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INVESTMENT ENTITIES: APPLYING THE CONSOLIDATION EXCEPTION (AMENDMENTS TO IFRS 10, IFRS 12 AND IAS 28)

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Summary

In December 2014, the International Accounting Standards Board (IASB) issued *Investment Entities: Applying the Consolidation Exception (Amendments to IFRS 10, IFRS 12 and IAS 28)*.

The amendments clarify a number of aspects of IFRS 10 *Consolidated Financial Statements*, IFRS 12 *Disclosure of Interests in Other Entities* and IAS 28 *Interests in Associates and Joint Ventures* in relation to the investment entities exception:

(i) How intermediate parent entities should apply the general scope exemption to preparing consolidated financial statements provided by IFRS 10.4, when the ultimate parent is an investment entity.

The amendments clarify 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 from preparing its own consolidated financial statements is available to the intermediate parent entity (so long as the other criteria of IFRS 10.4(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.

The amendments clarify that an investment entity parent consolidates a subsidiary only when:

- 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 IFRS 12 should be applied to an investment entity.

The amendments clarify that an investment entity that prepares financial statements in which all of its subsidiaries are measured at fair value through profit or loss (FVTPL) is required to present the disclosures relating to investment entities as required by IFRS 12.

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

The amendments clarify that for an entity that is not itself an investment entity but has an interest in an associate or joint venture that is an investment entity, the non-investment entity may, when applying the equity method, retain the fair value measurement applied by the investment entity associate or joint venture to account for its own interests in its subsidiaries.

The amendments are effective for annual periods beginning on or after 1 January 2016. Early application is permitted.

STATUS

Final

EFFECTIVE DATE

Annual periods beginning on or after 1 January 2016

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, the 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 would still be 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 above 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 following 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 prepare consolidated financial statements provided by IFRS 10.4, 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) The applicability of IFRS 12 to an investment entity

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

Summary of the amendments

The amendments to IFRS 10, IFRS 12 and IAS 28 clarify 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.

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, has a parent that is producing 'consolidated financial statements' given that no 'consolidation' procedures are taking place. Therefore, there were questions about whether the exemption afforded by IFRS 10.4(a) could be applied.

The IASB concluded that such entities should be able to apply the exemption afforded by IFRS 10.4(a).

Therefore relevant sections of paragraph 4(a) have been reworded 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) Accounting for 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 amendment to paragraph 32 of IFRS 10 clarifies 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) Applicability of IFRS 12 to the financial statements of an investment entity

The IASB received comments from constituents highlighting a lack of clarity about the applicability of IFRS 12 to the financial statements of an investment entity. It was noted that IFRS 12.6 stated that the Standard did not apply to an entity's separate financial statements without stating the applicability of IFRS 12 to an investment entity. Because investment entities prepare separate (and not consolidated) financial statements, this implied that investment entities were scoped out of IFRS 12. In contrast, IAS 27 explicitly requires an investment entity to present disclosures relating to investments entities required by IFRS 12.

Therefore, the IASB decided to clarify in IFRS 12 that the scope exclusion in IFRS 12.6 does not apply to the financial statements of a parent that is an investment entity and has measured all of its subsidiaries at fair value through profit or loss. This means that an investment entity is to present the disclosures relating to investment entities required by IFRS 12

(iv) 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:

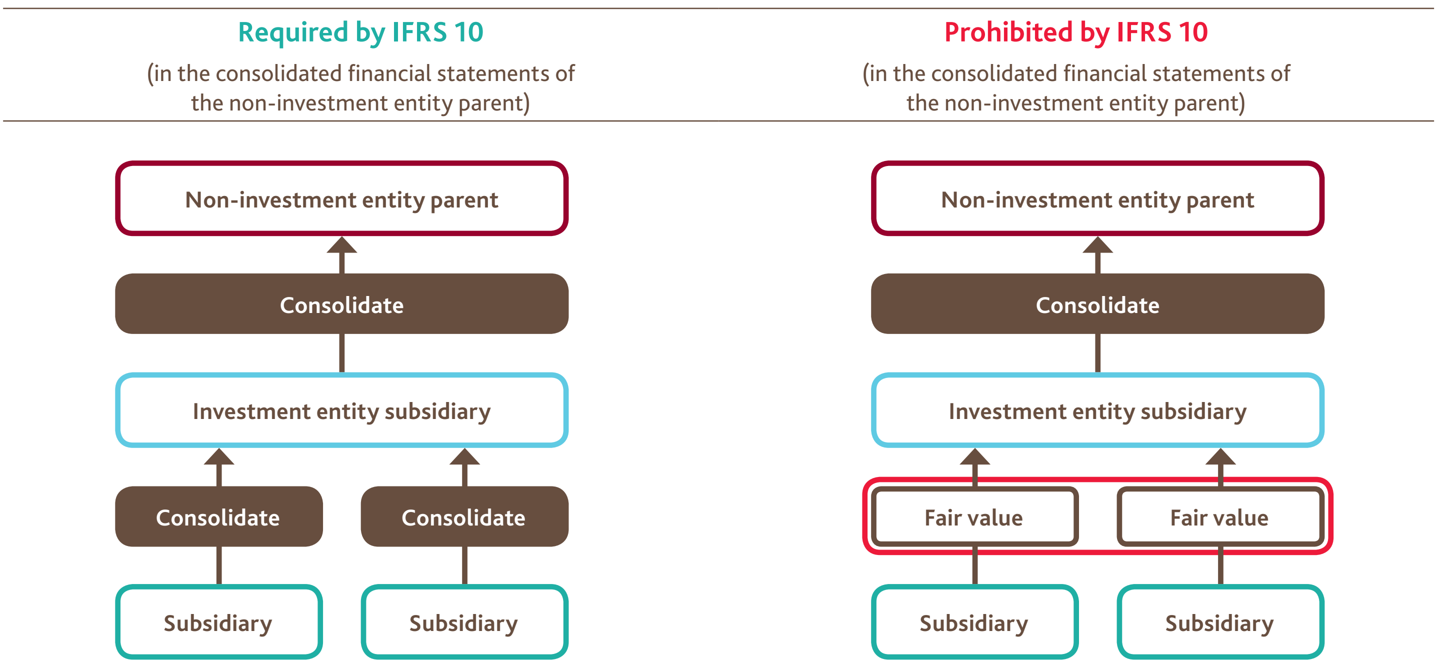

Figure 1: Current requirements of IFRS 10 for non-investment entity parents with subsidiaries that are investment entities

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.

IAS 28 has been amended to clarify for interests in associates or joint ventures that are investment entities, the entity may retain the fair value measurement applied by the associate or joint venture when it is applying the equity method.

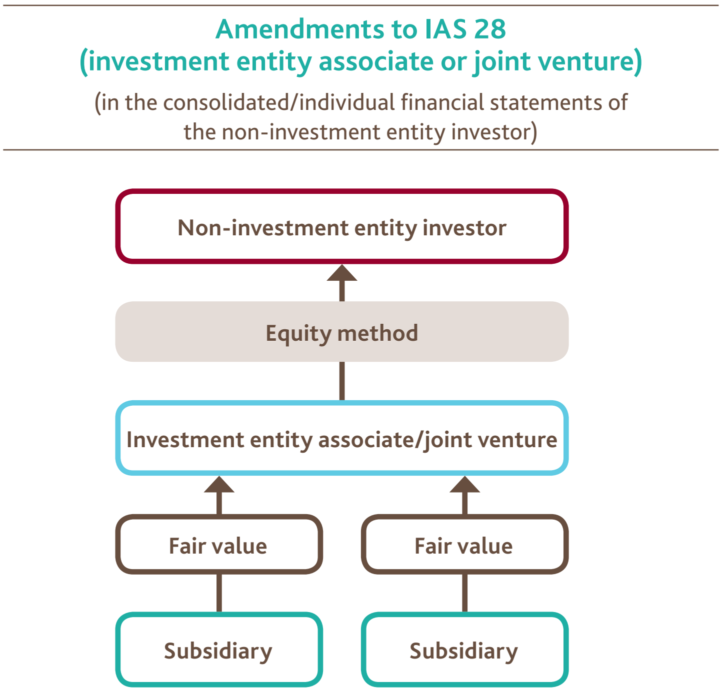

Figure 2: Amendments to IAS 28 for non-investment entity investors in equity accounted investees that are investment entities

What the amendments mean and what should entities do?

The amendments to IFRS 10 (points (i) and (ii) above) clarify the 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 amendments to IAS 28 (point (iv) above) introduce specific guidance regarding how a non-investment entity investor has to apply the equity method for investments in associates and joint ventures that are themselves investment entities.

Therefore those entities that are investment entities will need to determine whether their existing consolidation and equity accounting procedures would be consistent with the amendments. For points (i) and (ii), there is currently diversity in practice with some entities applying a 'hybrid' approach. Under this approach, the fair values recorded by the investment entity subsidiary are preserved on consolidation, with other activities being subject to normal consolidation procedures. For entities where the amendments will require a change in approach, the IASB's statement in paragraph BC240B that it was decided to 'clarify' IFRS 10 might suggest that those entities need to change their accounting in advance of the effective date, because 'clarify' might be taken to imply that IFRS 10 already required that approach. However, we consider that because a change needed to be made to IFRS 10, the amendments represent a substantive change rather than being simply a clarification of existing requirements.

Entities that are investment entities may also be affected by the clarification of the scope of IFRS 12 (point (iii) above) and may need to amend the disclosures that they include in their financial statements.

Effective date and transition

The amendments are effective for annual periods beginning on or after 1 January 2016. Early application is permitted.

The amendments are to be applied retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. However, an entity need only present the quantitative effects on the financial statements required by IAS 8.28(f) for the latest annual comparative period, and not for the current and all comparative periods, when the amendments are first applied.

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