

AASB Exposure Draft

ED 250
June 2014

Investment Entities: Applying the Consolidation Exception

Proposed amendments to AASB 10 and AASB 128

Comments to the AASB by 15 August 2014



Australian Government

**Australian Accounting
Standards Board**

Commenting on this AASB Exposure Draft

Constituents are strongly encouraged to respond to the AASB and the IASB. The AASB is seeking comment by 15 August 2014. This will enable the AASB to consider Australian constituents' comments in the process of formulating its own comments to the IASB, which are due by 15 September 2014. Comments should be addressed to:

The Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West Victoria 8007
AUSTRALIA
E-mail: standard@asb.gov.au

Respondents to the IASB are asked to send their comments electronically to the IFRS Foundation website (www.ifrs.org), using the 'Comment on a proposal' page.

All submissions on possible, proposed or existing financial reporting requirements, or on the standard-setting process, will be placed on the public record unless the Chairman of the AASB agrees to submissions being treated as confidential. The latter will occur only if the public interest warrants such treatment.

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AASB REQUEST FOR COMMENTS

The proposed amendments to IFRS 10 *Consolidated Financial Statements* (incorporated into AASB 10 *Consolidated Financial Statements*) and IAS 28 *Investments in Associates and Joint Ventures* (incorporated into AASB 128 *Investments in Associates and Joint Ventures*) are designed to clarify three issues related to the implementation of *Investment Entities*, issued in Australia as AASB 2013-5 *Amendments to Australian Accounting Standards – Investment Entities* in August 2013. The proposed amendments:

- amend IFRS 10 to confirm that the exemption from preparing consolidated financial statements set out in paragraph 4(a) of IFRS 10 continues to be available to a parent entity that is a subsidiary of an investment entity, even when the investment entity measures its subsidiaries at fair value in accordance with paragraph 31 of IFRS 10;
- amend IFRS 10 to clarify that the requirement for an investment entity to consolidate a subsidiary, instead of measuring it at fair value, applies only to those subsidiaries that act as an extension of the operations of the investment entity parent, and do not themselves qualify as investment entities; and
- amend IAS 28 to:
 - (a) provide relief to a non-investment entity investor by requiring it to retain, when applying the equity method, the fair value measurement applied by an investment entity associate to its interests in subsidiaries; and
 - (b) clarify that a non-investment entity investor that is a joint venturer in a joint venture that is an investment entity cannot, when applying the equity method, retain the fair value measurement applied by the investment entity joint venture to its interests in subsidiaries.

In light of the Australian Accounting Standards Board's (AASB's) policy of incorporating International Financial Reporting Standards (IFRSs) into Australian Accounting Standards, the AASB is inviting comments on:

- (a) any of the proposals in the attached International Accounting Standards Board (IASB) Exposure Draft, including the specific questions on the proposals as listed in the Invitation to Comment section of the attached IASB Exposure Draft; and
- (b) the 'AASB Specific Matters for Comment' listed below.

Submissions play an important role in the decisions that the AASB will make in regard to a Standard. The AASB would prefer that respondents supplement their opinions with detailed comments, whether supportive or critical, on the major issues. The AASB regards both critical and supportive comments as essential to a balanced review and will consider all submissions, whether they address all specific matters, additional issues or only one issue.

Due Date for Comments to the AASB

Comments should be submitted to the AASB by 15 August 2014. This will enable the AASB to consider those comments in the process of formulating its own comments to the IASB. Constituents are also strongly encouraged to send their response to the IASB.

Reduced Disclosure Requirements

AASB 1053 *Application of Tiers of Australian Accounting Standards* establishes a differential reporting framework consisting of two tiers of reporting requirements for preparing general purpose financial statements:

- (a) Tier 1: Australian Accounting Standards; and
- (b) Tier 2: Australian Accounting Standards – Reduced Disclosure Requirements.

Tier 2 comprises the recognition and measurement requirements of Tier 1 and substantially reduced disclosures corresponding to those requirements.

The proposals in this Exposure Draft would not make amendments to any disclosure requirements. Accordingly, this Exposure Draft does not give rise to any particular implications for Tier 2 disclosures.

AASB Specific Matters for Comment

The AASB would particularly value comments on the following:

1. whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:
 - (a) not-for-profit entities; and
 - (b) public sector entities, including GAAP/GFS implications;
2. whether, overall, the proposals would result in financial statements that would be useful to users;
3. whether the proposals are in the best interests of the Australian economy; and
4. unless already provided in response to specific matters for comment 1 – 3 above, the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative. In relation to quantitative financial costs, the AASB is particularly seeking to know the nature(s) and estimated amount(s) of any expected incremental costs, or cost savings, of the proposals relative to the existing requirements.

