Agenda ref 4

STAFF PAPER

September 2016

IFRS® Interpretations Committee Meeting

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

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This paper has been prepared for discussion at a public meeting of the IFRS Interpretations Committee (the Interpretations Committee). Comments on the application of IFRS Standards do not purport to set out acceptable or unacceptable application of IFRS Standards—only the Interpretations Committee or the International Accounting Standards Board (the Board) can make such a determination. Decisions made by the Interpretations Committee are reported in IFRIC® *Update*. The approval of a final Interpretation by the Board is reported in IASB® *Update*.

Introduction

1. 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 request related 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).

2. The Interpretations Committee tentatively decided to develop a draft IFRIC® Interpretation explaining the application of the requirements in IAS 28 and IFRS 9 to long-term interests.

3. The purpose of this paper is to discuss the following aspects of the proposals in the draft Interpretation:

   (a) presentation and disclosure;

   (b) illustrative example;

   (c) transition requirements, including those for first-time adopters; and

   (d) effective date.

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4. At this meeting, we will ask the Interpretations Committee to formally vote to give the staff permission to prepare the draft Interpretation for balloting, subject to no significant matters arising from a forthcoming Board meeting (see paragraphs 56–57).

Structure of this paper

5. The paper is structured as follows:

   (a) background;

   (b) staff analysis;

   (c) permission to ballot;

   (d) Appendix A—Revised example illustrating the accounting for long-term interests; and

   (e) Appendix B—IFRIC *Update* for May 2016.

Background

Issue raised

6. Paragraph 2.1(a) of IFRS 9 states that interests in associates and joint ventures that an entity accounts for applying 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. […]

7. 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 allocates 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.

8. In this respect, paragraph 38 states (emphasis added):

> […] 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. [….]

9. 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*.

10. 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.

11. The submitter observes that diversity exists 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.

Interpretations Committee's tentative decisions[1]

12. With respect to the application of the requirements in IAS 28 and IFRS 9 to long-term interests, the Interpretations Committee observed that:

    (a) an 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, it ignores those losses or that impairment when it accounts for long-term interests applying IFRS 9 in subsequent periods.

13. The Interpretations Committee tentatively decided to develop a draft Interpretation, explaining the application of the requirements in IAS 28 and IFRS 9 to long-term interests as described above in paragraph 12. This is because the feedback from outreach activities indicated that entities apply diverse reporting methods in accounting for long-term interests, and the issue is widespread. The draft Interpretation will not address what constitutes long-term interests.

14. As discussed by the Interpretations Committee, the proposals will be exposed as an interpretation of existing requirements in IFRS Standards and, thus, we are not proposing to change those requirements. We think that it is important to emphasise this point in the Introduction to the draft Interpretation and possibly also in the Basis for Conclusions.

[1] The IFRIC *Update* for the Interpretations Committee meeting in May 2016 is reproduced in Appendix B to this paper.

Staff analysis

Presentation and disclosure

Presentation

15. During previous Interpretations Committee discussions, a question was raised about how to present long-term interests, in particular when an entity allocates losses to long-term interests and the entity recognises an impairment loss on the net investment in an associate.

16. Paragraph 54(e) of IAS 1 *Presentation of Financial Statements* requires an entity to include in the statement of financial position a line item presenting the amounts relating to investments accounted for using the equity method. Because we do not consider long-term interests as a type of investment accounted for using the equity method, we understand this requirement to mean that an entity:

    (a) presents investments accounted for using the equity method separately from long-term interests; and, thus,

    (b) allocates its share of losses and impairment losses between investments accounted for using the equity method and long-term interests.

17. Paragraph 38 of IAS 28 specifies that an entity allocates its share of losses first to investments accounted for using the equity method and then to long-term interests. However, 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.

18. Paragraph 42 of IAS 28 says (emphasis added):

> […] 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. […]

19. These requirements might be read to imply that an entity does *not* allocate impairment losses between investments accounted for using the equity method and long-term interests because of the words 'net' as emphasised above.

