

## STAFF PAPER

October 2016

## IASB Meeting

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

1. The IFRS Interpretations Committee (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, in addition to IAS 28, to long-term interests in an associate or 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 observed that the feedback from outreach activities indicated that entities apply diverse reporting methods in accounting for long-term interests, and the issue is widespread. In response to the noted diversity in practice, and having considered the Interpretations Committee's agenda criteria described in paragraphs 5.14–5.22 of the [IFRS Foundation Due Process Handbook](#) (the Due Process Handbook), the Interpretations Committee tentatively decided to develop a draft IFRIC<sup>®</sup> Interpretation. Such a draft Interpretation would have specified which Standards apply to long-term interests, as well as how to apply those Standards.
3. At its meeting in September 2016, the Board discussed a summary of technical matters agreed by the Interpretations Committee, including an illustrative example to be included in the draft Interpretation. Although the Board agreed with the

technical conclusions reached by the Interpretations Committee, it was concerned that:

- (a) the draft Interpretation would have strayed into the application of the equity method in IAS 28. The Board anticipated that the focus of the feedback on the draft Interpretation would have been on the mechanics of the equity method, which has already been identified as an area requiring further research by the Board.
  - (b) as a consequence, clarification of the original question asked might be delayed. As described in paragraph 1, the original question was more narrowly focused on the scope of IFRS 9 and whether an entity applies IFRS 9, in addition to IAS 28, to long-term interests.
4. Accordingly, the Board objected to the release of the draft Interpretation. The Board instructed the staff to explore whether there is a more effective way of clarifying which Standards apply to long-term interests.
5. The purpose of this paper, therefore, is to discuss alternative ways to provide this clarification.

### **Summary of staff recommendation**

6. The staff recommend that the Board propose amendments to IAS 28 as an Annual Improvement. Those amendments would clarify that an entity accounts for long-term interests applying IFRS 9.
7. If the Board agrees, the staff recommend the following regarding transition:
- (a) to require retrospective application of the proposed amendments, but permit an entity not to restate comparative information unless the entity chooses to restate comparative information on initial application of IFRS 9;
  - (b) for insurance entities electing to apply the temporary exemption from IFRS 9, to also require retrospective application of the proposed

amendments, but permit those entities not to restate comparative information.

8. The staff also recommend an effective date of 1 January 2018.

### **Structure of the paper**

9. This paper is structured as follows:
  - (a) background;
  - (b) staff analysis;
  - (c) Appendix A—Assessment against the Interpretations Committee’s agenda criteria; and
  - (d) Appendix B—Summary of proposed transition requirements.

### **Background**

#### ***Issue raised***

10. 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:

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 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.

12. In this respect, paragraph 38 of IAS 28 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. ...
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 the assessment of evidence indicates that the net investment is impaired, 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 said that diversity exists in practice when 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 such diversity are likely to be more significant.

**Conclusion reached by the Board and the Interpretations Committee<sup>1</sup>**

16. Both the Board and the Interpretations Committee observed that, applying the existing requirements in IFRS Standards, an entity accounts for long-term interests applying IFRS 9, including its impairment requirements. In addition, long-term interests (as part of the net investment in an associate or joint venture) are subject to the loss allocation and impairment requirements in IAS 28.
17. Long-term interests are within the scope of IFRS 9 because the scope exception in paragraph 2.1(a) of IFRS 9 does not apply to those interests, on the grounds that:
- (a) the scope exception in paragraph 2.1(a) of IFRS 9 applies only to interests in an associate or joint venture that an entity accounts for using the equity method; and
  - (b) an entity does not account for long-term interests 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.

**Staff analysis*****What has caused any ambiguity?***

18. Paragraph 2.1 of IFRS 9 states the following:

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

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<sup>1</sup> See [IASB Update in February 2016](#) and [IFRIC Update in May 2016](#).

IFRS 10 *Consolidated Financial Statements*, IAS 27 *Separate Financial Statements* or IAS 28 *Investments in Associates and Joint Ventures*. However, in some cases, IFRS 10, IAS 27 or IAS 28 require or permit an entity to account for an interest in a subsidiary, associate or joint venture in accordance with some or all of the requirements of this Standard. ....

