entity recognises an impairment loss on the net investment in an associate. We understand that this concern arises because there are no presentation requirements that specifically address this situation.

59. In presenting and disclosing information about its interests in an associate or a joint venture, an entity applies the requirements in IFRS 7 *Financial Instruments: Disclosures,* IFRS 12 *Disclosure of Interests in Other Entities*, IAS 1 *Presentation of Financial Statements* and IAS 24 *Related Party Disclosures*. In addition, paragraph 38 of IAS 28 includes requirements on how to allocate losses to the different components of the net investment in an associate or a joint venture.

60. There are no specific requirements in IAS 28 on how to allocate impairment of the net investment to the different components of the net investment. We think that one way that an entity could do so is on the same basis as it allocates losses of the associate or joint venture as described in paragraph 38 of IAS 28 (ie in the reverse order of seniority).

61. We are not aware that the absence of IAS 28 impairment allocation requirements causes any particular issue in practice.

Assessment against the Interpretations Committee's agenda criteria

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

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;	**Yes.** Many respondents to the outreach confirmed that they have observed this issue and that there are differing views on the accounting treatment.
where financial reporting would be improved through the elimination, or reduction, of diverse reporting methods; and	**No.** Although there are differing views with respect to this issue, we think that the requirements in IFRS Standards provide an adequate basis to enable an entity to determine how to account for long-term interests in an associate or a joint venture.
that can be resolved efficiently within the confines of existing IFRS Standards and the *Conceptual Framework for Financial Reporting*.	Not applicable.
In addition:	
Can the Interpretations Committee address this issue in an efficient manner (paragraph 5.17)?	Not applicable.
The solution developed should be effective for a reasonable time period. (paragraph 5.21)	Not applicable.

Staff conclusion and recommendation

63. Applying the existing requirements in IFRS Standards, a summary of our analysis is as follows:

    (a) the scope exception in paragraph 2.1(a) of IFRS 9 does not apply to long-term interests, because:

        (i) the scope exception in that paragraph applies only to interests in an associate or a joint venture that an entity accounts for using the equity method; and

        (ii) long-term interests are not accounted for using the equity method.

    (b) an entity accounts for long-term interests as follows:

        (i) the entity accounts for long-term interests applying the requirements in IFRS 9, including the impairment requirements in IFRS 9;

        (ii) in allocating any losses of the associate or joint venture, the entity includes the carrying amount of those long-term interests (determined applying IFRS 9) as part of the net investment to which the losses are allocated;

        (iii) the entity then assesses the net investment for impairment applying the requirements in paragraphs 40 and 41A-43 of IAS 28; and

        (iv) if an entity allocates losses or recognises impairment applying steps (ii) and (iii) above, the entity ignores those losses or that impairment when it accounts for long-term interests applying IFRS 9 in subsequent periods, including when recognising any interest revenue on such interests applying IFRS 9.

64. We think that the requirements in IFRS Standards provide an adequate basis to enable an entity to determine how to account for long-term interests in an associate or a joint venture. Accordingly, we do not think that an amendment to IFRS Standards is required to answer the question raised in the submission.

65. As discussed in paragraphs 45–61, we acknowledge concerns about the potential outcome of applying the steps set out in paragraph 63(b) of this paper. However,

before considering any amendment to IAS 28 to address those concerns, we think that further research would be required to identify whether such an amendment would solve an identified problem, without creating new problems. We think that any consideration would need to be part of a research project and possibly linked to future research work on the equity method.

66. We also acknowledge that, in discussing this issue, some may be of the view that it is not straight-forward to piece together how the requirements in IAS 28 and IFRS 9 interact with respect to long-term interests. We think that issuing an agenda decision will provide clarity in this respect and is the best way to communicate how existing requirements interact together.

67. Consequently, we recommend that the Interpretations Committee should not add the issue to its agenda. The proposed wording for the tentative agenda decision is set out in Appendix A to this paper.

Questions 2–3 for the Interpretations Committee

2. Does the Interpretations Committee agree with the staff analysis and recommendation as summarised in paragraphs 63-67 of this paper?
3. Does the Interpretations Committee have any comments on the proposed wording of the tentative agenda decision set out in Appendix A to this paper?

