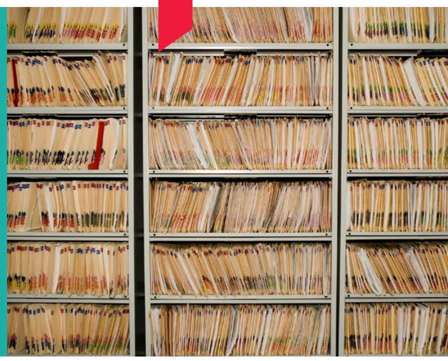
EXPOSURE DRAFT – INVESTMENT ENTITIES: APPLYING THE CONSOLIDATION EXCEPTION (PROPOSED AMENDMENTS TO IFRS 10 AND IAS 28)
INTERNATIONAL FINANCIAL REPORTING BULLETIN 2014/09



Summary

The International Accounting Standards Board (IASB) has issued Exposure Draft 2014/2 *Investment Entities: Applying the Consolidation Exception (Proposed amendments to IFRS 10 and IAS 28)* (the ED) for public comment.

The ED proposes amendments to clarify a number of aspects of IFRS 10 *Consolidated Financial Statements* and IAS 28 *Interests in Associates and Joint Ventures*. Areas addressed in the proposals include:

(i) How intermediate parent entities should apply the general scope exemption to preparing consolidated financial statements provided by paragraph 4 of IFRS 10, when the ultimate parent is an investment entity.

The ED proposes that so long as the entity's ultimate (or intermediate) parent produces financial statements that are in compliance with IFRS 10 (including an investment entity that accounts for its interests in all of its subsidiaries at fair value rather than consolidating them), the exemption available to the intermediate parent entity from presenting its own consolidated financial statements can be applied (so long as the other criteria of paragraph 4(a) have been met).

(ii) How an investment entity parent should account for a subsidiary that provides services related to its investment activities and is also itself an investment entity (that measures and presents its investments in particular subsidiaries at fair value through profit or loss).

The ED proposes that an investment entity parent only consolidates those subsidiaries if both the following criteria are met:

- The subsidiary is not itself an investment entity, and
- The subsidiary's main purpose is to provide services that relate to the investment entity's investment activities.

(iii) How a non-investment entity should account for its interests in any associates or joint ventures that are investment entities.

The ED proposes that a non-investment entity investor

- Retains the fair value measurement applied by its investment entity associate when it is applying the equity method
- Is prohibited from retaining the fair value measurement applied by its investment entity joint venture when it is applying the equity method.

The proposals are open for comment until 15 September 2014.

STATUS
Exposure Draft

EFFECTIVE DATE
To be confirmed

ACCOUNTING IMPACT
Clarification to the application of consolidation and equity accounting requirements of investment entities and non-investment entities with (direct and indirect) interests in investment entities.

Background

In October 2012, IASB issued an amendment to IFRS 10 that introduced a requirement that if an entity met the definition of an 'investment entity' it would be required to measure and present its investments in particular subsidiaries at fair value through profit or loss in its consolidated and separate financial statements, rather than consolidating them. An investment entity is still required to consolidate any subsidiaries that provides services related to the investment entity's investment activities, as these activities are simply an extension of the investment entity's own activities.

The amendment also introduced additional disclosure requirements for investment entities into IFRS 12 *Disclosure of Interests in Other Entities*.

In summary, an entity meets the definition of an investment entity if all of the following criteria are met:

– It obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services
– It commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both
– It measures and evaluates the performance of substantially all of its investments on a fair value basis.

In assessing whether it meets the definition an entity is required to consider whether it has the following typical characteristics of an investment entity:

– It has more than one investment
– It has more than one investor
– It has investors that are not related parties of the entity
– It has ownership interests in the form of equity or similar interests.

Not meeting one or more of the typical characteristics does not preclude an entity from being an investment entity. However, it does indicate that additional judgement is required in determining whether the entity meets the definition of an investment entity. Accordingly, an investment entity that does not meet one or more of the typical characteristics is required to disclose the reasons for concluding that it is nevertheless an investment entity.

For further details on the original amendment introducing the investment entity concept, please refer to BDO IFR Bulletin 2012/15 by clicking the link below:

http://www.bdointernational.com/Services/Audit/IFRS/IFR-Bulletins-2011/IFRB%202012/IFRB-2012-15.pdf

However, subsequent to the release of the investment entity amendment a number of constituents raised concerns regarding several implementation issues related to:

(i) How intermediate parent entities should apply the general scope exemption to preparing consolidated financial statements provided by paragraph 4 of IFRS 10, when the ultimate parent is an investment entity (and so does not consolidate some or all of its subsidiaries)
(ii) How an investment entity parent should account for a subsidiary that provides services related to its investment activities and is also itself an investment entity (which measures and presents its investments in particular subsidiaries at fair value through profit or loss)
(iii) How a non-investment entity should account for its interests in any associates or joint ventures that are investment entities.

