Hong Kong Institute of Certified Public Accountants
香港會計師公會

MEMBERS' HANDBOOK

Update No. 213

(Issued 11 January 2018)

This Update relates to Amendments to HKAS 28 *Investments in Associates and Joint Ventures*.

Amendments to HKAS 28 clarifies that companies account for long-term interests in an associate or joint venture – to which the equity method is not applied – using HKFRS 9 *Financial Instruments*. It contains an example that illustrates how companies apply the requirement in HKFRS 9 and HKAS 28 to long-term interests in an associate or joint venture.

The amendments are effective for periods beginning on or after 1 January 2019. Earlier application is permitted.

Document Reference and Title	***Instructions***	***Explanations***
VOLUME II		
Contents of Volume II	Discard existing page i and replace with revised page i.	Revised contents page
HONG KONG FINANCIAL REPORTING STANDARDS (HKFRS)		
HKAS 28 (2011) *Investments in Associates and Joint Ventures*	Replace the cover page and pages 2, 3 and 16 with revised cover page and revised pages 2, 3 and 16. Insert pages 15C–15D after page 15B and pages 35–44 after page 34.	Refer above

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

MEMBERS' HANDBOOK
CONTENTS OF VOLUME II

(Updated to January 2018)

HKAS 28 (2011)
Revised January ~~2017~~2018

Effective for annual periods
beginning on or after 1 January 2013

Hong Kong Accounting Standard 28 (2011)

Investments in Associates and Joint Ventures

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

CONTENTS

from paragraph

Hong Kong Accounting Standard 28 *Investments in Associates and Joint Ventures* (HKAS 28) is set out in paragraphs 1–47. All the paragraphs have equal authority. HKAS 28 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Appendix
Amendments to HKAS 28 *Long-term Interests in Associates and Joint Ventures*

The following sets out amendments required for this Standard resulting from amendments to HKAS 28 that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Standard and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

Paragraphs 14A and 45G–45K are added and paragraph 41 is deleted. Deleted text is struck through.

Equity method

14A An entity also applies HKFRS 9 to other financial instruments in an associate or joint venture 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 (see paragraph 38). An entity applies HKFRS 9 to such long-term interests before it applies paragraph 38 and paragraphs 40–43 of this Standard. In applying HKFRS 9, the entity does not take account of any adjustments to the carrying amount of long-term interests that arise from applying this Standard.

Application of the equity method

41 [Deleted] ~~The entity applies the impairment requirements in HKFRS 9 to its other interests in the associate or joint venture that are in the scope of HKFRS 9 and that do not constitute part of the net investment.~~

Effective date and transition

45G *Long-term Interests in Associates and Joint Ventures*, issued in January 2018, added paragraph 14A and deleted paragraph 41. An entity shall apply those amendments retrospectively in accordance with HKAS 8 for annual reporting periods beginning on or after 1 January 2019, except as specified in paragraphs 45H–45K. Earlier application is permitted. If an entity applies those amendments earlier, it shall disclose that fact.

45H An entity that first applies the amendments in paragraph 45G at the same time it first applies HKFRS 9 shall apply the transition requirements in HKFRS 9 to the long-term interests described in paragraph 14A.

45I An entity that first applies the amendments in paragraph 45G after it first applies HKFRS 9 shall apply the transition requirements in HKFRS 9 necessary for applying the requirements set out in paragraph 14A to long-term interests. For that purpose, references to the date of initial application in HKFRS 9 shall be read as referring to the beginning of the annual reporting period in which the entity first applies the amendments (the date of initial application of the amendments). The entity is not required to restate prior periods to reflect the application of the amendments. The entity may restate prior periods only if it is possible without the use of hindsight.

45J When first applying the amendments in paragraph 45G, an entity that applies the temporary exemption from HKFRS 9 in accordance with HKFRS 4 *Insurance Contracts* is not required to restate prior periods to reflect the application of the amendments. The entity may restate prior periods only if it is possible without the use of hindsight.

45K If an entity does not restate prior periods applying paragraph 45I or paragraph 45J, at the date of initial application of the amendments it shall recognise in the opening retained earnings (or other component of equity, as appropriate) any difference between:

(a) the previous carrying amount of long-term interests described in paragraph 14A at that date; and

(b) the carrying amount of those long-term interests at that date.

CONTENTS

Amendments to the Basis for Conclusions on IAS 28 *Long-term Interests in Associates and Joint Ventures*

This appendix contains amendments to the Basis for Conclusions of IAS 28 that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of the Basis for Conclusions of IAS 28 and this appendix will be deleted.

Paragraphs BC16A–BC16L and their related headings are added.

Equity method

Long-term interests in associates and joint ventures

BC16A The Board received a submission relating 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 (long-term interests). The submission asked whether long-term interests are within the scope of IFRS 9 and, if so, whether the impairment requirements in IFRS 9 apply to such long-term interests.

