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Mr Jean-Paul GAUZES
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EFRAG's Draft Endorsement Advice (DEA) to the European Commission regarding the IAS 28 Amendment on Long-term Interests in Associates and Joint Ventures

Dear Mr Gauzès, Cher Jean-Paul,

I am writing on behalf of the Autorité des Normes Comptables (ANC) to express our views on the above-mentioned EFRAG's Draft Endorsement Advice (DEA) regarding the IAS 28 Amendment on *Long-term Interests in Associates and Joint Ventures*. This letter sets out the most critical comments raised by interested stakeholders involved in ANC's due process. Our detailed comments are set out in the Appendix.

The purpose of the amendment is to provide clarifications to the accounting treatment of long-term interests in associates or joint-ventures as diversity in practice is expected to emerge with IFRS 9 implementation. ANC underlines that such diversity hasn't been observed so far and acknowledges that the amendment results from a trade-off between an urgent need to provide clarification on how to account for long term interests (as regard IAS 28 and IFRS 9), and the on-going work undertaken by IASB on the equity method research project, which outcome is still pending.

Therefore ANC's view is that this amendment should remain a short term solution before performing an in-depth review of IAS 28. ANC welcomes EFRAG's comment that "*the accounting treatment of long-term interests in an associate or joint venture should be considered more broadly in the IASB's equity method research project*". ANC believes EFRAG should proactively liaise with the IASB to fully revisit IAS 28 standard and to avoid developing additional IAS 28 amendments in the meanwhile.

In ANC's view, technical issues still raise conceptual concerns to be considered and further investigated in the upcoming IAS 28 research project: the proposed amendment does not clarify the very nature of long-term interest therefore subject to two different measurement models simultaneously. Such changes may differently be assessed depending on to whether the investee is a joint-venture or an associate. In addition, the new applicable impairment provisions may lead to double counting of losses not properly eliminated and in some instance conflict with IAS 21, notably when the transaction is denominated in foreign currency. Finally the amendment increases the complexity already resulting from simultaneous application of two standards and raises new presentation issues in the P&L. Many of those limits have been presented in the EFRAG's cover letter but are not always consistently detailed in the Appendix 2.

Finally, ANC believes that EFRAG's Endorsement Advice should be more balanced when considering the effects of the amendment in order to depict the limits and conceptual reservations and therewith provide European Commission with an informed opinion. In the same vein, ANC considers that Appendix 3 should be worded in a less positive way, notably when EFRAG states that the amendment will bring to constituents "*improved financial reporting*" knowing that the amendment is a short term and quick solution.

Yours sincerely, Amitiés !

Patrick de Cambourg

Patrick de CAMBOURG

Appendix - Highlighting technical limits and conceptual reservations

In this Appendix, ANC focuses on the technical limits and conceptual reservations identified in IAS 28 amendment that should be clearly highlighted and/or discussed in the final endorsement advice without necessarily changing the overall conclusion. The purpose of this Appendix is to enhance the consistency of EFRAG's cover letter with Appendices as well as to simultaneously foster an in-depth review of IAS 28 Amendment.

In ANC's view the following technical issues still raise conceptual concerns to be considered and further investigated in the upcoming IAS 28 research project.

(1) The proposed amendment does not clarify the very nature of long-term interest therefore subject to two different measurement models simultaneously. (2) Measurement requirements may be different depending on to whether the investee is a joint-venture or an associate. (3) In addition, the new applicable impairment provisions may conflict with IAS 21 and (4) lead to double counting of losses not properly eliminated. (5) Finally the amendment increases the complexity already resulting from simultaneous application of two standards and (6) raises new presentation issues in the P&L.

1. *The amendment does not clarify the very nature of long term interest therefore subject to two different measurement models simultaneously*

According to the amendment, long-term interest is considered to be a financial debt instrument. However, according to IAS 28.38[1] long-term interests still, in substance, form part of the entity's net investment in the associate or joint venture; where such net investment is analysed as quasi-equity (IAS 28). Accordingly, both standard and measurement models simultaneously apply to long-term interests:

- The first measurement model (IFRS 9) is based on expected losses and future cash flows and considers by nature, a long term interest is a loan measured at amortised cost under IFRS9 (impairment representing the credit risk for a lender);
- The second model (IAS 28) considers that long term interests, as part of the net investment, are basically quasi-equity and are therefore taken into consideration when allocating the actual and realised share of net losses on the equity investment (representing the allocation of the share of net losses for an investor).

The amendment relies on two different impairment models simultaneously applied to the same asset.

[1] IAS 28.38: *"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"*

Hence, the issue dealt with in this amendment will need to be revisited as soon as possible when revising IAS 28 standard in order to specify the accounting qualification of these items.

2. ***Measurement changes may differently be assessed depending on to whether the investee is a joint-venture or an associate***

Since 2011, IAS 28 standard applies to two different types of interests: joint-ventures and associates. IAS 28.BC 30 acknowledges that investor-investee relationships and the investment nature are different depending on the underlying interests. As joint venturers have a joint-control and associates only have a significant influence the nature of these investments often differs.

IAS 28 measurement requirements are the same so that differences between joint ventures and associates are dealt with by IFRS 12 in the disclosure requirements.