Summary of the proposals

The ED proposes three narrow-scope amendments to IFRS 10 and IAS 28 to clarify the implementation issues raised by constituents subsequent to the release of the investment entity amendment to IFRS 10 in 2012.

(i) General scope amendment of IFRS 10

IFRS 10.4(a) provides entities with an exemption from presenting consolidated financial statements if certain specified criteria are met, including whether the entity's ultimate (or intermediate) parent produces 'consolidated financial statements' that are available for public use and comply with IFRS.

As an investment entity is required to account for its interests in particular subsidiaries at fair value rather than consolidating them, constituents questioned whether an entity whose ultimate (or intermediate) parent is an investment entity is actually producing 'consolidated financial statements' given that no 'consolidation' procedures are taking place, and therefore whether the exemption afforded by paragraph 4(a) could be applied.

The IASB proposes that such entities should be able to apply the exemption afforded by paragraph 4(a).

Therefore the IASB proposes to reword the relevant sections of paragraph 4(a) to clarify that so long as the entity's ultimate (or intermediate) parent produces financial statements that are in compliance with IFRS 10 (including investment entities that account for its interests in all of its subsidiaries at fair value rather than consolidating them), the exemption available to the intermediate parent entity from presenting its own consolidated financial statements can be applied (so long as the other criteria of paragraph 4(a) have been met).

(ii) Treatment of subsidiaries of an investment entity that provide investment related services and are themselves investment entities

The original investment entity amendment to IFRS 10 requires an investment entity to consolidate (rather than measure at fair value) any subsidiaries that provide services related to the investment entity's investment activities, as these activities are simply an extension of the investment entity's own activities.

However constituents questioned how such a consolidation procedure would be applied if such subsidiaries were themselves investment entities (and had their own subsidiaries that were measured and presented at fair value rather than being consolidated).

The IASB proposes to amend IFRS 10 to clarify that an investment entity only consolidates those subsidiaries if both the following criteria are met:

– The subsidiary is not itself an investment entity, and
– The subsidiary's main purpose is to provide services that relate to the investment entity's investment activities.

(iii) Treatment of interests in associates and joint ventures that are investment entities, by investors that are non-investment entities

There may be instances where a non-investment entity has a subsidiary that is itself an investment entity that measures its interests in subsidiaries at fair value.

IFRS 10 is clear that it does not allow the non-investment entity parent to consolidate the results of its investment entity subsidiary based on the application of fair value measurement (as this would result in the non-investment entity parent applying the investment entity requirements of IFRS 10 when it is not permitted to).

In such circumstances, in preparing its own consolidated financial statements, the non-investment entity parent is required to consolidate the subsidiaries of the investment entity subsidiary into the investment entity subsidiary, and then consolidate the investment entity subsidiary. This is illustrated in the figure below:

