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

Objective

1 The objectives of this session are to:

(a) consider the comments EFRAG received in response to its Invitation to Comment on its draft endorsement advice on *Long-term Interests in Associates and Joint Ventures (Amendments to IAS 28)* ('the Amendments'); and

(b) discuss and agree to recommend to the EFRAG Board a final endorsement advice.

Background

2 On 12 October 2017, the IASB published the Amendments. 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'). The Amendments also clarify that:

(a) an entity applies the requirements in IFRS 9 to long-term interests before applying the loss allocation and impairment requirements in IAS 28 *Investments in Associates and Joint Ventures*; and

(b) in applying IFRS 9, the entity does not take account of any adjustments to the carrying amount of long-term interests that arise from the application of IAS 28.

EFRAG's initial assessment of the Amendments

3 On 15 December 2017, EFRAG issued a draft endorsement advice and a separate invitation to comment, requesting comments by 16 February 2018. The EFRAG Board approved the draft endorsement advice at its public meeting in December 2017, 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 highlight the following issues in its draft endorsement advice:

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

(b) complexity arising from applying two different IFRS Standards to long-term interests.

5 EFRAG noted that these issues resulted from existing requirements in IFRS 9 and IAS 28 and were not created by the Amendments.

6 EFRAG's draft endorsement advice also acknowledged the concerns about recognition of losses twice for the same financial asset, as the expected loss impairment requirements in IFRS 9 already reflect expected losses to be incurred on an interest in an associate or joint venture in the form of a loan. EFRAG however assessed that it would be difficult to separate the effect of losses from the two different sources (cash shortfalls and results of operations).

7 Lastly, in the draft endorsement advice, EFRAG 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.

Comment letters received

8 EFRAG received comment letters from ten respondents representing six national standard-setters, two preparers, one preparer organisation and one accounting organisation. A list of respondents is included in Appendix 1. EFRAG TEG members can find the comment letters received in response to EFRAG's Invitation to comment on IAS 28 project page under 'Documents' - 'Endorsement consultation'.

Summary of respondent's views

9 Seven out of ten respondents agreed with EFRAG's overall initial assessment for endorsement and did not provide further comments. Two respondents did not oppose to endorsement but expressed various concerns, which they suggested EFRAG should include in the endorsement advice. Lastly, one respondent was concerned that the Amendments, without an exception for separate financial statements, would not be conducive to the European public good and would not meet the technical criteria set out in the IAS Regulation.

Comment letter analysis

10 One respondent (national standard setter) agreed with the Amendments where the long-term interest is a debt instrument distinct from the equity investment. The respondent noted that in the cases of investments in joint ventures and in subsidiaries, the debt instrument is not always distinct from the equity instrument.

11 Specifically, in the case of 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 set out in the IAS Regulation. It was not clear to the EFRAG Secretariat whether the respondent's concerns related only to long-term interests when the investment in subsidiary is accounted for under the equity method in the separate financial statements or also when it is accounted for at cost.

12 Another respondent (preparer) considered that there were not sufficient grounds to oppose the endorsement of the Amendments, however, in the respondent's view, the Amendments do not resolve many of the fundamental questions on this topic and raise issues of a conceptual nature and a practical nature (the interaction between different IFRS Standards, the appropriate unit of account and the

complexity of accounting). The respondent encouraged EFRAG to liaise with the IASB to reassess the priority of the *Equity Method* research project.

13 The third respondent (national standard setter) considered that EFRAG's Endorsement Advice should be more balanced, when considering the effects of the Amendments, to depict the limits and conceptual reservations. The respondent also noted that Appendix 3 should be worded in a less positive way, when referring to the improvement in financial reporting, given that the Amendments are a short-term and quick solution. The respondent considered that the following technical and conceptual issues identified in the Amendments should be clearly highlighted in the final endorsement advice without necessarily changing the overall conclusion. In the respondent's view, these issues should be considered and further investigated in the IASB's *Equity Method* project:

(a) the Amendments do not clarify the nature of long-term interest and therefore result in applying two different measurement models simultaneously for the same asset;

(b) EFRAG's Endorsement Advice should assess the relevance of the Amendments to account for long-term interests in *joint ventures* (emphasis added), given they are economically different from interests in associates;

(c) the Amendments may conflict with IAS 21 *The Effects of Changes in Foreign Exchange Rates* when long-term interests are denominated in foreign currency. The impacts of IAS 21 and IFRS 9 would need to be separated and the lack of guidance might lead to diversity in practice;

(d) the Amendments may lead to double counting of losses not properly eliminated. The respondent considered (and demonstrated it with an example of an investment in a joint venture) that the effect of accounting for the expected credit losses of the long-term interest should be eliminated when calculating the share of the net gains/losses;