20. However, in our view, these requirements merely highlight that an entity can recognise reversals of impairment losses previously recognised on an investment in an associate, because those losses are not allocated to the underlying assets of the associate, including goodwill, when measuring the investment. Consistently with our understanding as described in paragraph 16 of this paper, we are of the view that an entity allocates impairment losses recognised on the net investment between the investment accounted for using the equity method and long-term interests.

21. Although we are not aware that the absence of IAS 28 impairment allocation requirements causes any particular issue in practice, we suggest that this would be a good opportunity to provide clarity on whether to allocate such impairment losses among the components of the net investment. This is because the draft Interpretation will address the accounting for long-term interests in general, and will clarify that long-term interests are a part of the net investment that is subject to the impairment requirements in IAS 28.

22. Consequently, we recommend that the draft Interpretation clarifies that an entity allocates impairment losses recognised on the net investment between the investment accounted for using the equity method and long-term interests.

Disclosure

23. IFRS Standards do not include disclosure requirements specifically for long-term interests. However, there are many disclosure requirements that relate to long-term interests, such as:

    (a) IFRS 12 *Disclosure of Interests in Other Entities*—paragraph 20 requires an entity to disclose information that enables users to evaluate the nature, extent and the financial effects of its interests in an associate, which include long-term interests.

(b) IFRS 7 *Financial Instruments: Disclosures*—which, among others, requires an entity to disclose:

(i) for financial assets measured at amortised cost, the carrying amounts (paragraph 8(f)) and a reconciliation of the opening to closing balance of the loss allowance (paragraph 35H);

(ii) for financial assets measured at fair value through profit or loss (FVPL), the carrying amounts (paragraph 8(a)), and

(iii) significant accounting policies used that are relevant to an understanding of the financial statements (paragraph 21).

(c) IAS 24 *Related Party Disclosures*—paragraph 18 requires an entity to disclose separately for associates and joint ventures:

(i) the amount of outstanding balances;

(ii) provisions for doubtful debts related to the amount of outstanding balances; and

(iii) the expense recognised during the period in respect of bad or doubtful debts.

24. We are therefore of the view that there are already sufficient disclosure requirements applying to long-term interests that enable users to understand the financial effects of such long-term interests. Consequently, we recommend that the draft Interpretation does not include any new disclosure requirements specifically for long-term interests.

Questions 1 and 2—Presentation and disclosure

1. Does the Interpretations Committee agree with the staff recommendation that the draft Interpretation should clarify that an entity allocates impairment losses recognised on the net investment between the investment accounted for using the equity method and long-term interests?

2. Does the Interpretations Committee agree with the staff recommendation that the draft Interpretation should not include any new disclosure requirements specific to long-term interests?

Illustrative example

25. Agenda paper 2 discussed at the Interpretations Committee meeting in May 2016 included an example illustrating the accounting for long-term interests. The Interpretations Committee found the example helpful in explaining the application of the requirements to long-term interests.

26. One Interpretations Committee member suggested that the example would be more helpful if it considered some other variations in facts in situations in which the amount of the net investment is reduced to zero.

27. Appendix A to this paper includes a revised example. All of the assumptions and most of the numbers are the same as those used in the original example in the May 2016 Agenda paper. In the following paragraphs, we explain the changes made and our rationale for the accounting for such changes. Appendix A to this paper includes a complete list of assumptions.

28. The following tables show the numbers used in the original example and in the revised example. Changes are shown in the shaded cells.

Original example

Carrying amount of interest / At the end of	Net Income/(Loss) of Associate	Preference Share applying IFRS 9 (fair value)	Loan applying IFRS 9[2] (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

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

Revised example[3]

Carrying amount of interest At the end of	Net Income/(Loss) of Associate	Preference Share applying IFRS 9 (fair value)	Loan applying IFRS 9[2] (amortised cost)
Period—4	CU(150)	CU40	CU50
Period—5	-	CU60	CU60

29. In both the original and revised examples, the carrying amount, which reflects allocations of losses, 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.

