Australian Government
Australian Accounting Standards Board

Memorandum

To:	**AASB Members**	**Date:**	13 May 2014
From:	**Kala Kandiah**	**Agenda Item:**	12.3 (M138)
Subject:	**Narrow Scope Amendments – Investment Entities**	**File:**	

Action

Receive an update on recent tentative decisions made by the IASB on narrow scope amendments to IFRS 10 *Consolidated Financial Statements* and decide whether there are any issues that need to be raised with the IASB on those tentative decisions at this stage.

Staff recommendation

Staff do not consider that there are any issues that warrant being raised with the IASB prior to the AASB drafting its submission on the forthcoming IASB ED.

Question to Board members:

Do you agree with staff's recommendation?

Background

1 The IFRS Interpretations Committee (the 'Interpretations Committee') received a request to clarify some issues related to the Investment Entities amendments in IFRS 10 *Consolidated Financial Statements* and discussed the issues in its November 2013 and January 2014 meetings, but did not reach a consensus on some of the issues.

2 Given the 1 January 2014 effective date of Investment Entities amendments, the IASB discussed the issues in its March 2014 meeting, with a view to propose amendments to IFRS 10 and IAS 28 *Investments in Associates and Joint Ventures, to* provide clarification on to issues.

3 These proposed amendments relate to the following:

(a) Issue 1: an investment entity subsidiary that also provides investment-related services to third parties;

(b) Issue 2: applicability of the exemption from preparing consolidated financial statements in IFRS 10; and

(c) Issue 3: application of the equity method by a non-investment entity investor to an investment entity investee.

Issue 1: an investment entity subsidiary that also provides investment-related services to third parties

4 In November 2013 and January 2014, the Interpretations Committee discussed a request to clarify the accounting by an investment entity that has an investment entity subsidiary (which has investees measured at fair value) and, additionally, provides investment-related services or activities.

5 According to the submitter, in the case in which an investment entity subsidiary meets the definition of an investment entity and, additionally, provides investment-related services or activities, it is unclear whether the investment entity parent should measure that subsidiary at fair value or consolidate it.

6 The Interpretations Committee tentatively concluded that an investment entity parent should account for all investment entity subsidiaries at fair value and recommended that IFRS 10 should be amended to make this clearer.

7 In the March 2014 meeting, the IASB decided to continue to develop proposals to amend IFRS 10 to confirm that all investment entity subsidiaries should be measured at fair value through profit or loss.

AASB staff views on Issue 1

8 AASB staff agree with the IASB's proposed amendment that investment entity subsidiaries that also provide investment related services to third parties should be fair valued as it is consistent with the IASB's previous decision not to create an exception to the fair value accounting requirements for all subsidiaries that are themselves investment entities.

Issue 2: applicability of the exemption from preparing consolidated financial statements in IFRS 10

9 In November 2013 and January 2014, the Interpretations Committee discussed a request to clarify the interaction between the investment entity amendments and the exemption from preparing consolidated financial statements requirements in IFRS 10.

10 The issue is whether the exemption set out in paragraph 4(a) of IFRS 10 is available to entities that, as a result of the amendments in Investment Entities, are measured at fair value in the consolidated financial statements of the parent entity.

11 The Interpretations Committee observed that an intermediate parent that does not provide investment-related services is included in its investment entity parent's financial statements at fair value, and not through a line-by-line consolidation.

12 Some of the Interpretations Committee members questioned whether it was appropriate for such an intermediate parent to qualify for the exemption from the requirement to prepare consolidated financial statements if the intermediate parent was not itself an investment entity. Those members thought that intermediate parents that have subsidiaries should only be exempted from presenting consolidated financial statements if the intermediate parents' accounts are reflected in the ultimate parent's consolidated financial statements on a line-by-line basis.

13 The Interpretations Committee did not reach a consensus on the issue and requested staff to consult the IASB on this issue.

14 The IASB discussed the issue in its March 2014 meeting and decided to amend IFRS 10 to confirm that the exemption from preparing consolidated financial statements set out in paragraph 4(a) of IFRS 10 should be available to an intermediate parent entity that is a subsidiary of an investment entity but that is not an investment entity itself.

AASB staff views on Issue 2

15 AASB staff do not agree with the IASB's proposed amendment on Issue 2 and share the same concerns as some of the Interpretations Committee members as outlined in paragraph 12 above. AASB staff would prefer narrowing the current exemption to require intermediary parent entities that are not investment entities to prepare consolidated financial statements even when the ultimate parent that is an investment entity prepares consolidated financial statements. This is because under the current exemption in IFRS 10, the ultimate parent entity (that is an investment entity) would not be consolidating the intermediary parent entity that is not an investment entity but presenting it at fair value.

Issue 3: application of the equity method by a non-investment entity investor to an investment entity investee

16 In January 2014, the Interpretations Committee discussed a request to clarify how a non-investment entity should account for investments in a joint venture that is an investment entity.

17 A non-investment entity parent of an investment entity must 'unwind' the fair value accounting of its investment entity subsidiaries and consolidate all subsidiaries in the group in accordance with paragraph 33 of IFRS 10. However, it is not clear whether the non-investment entity must also 'unwind' the fair value accounting of its joint ventures or associates that are investment entities.

18 The Interpretations Committee discussed the issue in its January 2014 meeting, but it did not reach a consensus. The Interpretations Committee asked staff to consult with the IASB on the issue.

19 The IASB discussed the issue in its March 2014 meeting and decided to amend IAS 28 so that, when applying the equity method:

(a) A non-investment entity that is party to a joint venture cannot retain the fair value accounting applied by that investment entity joint venture.

(b) A non-investment entity investor should, for cost-benefit reasons, retain the fair value accounting applied by an investment entity associate.

AASB staff views on Issue 3

20 AASB staff do not agree with the proposed amendments on Issue 3 and consider that a non-investment entity investor should apply the equity method to the group financial statements of an investment entity investee without any adjustments to unwind the fair value measurement of the investee's subsidiary and associate. This would be consistent with the guidance in paragraph 27 of IAS 28[i]

21 An investment entity investee invests in subsidiaries and associates with an investment entity objective, which is different from the objective of a non-investment entity investor when it invests in subsidiaries and associates. Therefore an investment entity investee's investment

transactions in subsidiaries and associates are not ‘like transactions or events’ with a non-investment entity investor investment transactions in subsidiaries and associates.

22 Based on the above point on ‘like transactions and events’, AASB staff do not consider that the fair value measurement of investment entity investee’s subsidiary and associate should be unwound before applying the equity method to account for Entity A’s investment in Entity I.

23 AASB staff also consider that the IFRS 10 guidance to unwind the fair value accounting of investment entity subsidiaries in the consolidated financial statements of a non-investment entity parent is not relevant when considering the application of the equity method as equity method is not consolidation.

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[i] Paragraph 27 of IAS 28 states “When an associate or a joint venture has subsidiaries, associates or joint ventures, the profit or loss, other comprehensive income and net assets taken into account in applying the equity method are those recognised in the associate’s or joint venture’s financial statements [. . .] after any adjustments necessary to give effect to uniform accounting policies (see paragraphs 35 and 36)”