(e) the Amendments increase the complexity resulting from applying simultaneously two IFRS Standards. The respondent disagreed with EFRAG's statement that any complexity does not arise from the Amendments themselves. Although the Amendments do not introduce any new concepts, they introduce a new way to apply existing concepts without providing clarifications on how to calculate an expected credit loss for long-term interests, and therefore diversity is expected to increase. In the respondent's view, long-term interests were not explicitly part of IFRS 9 before the Amendments, and hence EFRAG's Endorsement Advice on IFRS 9 did not specifically address interactions with IAS 28; and

(f) the Amendments might create issues in the presentation of profit or loss, as IFRS 9 losses are recognised as impairment losses, while in the respondent's view, the main risk related to an equity investment may be operational rather than financial (credit risk).

EFRAG Secretariat analysis and recommendation

14 Considering that nine out of ten respondents did not oppose the endorsement of the Amendments, the EFRAG Secretariat recommends maintaining the initial assessment that the Amendments satisfy the criteria for endorsement for use in the EU and therefore that EFRAG recommends their endorsement.

15 As mentioned in paragraphs 4 to 7 above, the draft endorsement advice letter already highlighted some concerns related to the Amendments. In relation to points 13(a) and (d) raised by one respondent, these are already included in EFRAG's

draft endorsement advice. The EFRAG Secretariat does not consider they should be analysed in more depth in an endorsement advice that relates to Amendments to endorsed IFRS Standards that are merely a practical way to address existing diversity in practice. Moreover, the EFRAG Secretariat does not see why the effect of accounting for the expected credit losses of the long-term interest should be eliminated when calculating the share of the net gains/losses.

16 The EFRAG Secretariat notes that the arguments raised in the draft endorsement advice letter are applicable for long-term interests both in associates and joint ventures. IAS 28 is applied by all entities that are investors with joint control of, or significant influence over, an investee and the requirements for the application of the equity method are the same for accounting for investments in associates and joint ventures. The EFRAG Secretariat considers that any reference would go beyond the scope of a draft endorsement advice on this limited scope amendment (point 13(b)).

17 Points 13(c), (e) and (f) are not, in the EFRAG Secretariat's view, created by the Amendments, but are due to existing requirements in IFRS 9 and IAS 28.

18 Regarding the effect of the Amendments on the separate financial statements of a parent entity (if the parent entity measures its investments in subsidiaries using the equity method in accordance with IAS 27 *Separate Financial Statements*), EFRAG raised this issue when commenting to the IASB's exposure draft as a topic that needed to be considered by the IASB in its *Equity Method* research project. We note that entities applying IFRS Standards in their stand-alone financial statements are required to calculate expected credit losses on debt-type financial assets that are within the scope of IFRS 9 (classified at either amortised cost, or fair value through other comprehensive income) including intercompany loans. The EFRAG Secretariat recommends not to change the letter in this respect, as we consider this issue is beyond the scope of the Amendments.

19 Although acknowledging the respondents' concerns, the EFRAG Secretariat considers that they are beyond the scope of an endorsement advice. In the EFRAG Secretariat's view, the endorsement advice letter already reflects the main concerns of constituents and therefore, does not recommend any further changes to it.

Question for EFRAG TEG

20 Does EFRAG TEG agree to recommend the final endorsement advice on the Amendments (Agenda paper 15-02) to the EFRAG Board?

Agenda Papers

21 In addition to this cover note, the EFRAG Secretariat has provided agenda paper 15-02 Endorsement Advice on *IAS 28 Long-term Interests in Associates and Joint Ventures* for this session.

Appendix 1 – List of respondents

1 The following constituents responded to EFRAG's Invitation to Comment:

	Name of respondent	**Type of respondent**	**Country**
1	Autorité Des Normes Comptables (ANC)	National Standard Setter	France
2	Accounting Standards Committee of Germany (ASCG)	National Standard Setter	Germany
3	Financial Reporting Council (FRC)	National Standard Setter	United Kingdom
4	The Institute of Chartered Accountants in England and Wales (ICAEW)	Accounting Organisation	United Kingdom
5	BusinessEurope	Association of preparers	Europe
6	BMW Group	Preparer	Germany
7	Instituto de Contabilidad y Auditoría de Cuentas (ICAC)	National Standard Setter	Spain
8	Organismo Italiano di Contabilità (OIC)	National Standard Setter	Italy
9	Comissão de Normalização Contabilística (CNC)	National Standard Setter	Portugal
10	CNP Assurances	Preparer	France