19. On the basis of outreach feedback and the previous discussions of the Interpretations Committee, we understand that some say it is not clear what ‘interests ... in associates and joint ventures’, referred to in paragraph 2.1(a) of IFRS 9, represent. In their view, it is not clear whether paragraph 2.1(a) is referring only to interests in an associate or joint venture that an entity accounts for using the equity method, or also to long-term interests that are discussed in paragraph 38 of IAS 28.
20. In addition, some say that paragraph 41 of IAS 28 can be read to imply that interests in an associate or joint venture that form part of the net investment are not subject to the IFRS 9 impairment requirements.
21. Paragraph 41 of IAS 28 states:

The entity applies the impairment requirements in IFRS 9 to its other interests in the associate or joint venture that are in the scope of IFRS 9 and that do not constitute part of the net investment.
22. In that case, those stakeholders interpret the requirements to say that an entity applies the requirements of IFRS 9 to long-term interests, except for the impairment requirements.

### **The staff view**

23. In our view, paragraph 41 of IAS 28 merely reiterates that IFRS 9 applies to an entity’s interests in an associate or joint venture that do not form part of the net investment. Accordingly, it does not add a new requirement, nor should it be read

to imply that the impairment requirements in IFRS 9 do not apply to interests that form part of the net investment (ie long-term interests).

24. 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. Consequently, an entity could not apply amortised cost accounting in IFRS 9 without also applying the impairment requirements in that Standard.
25. Regarding paragraph 2.1(a) of IFRS 9, there are two factors that support our view (and the Board's and Interpretations Committee's view) that the scope exclusion refers only to interests in an associate or joint venture that an entity accounts for using the equity method:
  - (a) The first is that paragraph 14 of IAS 28 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) The second is that paragraph 2.1(a) of IFRS 9 refers to 'interests...accounted for in accordance with ...IAS 28'. IAS 28 does not specify how to account for long-term interests to which the equity method is not applied. The only mention of long-term interests in IAS 28 is within paragraph 38 of that Standard, which specifies how to allocate losses of an associate or joint venture to the net investment. Accordingly, IAS 28 does not specify recognition or measurement requirements for long-term interests and, as such, we think that long-term interests are not accounted for in accordance with IAS 28.
26. For these reasons, we think that the requirements in IFRS 9 and IAS 28 are sufficient to enable an entity to conclude that IFRS 9 applies to long-term interests. Hence, we initially recommended to the Interpretations Committee that it publish an agenda decision to explain this.
27. However, the Interpretations Committee concluded that additional clarity in this respect, beyond an agenda decision, is required.

28. To provide this clarity about the scope of IFRS 9 in the context of long-term interests, we think that there are two amendments that could be made to IAS 28:

- (a) Delete paragraph 41 of IAS 28 (reproduced in paragraph 21 of this paper). As noted above, that paragraph merely reiterates what is already required by IFRS 9, but has created confusion about the applicability of the impairment requirements in IFRS 9 to long-term interests. Consequently, we think that deleting this paragraph would help to clarify that an entity applies all of the requirements in IFRS 9 to long-term interests, including the impairment requirements.
- (b) Amend paragraph 14 of IAS 28 to state explicitly that an entity accounts for long-term interests in accordance with IFRS 9, along the lines of the following (new text is underlined):

IFRS 9 *Financial Instruments* does not apply to interests in associates and joint ventures that are accounted for using the equity method. When instruments containing potential voting rights in substance currently give access to the returns associated with an ownership interest in an associate or a joint venture, the instruments are not subject to IFRS 9. In all other cases, instruments containing potential voting rights in an associate or a joint venture are accounted for in accordance with IFRS 9. An entity also accounts for long-term interests that, in substance, form part of the entity's net investment in an associate or joint venture (see paragraph 38) in accordance with IFRS 9.

29. We think that these proposed amendments would meet the criteria to be considered to be an Annual Improvement—Appendix A to this paper assesses the proposed amendments against the Interpretations Committee's agenda criteria, as well as the criteria relating to an Annual Improvement.



**Question 1—Proposed amendments to IAS 28**

1. Does the Board agree with the staff recommendation to propose an Annual Improvement that would:
  - (a) amend paragraph 14 of IAS 28, along the lines of the wording in paragraph 28(b) of this paper; and
  - (b) delete paragraph 41 of IAS 28?