Appendix A—Proposed wording for tentative agenda decision

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

IFRS 9 *Financial Instruments* and IAS 28 *Investments in Associates and Joint Ventures*—Measurement of long-term interests

The Interpretations Committee received a request relating to the interaction between IFRS 9 *Financial Instruments* and IAS 28 *Investments in Associates and Joint Ventures*. Specifically, the issue relates to whether an entity applies IFRS 9, IAS 28 or a combination of both Standards to the measurement of long-term interests in an associate or a joint venture that, in substance, form part of the ‘net investment’ in the associate or joint venture, but to which the equity method is not applied (‘long-term interests’).

The Interpretations Committee observed that:

(a) paragraph 14 of IAS 28 clarifies that the scope exception in paragraph 2.1(a) of IFRS 9 applies only to interests in an associate or a joint venture that an entity accounts for using the equity method; and

(b) long-term interests are not accounted for using the equity method. This is because:

  (i) paragraph 38 of IAS 28 distinguishes between the investment in an associate or a joint venture determined using the equity method and any long-term interests that, in substance, form part of the entity’s net investment in the associate or joint venture; and

  (ii) long-term interests are subject to only one part of the equity method procedures (ie the allocation of losses).

Consequently, the Interpretations Committee concluded that the scope exception in paragraph 2.1(a) of IFRS 9 does not apply to long-term interests.

The Interpretations Committee, therefore, observed the following:

(a) the entity accounts for long-term interests applying IFRS 9, including the

impairment requirements in IFRS 9;

(b) in allocating any losses of the associate or joint venture applying the requirements in paragraph 38 of IAS 28, the entity includes the carrying amount of those long-term interests (determined applying IFRS 9) as part of the net investment to which the losses are allocated;

(c) the entity then assesses for impairment the net investment in the associate or joint venture (of which the long-term interests are a part) by applying the requirements in paragraphs 40 and 41A-43 of IAS 28; and

(d) if an entity allocates losses or recognises impairment applying steps (b) and (c) above, the entity ignores those losses or that impairment when it accounts for long-term interests applying IFRS 9 in subsequent periods.

In the light of the existing requirements in IFRS Standards, the Interpretations Committee determined that neither an Interpretation nor an amendment to a Standard was necessary. Consequently, the Interpretations Committee [decided] not to add this issue to its agenda.

Appendix B—Example illustrating the accounting for long-term interests applying View B

B1. The assumptions used for the example are as follows:

(a) Investor has following types of interests in Associate:

(i) ordinary shares representing a 40 per cent ownership interest to which Investor applies the equity method (Equity Method interest);

(ii) preference shares that form part of the net investment in Associate and that are measured at FVPL applying IFRS 9 (Preference Share interest); and

(iii) a long-term loan that forms part of the net investment in Associate and that is measured at amortised cost applying IFRS 9 (Loan interest). The effective interest rate of the Loan interest is 5 per cent.

(b) For simplicity, throughout the illustrated periods, there has not been any objective evidence that the net investment in the associate is impaired applying IAS 28, nor a significant increase in credit risk associated with the Loan interest.

(c) The amount of initial investment in the Equity Method, Preference Share and Loan interests are CU200, CU100 and CU100, respectively.

(d) Investor does not have any legal or constructive obligation nor has it made payments on behalf of Associate, as described in paragraph 39 of IAS 28. Consequently, Investor stops recognising its share of losses once the carrying amount of its net investment in Associate is reduced to zero.

(e) The following table shows Associate's net income/(loss) for each period and the carrying amount at the end of each period for the Preference Share and Loan interests applying IFRS 9 (but before applying IAS 28):

At the end of / Carrying amount of interest	Net Income/(Loss) of Associate	Preference Share applying IFRS 9 (fair value)	Loan applying IFRS 9[6] (amortised cost)
Period 1	CU50	CU110	CU90
Period 2	CU(200)	CU90	CU70
Period 3	CU(500)	CU50	CU50
Period 4	CU(150)	CU50	CU40
Period 5	CU500	CU80	CU70
Period 6	CU500	CU110	CU90

B2. Based on these assumptions, Investor make the following journal entries:

At initial recognition

DR. Equity Method interest	CU200	
DR. Preference Share interest	CU100	
DR. Loan interest	CU100	
CR. Cash		CU400

To recognise the amounts invested in Associate

Period 1

DR. Preference Share interest	CU10	
CR. Profit or loss		CU10

To recognise the change in fair value (CU110-CU100)

DR. Profit or loss	CU10	
CR. Loan loss allowance (Loan interest)		CU10

To recognise an increase in Loan loss allowance

DR. Equity Method interest	CU20	
CR. Equity method income		CU20

*To recognise Investor's share of Associate's profit (CU50 * 40%)*

The carrying amount of Equity Method interest, Preference Share interest and Loan interest, net of allowance, at the end of period 1 is CU220, CU110 and CU90, respectively.

Period 2

DR. Profit or loss	CU20	
CR. Preference Share interest		CU20

To recognise the change in fair value (CU90-CU110)

[6] These amounts are shown net of loan loss allowances.

DR. Profit or loss	CU20	
CR. Loan loss allowance (Loan interest)		CU20

To recognise an increase in Loan loss allowance

DR. Equity method loss	CU80	
CR. Equity Method interest		CU80

*To recognise Investor's share of Associate's loss (CU200 * 40%)*

The carrying amount of Equity Method interest, Preference Share interest and Loan interest, net of allowance, at the end of period 2 is CU140, CU90 and CU70, respectively.

<u>Period 3</u>

DR. Profit or loss	CU40	
CR. Preference Share interest		CU40

To recognise the change in fair value (CU50-CU90)

DR. Profit or loss	CU20	
CR. Loan loss allowance (Loan interest)		CU20

To recognise an increase in loan loss allowance

DR. Equity method loss	CU200	
CR. Equity Method interest		CU140
CR. Preference Share interest		CU50
CR. Loan interest		CU10

*To recognise Investor's share of Associate's loss allocated in reverse order of seniority (CU500 * 40%)*

The carrying amount of Equity Method interest, Preference Share interest and Loan interest, net of allowance, at the end of period 3 is zero, zero and CU40, respectively.

<u>Period 4</u>

DR. Profit or loss	CU10	
CR. Loan loss allowance (Loan interest)		CU10

To recognise an increase in loan loss allowance

DR. Equity method loss	CU30	
CR. Loan interest		CU30

To recognise Investor's share of Associate's loss

*Investor limits the allocation of Associate's losses to CU30 because the net investment in Associate has been reduced to zero. Consequently, there is an unrecognised loss of CU30 (CU150 * 40% - CU30 recognised).*

Each of the carrying amount of Equity Method interest, Preference Share interest and Loan interest, net of allowance, at the end of period 4 is zero.

<u>Period 5</u>

DR. Preference Share interest	CU30	
CR. Profit or loss		CU30

To recognise the change in fair value (CU80-CU50)

DR. Loan loss allowance (Loan)	CU30	
CR. Profit or loss		CU30

To recognise a decrease in loan loss allowance

DR. Equity Method interest	CU80	
DR. Preference Share interest	CU50	
DR. Loan interest	CU40	
CR. Equity method income		CU170

To recognise Investor's share of Associate's profit

Investor allocates Associate's profit to each interest in order of seniority. Investor limits the allocation of Associate's profit to the Preference Share and Loan interests to the amount of equity method losses previously allocated to those interests, which in this case is CU50 and CU40, respectively.

*Applying the requirement in paragraph 39 of IAS 28, Investor recognises equity method income of CU170 (share of profit of CU200 (CU500 * 40%) during Period 5 less the balance of unrecognised losses of CU30 at the end of Period 4).*

The carrying amount of Equity Method interest, Preference Share interest and Loan interest, net of allowance, at the end of period 5 is CU80, CU80 and CU70, respectively.

<u>Period 6</u>

DR. Preference Share interest	CU30	
CR. Profit or loss		CU30

To recognise the change in fair value (CU110-CU80)

DR. Loan loss allowance (Loan)	CU20	
CR. Profit or loss		CU20

To recognise a decrease in loan loss allowance

DR. Equity Method interest	CU200	
CR. Equity method income		CU200

*To recognise Investor's share of Associate's profit (CU500 * 40%)*

The carrying amount of Equity Method interest, Preference Share interest and Loan interest, net of allowance, at the end of period 6 is CU280, CU110 and CU90, respectively.