Period—4

30. Investor first measures the Preference Share and Loan interests applying IFRS 9 and recognises the following:

DR. Profit or loss	CU10	
CR. Preference Share interest		CU10
To recognise the change in fair value (*CU40 − CU50*)		
DR. Cash	CU5	
CR. Interest revenue		CU5
To recognise interest revenue on Loan interest (*CU100 gross carrying amount × 5% effective interest rate*)		

31. Recognition of the change in the fair value of Preference Share interest would result in a carrying amount of negative CU10. This occurs because, in measuring Preference Share interest applying IFRS 9, Investor ignores the allocation of Associate's losses previously recognised in applying IAS 28.

32. However, a negative carrying amount of Preference Share interest would not be consistent with the requirements in paragraph 39 of IAS 28. Paragraph 39 of IAS 28 limits the carrying amount of the net investment to zero when an entity has not incurred a legal or constructive obligation, or made payments on behalf of the associate or joint venture. Consequently, Investor recognises the following:

[3] The numbers for Periods 1–3 in the revised example are the same as those used in the original example. Period 5 is added. The numbers for Period 6 and Period 7 in the revised example are the same as those in Period 5 and Period 6 in the original example.

DR. Preference Share interest	CU10	
CR. Equity method profit		CU10

33. This entry results in a carrying amount for Preference Share interest of zero. This can be viewed as reversing some of Investor's share of Associate's losses previously allocated to Preference Share interest.

34. Investor then allocates its share of Associate's losses for Period 4:

DR. Equity method loss	CU40	
CR. Loan interest		CU40

To recognise Investor's share of Associate's losses

35. The carrying amount of Equity Method interest, Preference Share interest and Loan interest, net of allowance, at the end of Period 4 is zero. The balance of the unrecognised Investor's share of Associate's losses is CU30 (CU150 × 40% − CU40 recognised + CU10 reversed).

Period—5

36. Investor first measures Preference Share interest and Loan interest applying IFRS 9 and recognises the following:

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

To recognise the change in fair value (CU60 − CU40)

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

To recognise a decrease in Loan loss allowance

DR. Cash	CU5	
CR. Interest revenue		CU5

To recognise interest revenue on Loan interest (CU100 gross carrying amount × 5% effective interest rate)

37. After the entries above, the carrying amount of Equity Method interest, Preference Share interest and Loan interest, net of allowance, is zero, CU20 and CU10, respectively. There is also an unrecognised Investor's share of Associate's losses of CU30 from Period 4. In this situation, Investor allocates the unrecognised loss to Preference Share interest and Loan interest because these interests have a

positive carrying amount to which the losses can be allocated. Consequently, Investor recognises the following:

DR. Equity method loss	CU30	
CR. Preference Share interest		CU20
CR. Loan interest		CU10

To recognise the previously unrecognised Investor's share of Associate's losses

38. The carrying amount of Equity Method interest, Preference Share interest and Loan interest, net of allowance, at the end of Period 5 is zero.

Summary

39. We agree with the Interpretations Committee that an illustrative example would be helpful in explaining the proposals in the draft Interpretation. Consequently, we recommend that the draft Interpretation includes an illustrative example.

40. The revised example outlined in this paper adds complexity to the original example, covering 'what if' scenarios that may not occur frequently in practice. Accordingly, there is a risk that including the revised example (as opposed to the original example) could confuse readers of the draft Interpretation, instead of helping them to understand the requirements.

41. Nonetheless, given the discussions at previous Interpretations Committee meetings, on balance, we recommend including the revised example in the draft Interpretation as described in Appendix A to this paper.

Question 3—Illustrative example

3. Does the Interpretations Committee agree with the staff recommendation that:

   (a) the draft Interpretation include an illustrative example; and

   (b) such an example should be along the lines of the revised example described in Appendix A to this paper?