June 2014

Exposure Draft ED/2014/2

Investment Entities: Applying the Consolidation Exception

Proposed amendments to IFRS 10 and IAS 28

Comments to be received by 15 September 2014

IASB[®]

 IFRS[®]

Investment Entities: Applying the Consolidation Exception

(Proposed amendments to IFRS 10 and
IAS 28)

Comments to be received by 15 September 2014

Exposure Draft ED/2014/2 *Investment Entities: Applying the Consolidation Exception* (Proposed amendments to IFRS 10 and IAS 28) is published by the International Accounting Standards Board (IASB) for comment only. The proposals may be modified in the light of the comments received before being issued in final form. Comments need to be received by **15 September 2014** and should be submitted in writing to the address below or electronically using our 'Comment on a proposal' page.

All comments will be on the public record and posted on our website unless the respondent requests confidentiality. Such requests will not normally be granted unless supported by good reason, for example, commercial confidence. Please see our website for details on this and how we use your personal data.

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Introduction

This Exposure Draft, published by the International Accounting Standards Board (IASB), contains proposed amendments to IFRS 10 *Consolidated Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures*. The amendments proposed address three issues submitted to the IFRS Interpretations Committee related to the implementation of *Investment Entities* (Amendments to IFRS 10, IFRS 12 and IAS 27), issued in October 2012.

Exemption from preparing consolidated financial statements

Paragraph 4(a) of IFRS 10 provides an exemption from presenting consolidated financial statements for a parent entity that meets specified criteria. One criterion is that its ultimate or any intermediate parent produces consolidated financial statements that are available for public use and comply with IFRS.

The IASB proposes to amend IFRS 10 to confirm that the exemption from preparing consolidated financial statements set out in paragraph 4(a) of IFRS 10 continues to be available to a parent entity that is a subsidiary of an investment entity, even when the investment entity measures its subsidiaries at fair value in accordance with paragraph 31 of IFRS 10.

A subsidiary that provides services that relate to the parent's investment activities

Paragraph 31 of IFRS 10 requires an investment entity to measure its investments in subsidiaries at fair value, except when paragraph 32 of IFRS 10 applies. Paragraph 32 requires an investment entity to consolidate a subsidiary that provides services that relate to the investment entity's investment activities. When a subsidiary of an investment entity itself meets the definition of an investment entity and, additionally, provides services that relate to the parent's investment activities, the wording in paragraph 32 is unclear as to whether the investment entity parent should measure that investment entity subsidiary at fair value or consolidate it.

The IASB proposes to amend IFRS 10 to clarify the limited situations in which paragraph 32 applies. The IASB proposes that the requirement for an investment entity to consolidate a subsidiary, instead of measuring it at fair value, applies only to those subsidiaries that act as an extension of the operations of the investment entity parent, and do not themselves qualify as investment entities. The main purpose of such a subsidiary is to provide support services that relate to the investment entity's investment activities (which may include providing investment-related services to third parties).

Application of the equity method by a non-investment entity investor to an investment entity investee

Paragraph 33 of IFRS 10 states that a non-investment entity parent of an investment entity cannot retain the fair value measurement applied by the investment entity to its interests in subsidiaries. That non-investment entity parent shall instead consolidate all subsidiaries in the group. However, IAS 28 does not contain an equivalent explicit statement related to 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:

- (a) provide relief to a non-investment entity investor by requiring it to retain, when applying the equity method, the fair value measurement applied by an investment entity associate to its interests in subsidiaries; and
- (b) clarify that a non-investment entity investor that is a joint venturer in a joint venture that is an investment entity cannot, when applying the equity method, retain the fair value measurement applied by the investment entity joint venture to its interests in subsidiaries.

Invitation to comment

The IASB invites comments on the proposals in this Exposure Draft, particularly on the questions set out below. Comments are most helpful if they:

- (a) comment on the questions as stated;
- (b) indicate the specific paragraph or group of paragraphs to which they relate;
- (c) contain a clear rationale; and
- (d) include any alternative that the IASB should consider, if applicable.

The IASB is not requesting comments on matters in IFRS 10 and IAS 28 that are not addressed in this Exposure Draft.

Comments should be submitted in writing so as to be received no later than **15 September 2014**.

Questions for respondents

Question 1—Exemption from preparing consolidated financial statements
--

<p>The IASB proposes to amend IFRS 10 to confirm that the exemption from preparing consolidated financial statements set out in paragraph 4(a) of IFRS 10 continues to be available to a parent entity that is a subsidiary of an investment entity, even when the investment entity measures its subsidiaries at fair value in accordance with paragraph 31 of IFRS 10. Do you agree with the proposed amendment? Why or why not?</p>
--

Question 2—A subsidiary that provides services that relate to the parent's investment activities

<p>The IASB proposes to amend IFRS 10 to clarify the limited situations in which paragraph 32 applies. The IASB proposes that the requirement for an investment entity to consolidate a subsidiary, instead of measuring it at fair value, applies only to those subsidiaries that act as an extension of the operations of the investment entity parent, and do not themselves qualify as investment entities. The main purpose of such a subsidiary is to provide support services that relate to the investment entity's investment activities (which may include providing investment-related services to third parties). Do you agree with the proposed amendment? Why or why not?</p>

Question 3—Application of the equity method by a non-investment entity investor to an investment entity investee

The IASB proposes to amend IAS 28 to:

- (a) require a non-investment entity investor to retain, when applying the equity method, the fair value measurement applied by an investment entity associate to its interests in subsidiaries; and
- (b) clarify that a non-investment entity investor that is a joint venturer in a joint venture that is an investment entity cannot, when applying the equity method, retain the fair value measurement applied by the investment entity joint venture to its interests in subsidiaries.

