International Financial Reporting Standard

Long-term Interests in Associates and Joint Ventures

October 2017

ILLUSTRATIVE EXAMPLE

[IAS 28]

[Related to AASB 2017-7]

Illustrative Example—Long-term Interests in Associates and Joint Ventures

This example portrays a hypothetical situation illustrating how an entity (investor) accounts for long-term interests that, in substance, form part of the entity's net investment in an associate (long-term interests) applying IFRS 9 and IAS 28 based on the assumptions presented. The entity applies IFRS 9 in accounting for long-term interests. The entity applies IAS 28 to its net investment in the associate, which includes long-term interests. The analysis in this example is not intended to represent the only manner in which the requirements in IAS 28 could be applied.

Assumptions

The investor has the following three types of interests in the associate:

(a) O Shares—ordinary shares representing a 40% ownership interest to which the investor applies the equity method. This interest is the least senior of the three interests, based on their relative priority in liquidation.

(b) P Shares—non-cumulative preference shares that form part of the net investment in the associate and that the investor measures at fair value through profit or loss applying IFRS 9.

(c) LT Loan—a long-term loan that forms part of the net investment in the associate and that the investor measures at amortised cost applying IFRS 9, with a stated interest rate and an effective interest rate of 5% a year. The associate makes interest-only payments to the investor each year. The LT Loan is the most senior of the three interests.

The LT Loan is not an originated credit-impaired loan. Throughout the years illustrated, there has not been any objective evidence that the net investment in the associate is impaired applying IAS 28, nor does the LT Loan become credit-impaired applying IFRS 9.

The associate does not have any outstanding cumulative preference shares classified as equity, as described in paragraph 37 of IAS 28. Throughout the years illustrated, the associate neither declares nor pays dividends on O Shares or P Shares.

The investor has not incurred any legal or constructive obligations, nor made payments on behalf of the associate, as described in paragraph 39 of IAS 28. Accordingly, the investor does not recognise its share of the associate's losses once the carrying amount of its net investment in the associate is reduced to zero.

The amount of the investor's initial investment in O Shares is CU200,[1] in P Shares is CU100 and in the LT Loan is CU100. On acquisition of the investment, the cost of the investment equals the investor's share of the net fair value of the associate's identifiable assets and liabilities.

This table summarises the carrying amount at the end of each year for P Shares and the LT Loan applying IFRS 9 but before applying IAS 28, and the associate's profit (loss) for each year. The amounts for the LT Loan are shown net of the loss allowance.

At the end of	P Shares applying IFRS 9 (fair value)	LT Loan applying IFRS 9 (amortised cost)	Profit (Loss) of the associate
Year 1	CU110	CU90	CU50
Year 2	CU90	CU70	CU(200)
Year 3	CU50	CU50	CU(500)
Year 4	CU40	CU50	CU(150)
Year 5	CU60	CU60	–
Year 6	CU80	CU70	CU500
Year 7	CU110	CU90	CU500

Analysis

Year 1

The investor recognises the following in Year 1:

Investments in the associate:		
DR. O Shares	CU200	
DR. P Shares	CU100	
DR. LT Loan	CU100	
CR. Cash		CU400
To recognise the initial investment in the associate		
DR. P Shares	CU10	
CR. Profit or loss		CU10
To recognise the change in fair value (CU110 – CU100)		
DR. Profit or loss	CU10	
CR. Loss allowance (LT Loan)		CU10
To recognise an increase in the loss allowance (CU90 – CU100)		
DR. O Shares	CU20	
CR. Profit or loss		CU20
To recognise the investor's share of the associate's profit (CU50 × 40%)		

1 In this Illustrative Example, currency amounts are denominated in currency units (CU).

At the end of Year 1, the carrying amount of O Shares is CU220, P Shares is CU110 and the LT Loan (net of loss allowance) is CU90.

Year 2

The investor recognises the following in Year 2:

DR. Profit or loss	CU20	
CR. P Shares		CU20

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

DR. Profit or loss	CU20	
CR. Loss allowance (LT Loan)		CU20

To recognise an increase in the loss allowance (CU70 – CU90)

DR. Profit or loss	CU80	
CR. O Shares		CU80

To recognise the investor's share of the associate's loss (CU200 × 40%)

At the end of Year 2, the carrying amount of O Shares is CU140, P Shares is CU90 and the LT Loan (net of loss allowance) is CU70.