Transition requirements, including those for first-time adopters

42. Retrospective application of the draft Interpretation applying IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* would lead to consistency across reporting periods within an entity and across different entities.

43. We think retrospective application would be feasible for the draft Interpretation because an entity would be likely to have sufficient information to implement the proposals retrospectively. This is because paragraph 39 of IAS 28 implicitly requires an entity to keep track of the amount of losses attributable to the entity's interests in an associate.

44. Having said that, we recommend that the draft Interpretation should provide relief from presenting comparative information that complies with the Interpretation—the same type of relief provided in IFRS 9 on initial application of that Standard. In considering whether there is a need to provide transition relief, we observe that our outreach suggests that some entities will not have applied some or all of the requirements in IFRS 9 (IAS 39) to long-term interests before applying the Interpretation. We think that the costs for such entities of applying the Interpretation, without any transition relief for comparative periods, would be likely to outweigh the benefits. This is because:

    (a) a partial restatement of comparative information in which only the proposals in the draft Interpretation, but not the requirements in IFRS 9, are reflected in comparative periods might not be particularly useful. This is because, even if an entity applies the Interpretation retrospectively, the entity could still account for long-term interests applying IFRS 9 in the current period but applying IAS 39 in the comparative period. Hence, the accounting for long-term interests might not be comparable. In these situations, we think that the benefits of a mandatory restatement of comparative information only for the effects of the Interpretation would not justify the costs of doing so.

    (b) as discussed in the following section, we are recommending an effective date for the Interpretation of 1 January 2018. An option not to restate the comparative information would alleviate any potential concern that there is a short period between the expected issue date of the Interpretation and the proposed effective date.

45. However, if an entity chooses to restate the comparative information on initial application of IFRS 9, it should also restate the comparative information for the effects of this Interpretation. This is because, in that case, an entity would account for long-term interests in a consistent and comparable way across reporting periods.

46. On the basis of our analysis, we recommend that the draft Interpretation should:

(a) require retrospective application of the proposals; and

(b) permit, but not require, restatement of comparative information, unless an entity chooses to restate the comparative information on initial application of IFRS 9.

Transition requirements for entities that issue insurance contracts

47. The Board published the Exposure Draft *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts* in December 2015 (the 'ED'). The ED proposes to introduce an optional temporary exemption from applying IFRS 9 for entities whose predominant activity is issuing contracts within the scope of IFRS 4 *Insurance Contracts*. If an entity applies this exemption, it will continue to apply IAS 39 after 1 January 2018.

48. We recommend that the same transition requirements as described in paragraph 46 should apply for entities applying the optional exemption from IFRS 9. This is because there might not be sufficient time for those entities that choose the optional exemption from IFRS 9, and which are affected by the Interpretation and possibly did not apply IAS 39 previously to long-term interests, to restate comparative information applying IAS 39 to long-term interests.

49. In saying that, we recommend that the draft Interpretation does not provide additional transition relief for those entities. Although it may be more difficult to apply IAS 39 for the first time to long-term interests than IFRS 9 (given the transition requirements in IFRS 9), we would expect, at most, only a narrow set of entities that could choose the optional exemption to possibly be affected by the

Interpretation—we are not aware that any of those entities would not have applied IAS 39 previously to long-term interests. Including specific transition requirements for such entities would add complexity to the proposals for possibly little, if any, benefit.

First-time adopters

50. Paragraph E1 of IFRS 1 *First-time Adoption of International Financial Reporting Standards* provides relief to first-time adopters from presenting comparative information that complies with IFRS 9. This short-term relief is available for first-time adopters whose first IFRS reporting period begins before 1 January 2019. For the same reasons provided in paragraph 44–45 of this paper, we recommend that the draft Interpretation should provide those first-time adopters with relief from presenting comparative information that complies with the Interpretation, unless the first-time adopter chooses to restate the comparative information relating to IFRS 9 on initial adoption of IFRS Standards.