***Transition requirements, including those for first-time adopters***

30. Retrospective application of the proposed amendments to IAS 28 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.
31. We think retrospective application would be feasible for the proposed amendments because an entity would be likely to have sufficient information to implement the proposed amendments retrospectively. This is because paragraph 22(c) of IFRS 12 *Disclosure of Interests in Other Entities* and paragraph 39 of IAS 28 require an entity to keep track of the amount of losses attributable to the entity's interests in an associate or joint venture.
32. Having said that, paragraph 7.2.15 of IFRS 9 provides relief from presenting comparative information that complies with IFRS 9. Therefore, we recommend that an entity should apply the amendments retrospectively, but should not be required to restate comparative information unless it chooses to restate comparative information on initial application of IFRS 9. This is because:
  - (a) the proposed amendments would clarify the applicability of IFRS 9 to long-term interests;
  - (b) there would appear to be little benefit in requiring an entity to restate comparative information that complies with the proposed amendments while the entity has an option not to restate comparative information that complies with the requirements in IFRS 9; and

- (c) as discussed in the following section, we are recommending an effective date for the proposed amendments of 1 January 2018. Providing transition relief from presenting comparative information would alleviate any potential concern that there is a short period between the expected date of issuing the amendments and the proposed effective date.

*Transition requirements for entities that issue insurance contracts*

33. The Board amended IFRS 4 *Insurance Contracts* in September 2016, which introduced an optional temporary exemption from applying IFRS 9 for entities whose predominant activity is issuing insurance contracts. Those entities electing to apply the temporary exemption from IFRS 9 would not be able to make use of the transition relief provided in IFRS 9 because they will not apply IFRS 9 as from 1 January 2018. We think that there might be insufficient time for these entities to apply the proposed amendments retrospectively if they did not apply IAS 39 previously to long-term interests. Consequently, we recommend that, for those entities electing to apply the temporary exemption from IFRS 9, the Board should:
- (a) require retrospective application of the proposed amendments; and
  - (b) permit, but not require, restatement of comparative information that complies with the proposed amendments.
34. We recommend that the Board 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 proposed amendments—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.
35. Appendix B to this paper illustrates the staff recommendations regarding the transition requirements.

*First-time adopters*

36. Paragraph E1 of IFRS 1 *First-time Adoption of International Financial Reporting Standards* provides relief for 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 reasons set out in paragraph 32, we recommend that a first-time adopter be provided with the same relief from presenting comparative information as is included in paragraph E1 of IFRS 1.
37. Our recommendations regarding the transition requirements, including those for first-time adopters, are consistent with the tentative conclusions reached by the Interpretations Committee.

**Question 2—Transition requirements**

2. Does the Board agree with the staff recommendation:
- (a) to require retrospective application of the proposed amendments, but permit an entity not to restate comparative information unless the entity chooses to restate comparative information on initial application of IFRS 9; and
  - (b) for insurance entities electing to apply the temporary exemption from IFRS 9, to also require retrospective application of the proposed amendments, but permit those entities not to restate comparative information?

**Effective date**

38. We think it is important that the proposed amendments have the same effective date as IFRS 9, which is 1 January 2018. This is because the proposed amendments would clarify the applicability of IFRS 9 to long-term interests. In addition, the transition requirements in IFRS 9 would be helpful to entities when first applying the proposed amendments. Those transition requirements would not be available to an entity if it initially applies IFRS 9 to long-term interests at a date later than when it initially applies IFRS 9. This is because the transition

requirements in IFRS 9 are available only when an entity first applies the Standard.

39. Some might be concerned that an effective date of 1 January 2018 for the proposed amendments might not allow sufficient time for preparers to implement the proposed amendments. However, we think that 1 January 2018 would be feasible because an entity would be likely to have sufficient information to implement the proposed amendments. This is because:
- (a) the initial application of IFRS 9 requires an entity to determine a carrying amount for long-term interests applying the requirements in IFRS 9. In effect, this ‘resets’ the carrying amount of long-term interests, previously determined applying other Standards.
  - (b) the proposed amendments do not affect how an entity measures long-term interests applying IFRS 9. In other words, these proposed amendments are consistent with the initial application of IFRS 9.
  - (c) paragraph 22(c) of IFRS 12 and paragraph 39 of IAS 28 require an entity to keep track of the amount of losses attributable to the entity’s interests in an associate or joint venture.
  - (d) as discussed in the previous section, we recommend that the proposed amendments include transition relief from presenting comparative information.
40. For these reasons, we recommend that the effective date of the proposed amendments should be 1 January 2018.
41. We also recommend permitting earlier application of the proposed amendments. We do not anticipate many entities applying IFRS 9 early to also have long-term interests. Nonetheless, if any such entities do exist, then they can benefit from applying the proposed amendments early.
42. Our recommendation regarding the effective date is consistent with the tentative conclusion reached by the Interpretations Committee.