<u>Periods 1–6</u>

DR. Interest receivable	CU5	
CR. Interest revenue		CU5

To recognise interest revenue on Loan interest

Investor ignores the allocation of losses to the Loan interest for the purpose of measuring interest revenue on the Loan interest. Consequently, Investor calculates interest revenue for Periods 1–6 using the gross carrying amount of the Loan interest of CU100 and the effective interest rate of 5 per cent.

B3. The following summarises the balance of, and allocation of losses for, each interest in Associate at the end of and during each period:

	IFRS 9 (Step 1)				IAS 28 allocation (Step 2)											
	Loan			PS		Ordinary Share			PS			Loan			
Period	Gross	Allow-ance	Net	FV	Equity Pick up (maximum)	Beg.	Allocation	After allocation	IFRS 9 amount	Allocation	After allocation	IFRS 9 net amount	Allocation	After allocation	Unallocated (unreported losses)
								A			B			C	
1	100	-10	90	110	20	200	20	220	110	0	110	90	0	90	0
2	100	-30	70	90	-80	220	-80	140	90	0	90	70	0	70	0
3	100	-50	50	50	-200	140	-140	0	50	-50	0	50	-10	40	0
4	100	-60	40	50	-60	0	0	0	0	0	0	30	-30	0	-30
5	100	-30	70	80	80	0	80	80	30	50	80	30	40	70	130
6	100	-10	90	110	200	80	200	280	110	0	110	90	0	90	0

	Summary of PL effects						
Period	Loan	PS	IAS 28	Total	Net invest-ment bal.	Change in Net Investme	Check
	D	E	F	G=D+E +F	=A+B+C	H	G=H
Beg.					400		
1	-10	10	20	20	420	20	TRUE
2	-20	-20	-80	-120	300	-120	TRUE
3	-20	-40	-200	-260	40	-260	TRUE
4	-10	0	-30	-40	0	-40	TRUE
5	30	30	170	230	230	230	TRUE
6	20	30	200	250	480	250	TRUE

Appendix C—Unsolicited comment letter received after the March 2016 Interpretations Committee's meeting

IASB
30 Cannon Street
London EC4M 6XH
UK

April 8, 2016

Dear Mr. Hoogervorst,

We would like to draw your attention to the analysis you made in your recent meeting about measurement of long-term interests that, in substance, form part of the net investment in associates and joint-ventures.

The conclusion that only interests in associates and joint ventures that are accounted for using the equity method are excluded from the scope of IAS 39 (and the forthcoming IFRS 9) is debatable. In this context we regret that the Board did not examine the relevance of the accounting treatment that is obtained with this conclusion as a whole.

Firstly, to be considered to be, in substance, part of the net investment, long-term interests should be items for which settlement is neither planned nor likely to occur in the foreseeable future. We therefore wonder how this characteristic should be considered in the IAS 39 impairment model (and that of the forthcoming IFRS 9). One may conclude that the absence of settlement, especially when the JV or associates make losses, will lead systematically to an impairment. In this case, long-term interests would never be able to absorb the JV or associate losses of the period in excess of the equity interest.

Secondly, as soon as a long-term investment begins to absorb losses of the period, should one not consider that, in practice, it is accounted for using the equity method (even though it is true that all the equity-accounting mechanisms are not applied to it)? We believe that one should be consistent in the approach and reflect the holistic situation of the net investment of which the long-term interests form part. For this reason, in order to allow long-term interests to absorb losses, we believe they should first absorb the equity-

accounted losses of the period and then be tested within the entire investment for impairment. We therefore ask the Board to reconsider its conclusions and to further explore view D as developed in the Agenda Paper which propose that "long-term interests are within the scope of IFRS 9 for classification and measurement purposes, excluding impairment (and are subject to the loss allocation requirements in paragraph 38 of IAS 28). In addition, these interests are also subject to the impairment requirements in paragraphs 40-43 of IAS 28."

We remain at your disposal should you need further clarification or background information.

Yours sincerely,

Patrice
MARTEAU
Chairman