Question 4—Transition provision

4. Does the Interpretations Committee agree with the staff recommendation that the draft Interpretation should:

   (a) require retrospective application of the proposals;

   (b) permit but not require restatement of comparative information, unless an entity chooses to restate comparative information on initial application of IFRS 9; and

   (c) for first-time adopters whose first IFRS reporting period begins before 1 January 2019, permit but not require restatement of comparative information, unless the first-time adopter chooses to restate the comparative information relating to IFRS 9 on initial adoption of IFRS Standards.

Effective date

51. We believe it is important that this Interpretation has the same effective date as IFRS 9, which is 1 January 2018. This is because the Interpretation would interpret the application of the requirements in IFRS 9, as well as IAS 28.

52. Different effective dates for IFRS 9 and the Interpretation could potentially be burdensome for both preparers and users of financial statements. Unless the respective effective dates are the same, preparers might be required to apply the new accounting requirements in IFRS 9 to long-term interests, and then apply the Interpretation within a short period of time thereafter. This would be burdensome if an entity were to interpret the requirements in a way that is not consistent with the draft Interpretation. In addition, IFRS 9 includes transition requirements that would be helpful to entities when first applying the Interpretation.

53. Some might be concerned that a proposed effective date of 1 January 2018 for the Interpretation might not allow sufficient time for preparers to implement the Interpretation. However, we think that 1 January 2018 would be feasible because an entity would be likely to have sufficient information to implement the proposals in the draft Interpretation. This is because:

    (a) initial application of IFRS 9 requires the re-measurement of long-term interests. In effect, this ‘resets’ the carrying amount of long-term interests;

    (b) the proposals in the draft Interpretation do not affect how an entity measures long-term interests applying IFRS 9. In other words, the draft Interpretation does not interfere with the initial application of IFRS 9;

    (c) paragraph 39 of IAS 28 implicitly requires an entity to keep track of the amount of losses attributable to the entity’s interests in an associate or a joint venture; and

    (d) as discussed in the previous section, we are proposing to provide transition relief from presenting comparative information that complies with the Interpretation.

54. For these reasons, we recommend that the proposed effective date of the draft Interpretation should be 1 January 2018.

55. We think that the draft Interpretation does not need to include an option to early apply the Interpretation. We do not see any benefit in adding this option to the Interpretation because we expect there to be a short time period between the date of issuing the Interpretation and the effective date of 1 January 2018. Thus, we do not expect many, if any, entities to actually want to apply the Interpretation early. We also note that the Interpretation is not proposing to change any of the existing requirements.

Question 5—Effective date

5. Does the Interpretations Committee agree with the staff recommendation that the draft Interpretation should include a proposed effective date of 1 January 2018?

Permission to ballot

56. The *Due Process Handbook* states that once the Interpretations Committee is satisfied that it has addressed all of the matters relating to the draft Interpretation, it votes to see if there is general agreement that the staff should prepare the draft Interpretation for balloting.[4] It also states that the staff presents a paper to the Board which (a) summarises the steps that have been taken in developing the proposals and (b) recommends a comment period for the draft Interpretation.[5]

57. Consequently, we will ask you to vote at this meeting on whether there is general agreement that the staff should prepare the draft Interpretation for balloting, subject to no significant matters arising from a forthcoming Board meeting.

[4] Paragraph 7.9 of the Due Process Handbook

[5] Paragraph 7.7 of the Due Process Handbook

Questions 6 and 7—Permission to ballot

6. Is the Interpretations Committee satisfied that it has addressed all relevant matters in developing the draft Interpretation?

7. Provided that the Board does not raise any significant matters, does the Interpretations Committee agree that the staff should prepare a ballot draft of the proposed draft Interpretation for public comment?

Appendix A—Revised example illustrating the accounting for long-term interests

A1. The assumptions used for the example are as follows:

(a) Investor has the 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 Associate is impaired applying IAS 28, nor a significant increase in the credit risk associated with Loan interest.