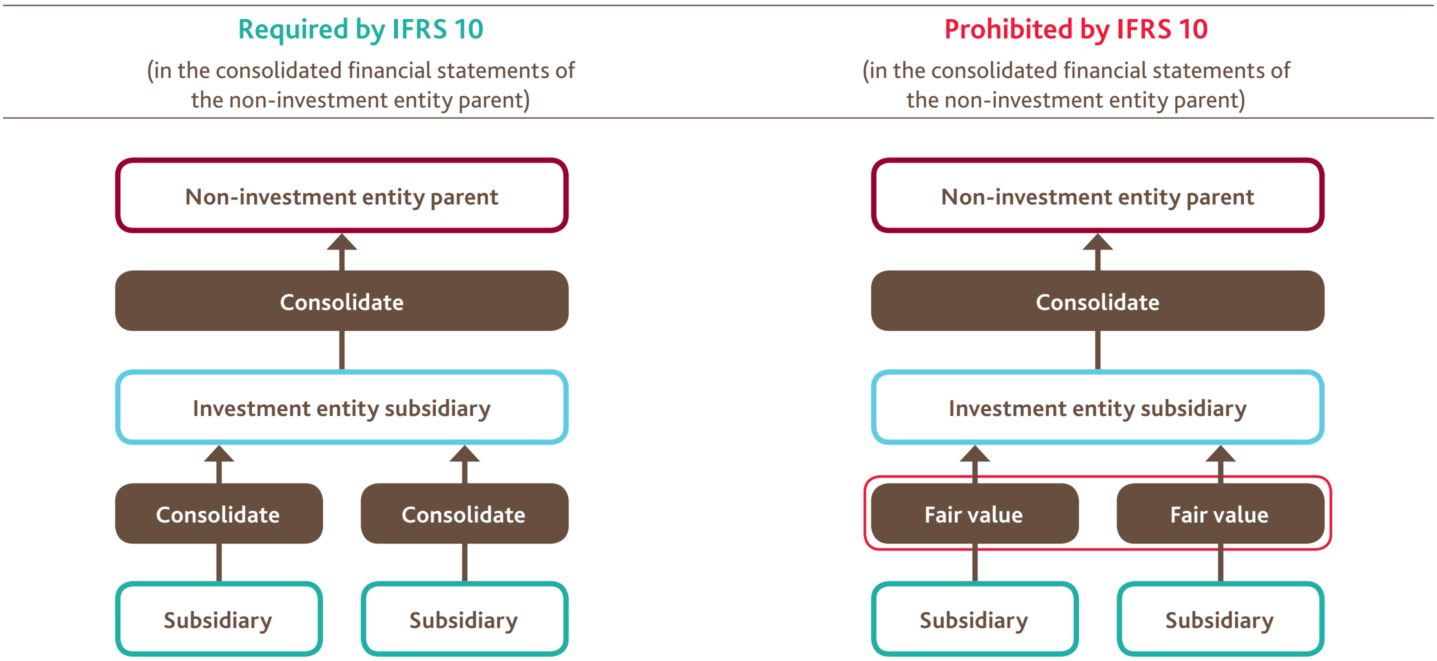


Figure 1: Current requirements of IFRS 10 for non-investment entity parents with subsidiaries that are investment entities

However, IAS 28 does not currently contain similar requirements and guidance regarding the application of the equity method by a non-investment entity investor for its investments in joint ventures or associates that are investment entities.

The IASB proposes to amend IAS 28 to clarify when an investor can and cannot retain the fair value measurement applied by its equity accounted investment entities:

– For interests in associates that are investment entities, the entity retains the fair value measurement applied by the associate when it is applying the equity method

– For interests in joint ventures that are investment entities, the entity is not permitted to retain the fair value measurement applied by the joint venture when it is applying the equity method.

  This requirement would align the treatment of investees where there is joint control and control, rather than basing the accounting approach on whether investees are accounted for using the equity method.

Proposed requirement of IAS 28 (joint venture)

in the consolidated/individual financial statements of the non-investment entity investor)

Proposed requirement of IAS 28 (associate)

(in the consolidated/individual financial statements of the non-investment entity investor)

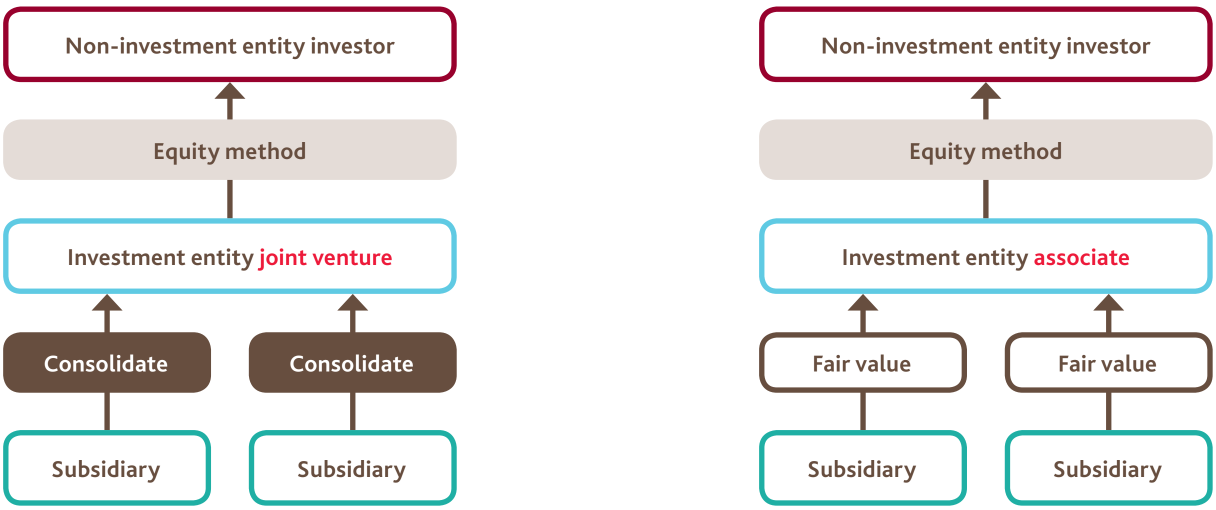


Figure 2: Proposed requirements of IAS 28 for non-investment entity investors in equity accounted investees that are investment entities

What the proposals mean and what should entities do in response to the ED?

The proposed amendments to IFRS 10 (points (i) and (ii) above) will clarify the existing consolidation requirements relating to those entities that are themselves investment entities, or have interests in or have an ultimate parent that is, an investment entity.

The proposed amendments to IAS 28 (point (iii) above) introduce specific guidance regarding how non-investment entity investor is to apply the equity method for investments in associates and joint ventures that are themselves investment entities.

The investment entity amendment was effective for periods beginning on or after 1 January 2014, however it was able to be adopted early.

Therefore those entities that have adopted the investment entity amendment early, or have already applied to interim reporting periods in 2014, will need to determine whether the consolidation and equity accounting procedures would be consistent with the proposed amendments should they be finalised as currently drafted.

At this stage the ED does not contain any transition guidance regarding the proposed amendments.

Effective date and comment period

The effective date is yet to be confirmed. The proposals are open for comment until 15 September 2014.

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