Year 3

Applying paragraph 14A of IAS 28, the investor applies IFRS 9 to P Shares and the LT Loan before it applies paragraph 38 of IAS 28. Accordingly, the investor recognises the following in Year 3:

DR. Profit or loss	CU40	
CR. P Shares		CU40

To recognise the change in fair value (CU50 – CU90)

DR. Profit or loss	CU20	
CR. Loss allowance (LT Loan)		CU20

To recognise an increase in the loss allowance (CU50 – CU70)

DR. Profit or loss	CU200	
CR. O Shares		CU140
CR. P Shares		CU50
CR. LT Loan		CU10

To recognise the investor's share of the associate's loss in reverse order of seniority as specified in paragraph 38 of IAS 28 (CU500 × 40%)

At the end of Year 3, the carrying amount of O Shares is zero, P Shares is zero and the LT Loan (net of loss allowance) is CU40.

Year 4

Applying IFRS 9 to its interests in the associate, the investor recognises the following in Year 4:

DR. Profit or loss	CU10	
CR. P Shares		CU10

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

Recognition of the change in fair value of CU10 in Year 4 results in the carrying amount of P Shares being negative CU10. Consequently, the investor recognises the following to reverse a portion of the associate's losses previously allocated to P Shares:

DR. P Shares	CU10	
CR. Profit or loss		CU10

To reverse a portion of the associate's losses previously allocated to P Shares

Applying paragraph 38 of IAS 28, the investor limits the recognition of the associate's losses to CU40 because the carrying amount of its net investment in the associate is then zero. Accordingly, the investor recognises the following:

DR. Profit or loss	CU40	
CR. LT Loan		CU40

To recognise the investor's share of the associate's loss

At the end of Year 4, the carrying amount of O Shares is zero, P Shares is zero and the LT Loan (net of loss allowance) is zero. There is also an unrecognised share of the associate's losses of CU30 (the investor's share of the associate's cumulative losses of CU340 − CU320 losses recognised cumulatively + CU10 losses reversed).

Year 5

Applying IFRS 9 to its interests in the associate, the investor recognises the following in Year 5:

DR. P Shares	CU20	
CR. Profit or loss		CU20

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

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

To recognise a decrease in the loss allowance (CU60 – CU50)

After applying IFRS 9 to P Shares and the LT Loan, these interests have a positive carrying amount. Consequently, the investor allocates the previously unrecognised share of the associate's losses of CU30 to these interests.

DR. Profit or loss	CU30	
CR. P Shares		CU20
CR. LT Loan		CU10

To recognise the previously unrecognised share of the associate's losses

At the end of Year 5, the carrying amount of O Shares is zero, P Shares is zero and the LT Loan (net of loss allowance) is zero.

Year 6

Applying IFRS 9 to its interests in the associate, the investor recognises the following in Year 6:

DR. P Shares	CU20	
CR. Profit or loss		CU20

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

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

To recognise a decrease in the loss allowance (CU70 – CU60)

The investor allocates the associate's profit to each interest in the order of seniority. The investor limits the amount of the associate's profit it allocates to P Shares and the LT Loan to the amount of equity method losses previously allocated to those interests, which in this example is CU60 for both interests.

DR. O Shares	CU80	
DR. P Shares	CU60	
DR. LT Loan	CU60	
CR. Profit or loss		CU200

To recognise the investor's share of the associate's profit (CU500 × 40%)

At the end of Year 6, the carrying amount of O Shares is CU80, P Shares is CU80 and the LT Loan (net of loss allowance) is CU70.

Year 7

The investor recognises the following in Year 7:

DR. P Shares	CU30	
CR. Profit or loss		CU30

To recognise the change in fair value (CU110 – CU80)

DR. Loss allowance (LT Loan)	CU20	
CR. Profit or loss		CU20

To recognise a decrease in the loss allowance (CU90 – CU70)

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DR. O Shares CU200

CR. Profit or loss CU200

To recognise the investor's share of the associate's profit (CU500 × 40%)

At the end of Year 7, the carrying amount of O Shares is CU280, P Shares is CU110 and the LT Loan (net of loss allowance) is CU90.

Years 1–7

When recognising interest revenue on the LT Loan in each year, the investor does not take account of any adjustments to the carrying amount of the LT Loan that arose from applying IAS 28 (paragraph 14A of IAS 28). Accordingly, the investor recognises the following in each year:

DR. Cash CU5

CR. Profit or loss CU5

To recognise interest revenue on LT Loan based on the effective interest rate of 5%

Summary of amounts recognised in profit or loss

This table summarises the amounts recognised in the investor's profit or loss.

Items recognised / During	Impairment (losses), including reversals, applying IFRS 9	Gains (losses) of P Shares applying IFRS 9	Share of profit (loss) of the associate recognised applying the equity method	Interest revenue applying IFRS 9
Year 1	CU(10)	CU10	CU20	CU5
Year 2	CU(20)	CU(20)	CU(80)	CU5
Year 3	CU(20)	CU(40)	CU(200)	CU5
Year 4	–	CU(10)	CU(30)	CU5
Year 5	CU10	CU20	CU(30)	CU5
Year 6	CU10	CU20	CU200	CU5
Year 7	CU20	CU30	CU200	CU5