(c) The amount of initial investment in the Equity Method interest, Preference Share interest and Loan interest 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 no longer recognises its share of Associate’s 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 interest and Loan interest applying IFRS 9 (but before applying IAS 28):

Carrying amount of interest At the end of	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)	CU40	CU50
Period—5	-	CU60	CU60
Period—6	CU500	CU80	CU70
Period—7	CU500	CU110	CU90

A2. 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.

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

Period—2

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

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

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.

Period—3

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.

Period—4

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

To recognise the change in fair value (CU40 − CU50)

DR. Equity method loss	CU40	
DR. Preference Share interest	CU10	
CR. Loan interest		CU40
CR. Equity method profit		CU10

To recognise Investor's share of Associate's loss

Investor recognises and allocates equity method profit of CU10 to Preference Share interest so that the carrying amount of the interest is not below zero.

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% − CU40 recognised + CU10 reversed).

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.

Period—5

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

To recognise the change in fair value (CU60 − CU40)

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

To recognise a decrease in loan loss allowance

DR. Equity method loss	CU30	
CR. Preference Share interest		CU20
CR. Loan loss allowance (Loan)		CU10

To recognise the previously unrecognised share of Associate's losses

Investor allocates the previously unrecognised share of Associate's losses of CU30 to Preference Share interest and Loan interest because those interests have a positive carrying amount to which losses can be allocated.

Each of the carrying amount of Equity Method interest, Preference Share interest and Loan interest, net of allowance, at the end of Period—5 is zero.

Period—6

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

To recognise the change in fair value (CU80 − CU60)

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

To recognise a decrease in loan loss allowance

DR. Equity Method interest	CU80	
DR. Preference Share interest	CU60	
DR. Loan interest	CU60	
CR. Equity method income		CU200

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

Investor allocates Associate's profit to each interest in order of seniority. Investor limits the allocation of Associate's profit to the Preference Share interest and Loan interest to the amount of equity method losses previously allocated to those interests, which in this case is CU60 for both interests.

The carrying amount of Equity Method interest, Preference Share interest and Loan interest, net of allowance, at the end of Period—6 is CU80, CU80 and CU70, respectively.

Period—7

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.

Periods—1–7

DR. Cash	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—1–7 using the gross carrying amount of the Loan interest of CU100 and the effective interest rate of 5 per cent.

A3. 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.	Profit/Loss Allocation	After allocation	Beg.	Loss Allocation	After allocation	Beg.	Loss 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	-50	50	40	-60	0	0	0	-10	10	0	40	-40	0	-30
5	100	-40	60	60	0	0	0	0	20	-20	0	10	-10	0	0
6	100	-30	70	80	200	0	80	80	20	60	80	10	60	70	0
7	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 Investment
	D	E	F	G=D+E +F	=A+B+C	H
Beg.					400	
1	-10	10	20	20	420	20
2	-20	-20	-80	-120	300	-120
3	-20	-40	-200	-260	40	-260
4	0	-10	-30	-40	0	-40
5	10	20	-30	0	0	0
6	10	20	200	230	230	230
7	20	30	200	250	480	250

Appendix B—IFRIC *Update* for May 2016

IFRS 9 *Financial Instruments* and IAS 28 *Investments in Associates and Joint Ventures*—Measurement of long-term interests (Agenda Paper 2)

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–the allocation of losses.

Consequently, on the basis of an analysis of the requirements in IAS 28 and IFRS 9, the Interpretations Committee noted that the scope exception in paragraph 2.1(a) of IFRS 9 does not apply to long-term interests.

The Interpretations Committee observed the following:

a. an 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.

The Interpretations Committee noted that the feedback from outreach activities indicated that there are diverse reporting methods applied to account for long-term interests and that the issue is widespread. Consequently, the Interpretations Committee tentatively decided to develop a draft Interpretation, which would explain how to account for long-term interests.

Next steps

The staff will prepare a draft Interpretation.