**Question 3—Effective date**

3. Does the Board agree with the staff recommendation that the proposed amendments should include a proposed effective date of 1 January 2018, with earlier application permitted?

## Appendix A—Assessment against the Interpretations Committee’s agenda criteria

A1. We have assessed this issue against the agenda criteria of the current *Due Process Handbook* as follows:

### Agenda criteria

<p>We should address issues (5.16):</p> <p>that have widespread effect and have, or are expected to have, a material effect on those affected.</p> <p>...where financial reporting would be improved through the elimination, or reduction, of diverse reporting methods.</p> <p>...that can be resolved efficiently within the confines of existing Standards and the <i>Conceptual Framework for Financial Reporting</i>.</p> <p>Is the issue sufficiently narrow in scope that the Interpretations Committee can address it in an efficient manner, but not so narrow that it is not cost-effective for it to undertake the due process that would be required when making changes to IFRS (5.17)?</p> <p>Will the solution developed by the Interpretations Committee be effective for a reasonable time period (5.21)? (The Interpretations Committee will not add an item to its agenda if the issue is being addressed in a forthcoming Standard and/or if a short-term improvement is not justified).</p>	<p><b>Yes.</b> Many respondents to the outreach confirmed that they have observed this issue, and that there are differing views on the accounting treatment.</p> <p><b>Yes.</b> We think that a clarification with respect to the scope of IFRS 9 before IFRS 9 is effective would improve financial reporting.</p> <p><b>Yes.</b> We think that an amendment can resolve the issue efficiently within the confines of existing IFRS Standards because it merely clarifies that IFRS 9 applies to long-term interests, and does not amend existing requirements.</p> <p><b>Yes.</b> The issue is not being addressed as part of an active Board project. The accounting for long-term interests may be considered as part of the research project on the equity method. However, we expect that any amendment that might arise from that project would not be effective for some time. Consequently, we expect that the amendment proposed in this paper will be effective for a reasonable time period.</p>
<p>In addition to the implementation and maintenance criteria, an annual improvement should (6.11, 6.12):</p>	
<p>Replace unclear wording;</p> <p>Provide missing guidance; or</p> <p>Correct minor unintended consequences, oversights or conflict.</p> <p>Not change an existing principle or propose a new principle.</p> <p>Not be so fundamental that the IASB will have to meet several times to conclude (6.14).</p>	<p><b>Yes.</b> We think that the proposed amendment would clarify that IFRS 9 (including its impairment requirements) applies to long-term interests, by amending wording in IAS 28 that some read to imply the opposite.</p> <p><b>Yes.</b> The proposed amendment would merely clarify that IFRS 9 applies to long-term interests. It does not change an existing principle, nor does it relate to a new principle.</p> <p><b>Yes.</b> We do not consider the proposed clarification of the scope of IFRS 9 to be so fundamental that the Board will have to meet several times to conclude.</p>

## Appendix B—Summary of proposed transition requirements

B1. The following tables illustrate the possible outcomes from applying the transition requirements recommended by the staff in this paper:

**Entities applying IFRS 9 from 1 January 2018** **IFRS Standards that would apply to long-term interests**

<b>Variation 1 (paragraph 32)</b>	<u>Comparatives</u>	<u>Current</u>
Entity applies IFRS 9 and restates comparative information	IFRS 9	IFRS 9

<b>Variation 2 (paragraph 32)</b>	<u>Comparatives</u>	<u>Current</u>
Entity applies IFRS 9 and does <u>not</u> restate comparative information: and		
(a) Entity has previously applied IAS 39 to its long-term interests	IAS 39	IFRS 9
(b) Entity has not previously applied IAS 39 to its long-term interests	Other	IFRS 9

**Insurance entities applying the temporary exemption from IFRS 9**

<b>Variation 3 (paragraph 33)</b>	<u>Comparatives</u>	<u>Current</u>
Entity applies IAS 39 and chooses not to restate comparative information applying the proposed amendments, and		
(a) Entity has previously applied IAS 39 to its long-term interests	IAS 39	IAS 39
(b) Entity has not previously applied IAS 39 to its long-term interests	Other	IAS 39

<b>Variation 4 (paragraph 33)</b>	<u>Comparatives</u>	<u>Current</u>
Entity applies IAS 39 and chooses to restate comparative information applying the proposed amendments.	IAS 39	IAS 39