The well-founded of this situation has been assessed each time a change in IAS 28 has been endorsed. However, the current IAS 28 amendment modifies measurement principles and such change should be assessed in the endorsement advice to check the relevance of the proposed accounting method and to ensure the adequacy of accounting in a similar way economically different transactions.

3. ***The IAS 28 amendment leads to impairment provisions that may conflict with IAS 21 ones***

ANC believes that long-term interests should be managed together with the equity interest as a net investment. However, a different solution has been retained in IAS 28 amendment.

IAS 28 amendment may conflict with IAS 21.32 when long term interests are denominated in foreign currency. In practice, IAS 21.32 specifies that exchange differences arising on a monetary item that forms part of a reporting entity's net investment shall be recognized in OCI and reclassified from equity to profit and loss on disposal of the net investment, which method differs from IAS 28 amendment.

For a long-term interest denominated in foreign currency it will be necessary to split the presentation of IAS 21 and IFRS 9 impacts keeping in mind that the lack of guidance in the standard may lead to diversity in practice. Such conflict could lead to distortions in the presentation of equity and profit and loss, impairing at the same time comparability.

4. *The IAS 28 amendment may lead to double counting of losses not properly eliminated*

EFRAG mentions[2] that some constituents consider the amendment *"could lead to the recognition of losses twice on the same asset"*. ANC supports this view and disagrees with EFRAG conclusion considering such "double counting" is acceptable as IAS 28 and IFRS 9 have different measurement objectives.

In fact, we illustrate our concern with the help of the following example of an investee being a joint venture 50/50:

Opening balance of the net investment	
Equity	100
Long term interest	200

Impacts to be considered in N	
IFRS 9 Expected Credit Loss (Level 1)	-10
IAS 28 share in net losses (50% of 120)	-60

Closing balance	
Equity	40
Long term interest	190

Applying the amendment to this example:

1) The long term interest is reduced before the share of losses is taken into account.
2) From an economic standpoint, providing for the ECL (by 10) should "relieve" the net investee by the same amount and therefore reduce the share in net losses. In fact the share in net losses should be 50%(-120+10)= -55. The closing balance of equity being then 45.

In other words, double counting relates to the impact on the share in net losses of the "waiver" of long term investment. Even if the Expected Credit Loss (ECL) cannot economically be considered as a debt waiver, from an accounting point of view, the provision for ECL should partially be eliminated in the consolidation process. Absent such elimination, there is a double counting effect applying IFRS 9 impairment model before applying IAS 28.

In practice and in case of financial difficulties in the investee, IAS 28 deals with both parts of the net investments: namely the equity part and the long term investment part. For the purpose of assessing the financial risk on the investor, it is implicitly acknowledged in IAS 28 that both components of a net investment share the financial risk together and that there is conceptual basis to consider both components together instead of disaggregating them. Therefore, the amendment has changed these underlying concepts and this has to be considered in EFRAG's assessment.

[2] in § 37 of the Appendix 2

5. *The IAS 28 amendment increases the complexity resulting from simultaneous application of two standards (IFRS 9 and IAS 28)*

ANC supports EFRAG's comment[3] stating that the "*the application of two different IFRS Standards to long-term interest is somewhat complex and may also limit the relevance of the resulting carrying amount*", but disagrees with the conclusion considering no specific assessment is required as no new concept has been introduced.

In ANC's view, if the amendment does not introduce any new concept, it however introduces a new way of applying the existing concepts without providing clarifications on how to calculate an Expected Credit Loss (ECL) for such long term investments. Isolating the long term interest component within a net investment (before IAS 28 applies) may be challenging. In practice, it appears to be highly complex to assess the expected loss for these specific long-term interests as requires taking into account (i) the entity's own credit risk (venture or associate), (ii) business objectives and (iii) the absence of redemption term. The amendment does not help improving the reliability of that isolated estimate. In addition, the practical difficulties when performing impairment tests are expected to increase diversity and alter comparability.

In our view, the IFRS 9 endorsement advice did not specifically address such potential interactions with IAS 28 since, before the amendment, long term interests were not explicitly part of IFRS 9. Therefore ANC does not concur with EFRAG stating that "*the requirements in IFRS 9 lead to reliable information and [...] this also applies when financial instruments are classified as long-term interests*"[4].

6. *The IAS 28 amendment raises additional presentation issues in the P&L*

The relevance of the amendment is also disputed since the main risk related to an equity investment may be operational rather than financial (credit risk).

Applying first IFRS 9 raises presentation issues due to the fact that the expected loss effects are recognized as impairment losses (determined in accordance with section 5.5 of IFRS 9) in the financial income or operating income, but are booked as share in losses from associates only when allocating IAS 28 share of net loss (in a second step).

[3] in the cover letter and § 5 of Appendix 3

[4] § 16 of Appendix 2 on reliability

An entity having a long term interest with one of its joint venture or associate, may not act as a bank or for mere financial purpose, but rather based on strategic and business decisions. Such long term interests are often provided when external financing is not competitive or available and also when the parent company considers potential conversion of that interest into equity. Therefore, presenting changes in long term interest as impairment losses determined in accordance with section 5.5 of IFRS 9 instead of share in losses from associates may not be relevant.