BC16B In considering the submission, the Board and the IFRS Interpretations Committee discussed the accounting for long-term interests applying the requirements in IFRS 9 and IAS 28, without reconsidering those requirements. The submission was narrowly and clearly defined, and both bodies concluded they could respond to the submission most efficiently by considering only the submission received. Any reconsideration of the accounting for long-term interests could not be undertaken as a narrow-scope project and would be likely to involve reconsideration of the equity method, a topic included in the Board's pipeline of future research projects. Consequently, the Board limited the amendments to clarifying its intentions when it issued the requirements in IFRS 9 and IAS 28.

BC16C The Board concluded that with respect to interests in an associate or joint venture, paragraph 2.1(a) of IFRS 9 excludes from the scope of IFRS 9 only interests to which the equity method is applied. Accordingly, the scope exclusion in that paragraph does not include long-term interests (as described in paragraph 38 of IAS 28). In reaching this conclusion, the Board noted that IAS 28 mentions long-term interests and the net investment, which includes long-term interests, only in the context of recognising losses of an associate or joint venture and impairment of the net investment in the associate or joint venture. IAS 28 does not specify requirements for other aspects of recognising or measuring long-term interests. Thus, long-term interests are not accounted for in accordance with IAS 28, as envisaged in paragraph 2.1(a) of IFRS 9. The Board also noted 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'.

BC16D The Board clarified in paragraph 14A of IAS 28 that IFRS 9, including its impairment requirements, applies to long-term interests. The Board also deleted paragraph 41 as part of the amendments. That paragraph had merely reiterated requirements in IFRS 9, and had created confusion about the accounting for long-term interests.

BC16E Respondents to the Board's Exposure Draft on long-term interests suggested that it further clarify how the requirements in IAS 28 and IFRS 9 apply to long-term interests because, in the respondents' view, the benefits of the amendments would be limited without such clarifications. Respondents also suggested including an illustrative example.

BC16F In response, the Board clarified that an entity applies IFRS 9, rather than IAS 28, in accounting for long-term interests. Thus, when applying IFRS 9, it does not take account of any losses of the associate or joint venture, or any impairment losses on the net investment, recognised as adjustments to the net investment in the associate or joint venture applying IAS 28.

BC16G In addition, at the same time it issued the amendments, the Board published an example that illustrates how entities apply the requirements in IAS 28 and IFRS 9 with respect to long-term interests.

Effective date and transition

BC16H The Board proposed to align the effective date of the amendments with the effective date of IFRS 9—annual reporting periods beginning on or after 1 January 2018. Some respondents said an effective date of 1 January 2018 would not allow sufficient time to implement the amendments. In particular, the respondents mentioned entities in jurisdictions that have a translation or endorsement process for IFRS Standards.

BC16I In the light of these concerns, the Board set an effective date of annual reporting periods beginning on or after 1 January 2019, with earlier application permitted. The Board noted that if an entity elects to apply the amendments when it first applies IFRS 9, then it would benefit from applying the transition requirements in IFRS 9 to long-term interests.

BC16J Considering the effective date of 1 January 2019 and the requirement to apply the amendments retrospectively, the Board also provided transition requirements similar to those in IFRS 9 for entities that apply the amendments after they first apply IFRS 9. This is because retrospective application may not have been possible without the use of hindsight. When the Board developed IFRS 9, it provided transition requirements for scenarios in which it would have been impracticable for an entity to apply particular requirements retrospectively. Consequently, the Board provided similar transition requirements in the amendments to IAS 28 for long-term interests because the effect of the amendments might be that an entity applies IFRS 9 for the first time to those interests. Accordingly, for example, such an entity would assess its business model for such long-term interests based on the facts and circumstances that exist on the date it first applies the amendments (for example, 1 January 2019 for an entity applying the amendments from that date).

BC16K The Board noted that at the date of initial application of the amendments an entity would be able to use these transition requirements only for long-term interests and not for other financial instruments to which the entity has already applied IFRS 9. Accordingly, for example, an entity is not permitted (or required) to reconsider any of its fair value option elections for financial instruments to which the entity has already applied IFRS 9.

BC16L The Board also decided to provide relief from restating prior periods for entities electing, in accordance with IFRS 4 *Insurance Contracts*, to apply the temporary exemption from IFRS 9. The Board observed that the effect of the amendments for such entities might be that they apply IAS 39 for the first time to long-term interests.

Dissenting opinion

Dissent of Mr Takatsugu Ochi from *Long-term Interests in Associates and Joint Ventures* (Amendments to IAS 28)

DO1 Mr Ochi voted against the publication of *Long-term Interests in Associates and Joint Ventures* (Amendments to IAS 28). The reasons for his dissent are set out below.

DO2 Mr Ochi believes that interests in an associate or joint venture should be subject to either the requirements in IFRS 9 or the requirements in IAS 28, but not both. Accordingly, he disagrees with amending IAS 28 without also specifying the types of interests in an associate or joint venture that an entity accounts for using the equity method, and the types of interests in such entities that an entity accounts for applying IFRS 9.

DO3 Mr Ochi notes that the amendments would result in 'dual application' of accounting requirements to the same asset, which he thinks is contrary to basic principles of accounting standards. He believes that such dual application of accounting requirements might result in double counting and, therefore, could undermine the quality of financial statements.

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.

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

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%)

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)

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