Long-term Interests in Associates and Joint Ventures (Amendments to IAS 28) Cover note

Objective of the session

1 The objective of this session is to discuss and approve EFRAG's final endorsement advice ('FEA') on *Long-term Interests in Associates and Joint Ventures (Amendments to IAS 28 Investments in Associates and Joint Ventures)* ('the Amendments').

Background

2 On 12 October 2017, the IASB published the Amendments, which are effective for annual periods beginning on or after 1 January 2019 with earlier application permitted. The Amendments clarify that IFRS 9 *Financial Instruments* applies to financial instruments in associates or joint ventures to which the equity method is not applied. These include long-term interests that, in substance, form part of the entity's net investment in an associate or joint venture ('long-term interests').

3 The EFRAG Board approved the draft endorsement advice ('DEA') at its public meeting in December 2017 and decided to finalise the endorsement advice at a public meeting rather than by written procedure. EFRAG's preliminary assessment was that the Amendments satisfy the criteria for endorsement for use in the European Union ('EU') and, therefore, recommended their endorsement.

4 However, EFRAG did include concerns raised by the interaction of IFRS 9 and IAS 28 in its DEA (noting that these issues resulted from existing requirements in IFRS 9 and IAS 28 and were not created by the Amendments):

(a) limitations on relevance and understandability of the carrying amount of long-term interests and complexity arising from applying a combination of measurement requirements in two IFRS Standards; and

(b) potential of recognition of losses twice for the same financial asset.

5 EFRAG's DEA also referred to its comment letter to the IASB, where it recommended that the accounting treatment of long-term interests should be considered more broadly in the IASB's *Equity Method* research project. Pending the outcome of this project, EFRAG concluded that the Amendments are likely to improve the quality of financial reporting.

EFRAG TEG discussion and recommendation to the EFRAG Board

6 EFRAG TEG considered the comments that EFRAG received in response to its DEA at its March 2018 meeting and advised the EFRAG Board to support the endorsement of the Amendments.

7 At this meeting, the discussion mainly focused on the concerns raised by one respondent about the application of the Amendments in a parent's separate financial statements when the parent elects to measure its investments in subsidiaries using

the equity method in accordance with IAS 27 *Separate Financial Statements*. The respondent argued that, for investments in subsidiaries, the long-term interest takes the nature of a capital contribution, as it has a similar risk profile to an equity instrument. The respondent was of the view that, without a scope exemption for separate financial statements, the Amendments would not be conducive to the European public good and would not meet the technical criteria in the IAS Regulation.

8 While expressing sympathy for the respondent's comments, many EFRAG TEG members considered that accounting for loans to subsidiaries in a parent's separate financial statements is broader issue that went beyond the scope of the Amendments.

9 Twelve EFRAG TEG members voted in favour of finalising the FEA without amendment to the DEA. Three members did not support the FEA and one member was not present. One member did not support the endorsement advice because, in his view, the issue of the separate financial statements mentioned above was not sufficiently addressed. After the meeting, this member sent to the EFRAG Secretariat a proposed suggested addition to the endorsement advice for consideration by the EFRAG Board. The member suggested adding the following:

(a) in the cover letter under the last paragraph of section 'Do the Amendments meet the IAS Regulation technical endorsement criteria?', the following text: '*This could be particularly relevant in separate financial statements, when the parent entity chooses to measure an investment in a subsidiary using the equity method'*;

(b) in Appendix 2, after paragraph 12: '*With reference to separate financial statements, EFRAG acknowledges that applying IFRS 9 impairment requirements to long-term interests in subsidiaries may not bring relevant information for users of the separate financial statements of the parent entity. This is because when the parent controls a subsidiary, the parent has the ability to control the cash flows and the payment/repayment terms of the long-term interest and it has the ability to convert the long-term interest into equity. In these circumstances, the long-term interest assumes a risk profile similar to the one of an equity instrument and the expected credit loss model may be complex to apply, because the parent has the ability to change the contractual terms at any time. It is also noted that for those reasons FASB has excluded loans and receivables between entities under common control from the scope of its expected losses impairment model'*; and

(c) in paragraph 22 of Appendix 2, specifying that this paragraph refers to long-term interests *in associates or joint ventures (emphasis added)*.

10 Two members did not support the endorsement advice because they considered that the Amendments could lead to double-counting of losses and therefore were not an improvement to financial reporting.

Agenda papers

11 In addition to this cover note, agenda paper 12-02 *Endorsement advice on IAS 28 Amendments* has been provided for this session.

Questions for the EFRAG Board

12 Does the EFRAG Board approve EFRAG's FEA as per agenda paper 12-02?

13 Does the EFRAG Board want to amend the FEA as suggested by one of the dissenting EFRAG TEG members, as per paragraph 9?