Do you agree with the proposed amendments? Why or why not?

How to comment

Comments should be submitted using one of the following methods.

Electronically Visit the 'Comment on a proposal page', which can be found at:
(our preferred method) go.ifrs.org/comment

Email Email comments can be sent to: commentletters@ifrs.org

Postal IFRS Foundation
30 Cannon Street
London EC4M 6XH
United Kingdom

All comments will be on the public record and posted on our website unless confidentiality is requested. Such requests will not normally be granted unless supported by good reason, for example, commercial confidence. Please see our website for details on this and how we use your personal data.

[Draft] Amendments to IFRS 10 Consolidated Financial Statements

Paragraphs 4 and 32 are amended. Deleted text is struck through and new text is underlined. Paragraphs 31 and 33 are not amended, but have been included for ease of reference.

Scope

- 4 An entity that is a parent shall present consolidated financial statements. ~~This IFRS applies to all entities, except as follows:~~
- (a) a parent need not present consolidated financial statements if it meets all the following conditions:
 - (i) it is a wholly-owned subsidiary or is a partially-owned subsidiary of another entity and all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements;
 - (ii) its debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);
 - (iii) it did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; and
 - (iv) its ultimate or any intermediate parent produces ~~consolidated~~ financial statements that are available for public use and comply with IFRSs, including the requirements of this IFRS to consolidate subsidiaries or measure them at fair value.
 - (b) post-employment benefit plans or other long-term employee benefit plans to which IAS 19 *Employee Benefits* applies.
 - (c) an investment entity ~~need not present consolidated financial statements~~ if it that is required, in accordance with paragraph 31 of this IFRS, to measure all of its subsidiaries at fair value through profit or loss.

...

Investment entities: exception to consolidation

- 31 **Except as described in paragraph 32, an investment entity shall not consolidate its subsidiaries or apply IFRS 3 when it obtains control of another entity. Instead, an investment entity shall measure an investment in a subsidiary at fair value through profit or loss in accordance with IFRS 9.**

- 32 Notwithstanding the requirement in paragraph 31, if an investment entity has a subsidiary that ~~provides~~ is not itself an investment entity and whose main purpose is to provide services that relate to the investment entity's investment activities (see paragraphs B85C–B85E), it shall consolidate that subsidiary in accordance with paragraphs 19–26 of this IFRS and apply the requirements of IFRS 3 to the acquisition of any such subsidiary.
- 33 A parent of an investment entity shall consolidate all entities that it controls, including those controlled through an investment entity subsidiary, unless the parent itself is an investment entity.

In Appendix B, paragraph B85E is amended. Deleted text is struck through and new text is underlined. Paragraphs B85B–B85D are not amended, but have been included for ease of reference.

Business purpose

- B85B The definition of an investment entity requires that the purpose of the entity is to invest solely for capital appreciation, investment income (such as dividends, interest or rental income), or both. Documents that indicate what the entity's investment objectives are, such as the entity's offering memorandum, publications distributed by the entity and other corporate or partnership documents, will typically provide evidence of an investment entity's business purpose. Further evidence may include the manner in which the entity presents itself to other parties (such as potential investors or potential investees); for example, an entity may present its business as providing medium-term investment for capital appreciation. In contrast, an entity that presents itself as an investor whose objective is to jointly develop, produce or market products with its investees has a business purpose that is inconsistent with the business purpose of an investment entity, because the entity will earn returns from the development, production or marketing activity as well as from its investments (see paragraph B85I).
- B85C An investment entity may provide investment-related services (eg investment advisory services, investment management, investment support and administrative services), either directly or through a subsidiary, to third parties as well as to its investors, even if those activities are substantial to the entity.
- B85D An investment entity may also participate in the following investment-related activities, either directly or through a subsidiary, if these activities are undertaken to maximise the investment return (capital appreciation or investment income) from its investees and do not represent a separate substantial business activity or a separate substantial source of income to the investment entity:
- (a) providing management services and strategic advice to an investee; and
 - (b) providing financial support to an investee, such as a loan, capital commitment or guarantee.
- B85E If an investment entity has a subsidiary that ~~provides~~ is not itself an investment entity and whose main purpose is to support the investment entity's investment

activities by providing investment-related services or activities, such as those described in paragraphs B85C–B85D, to the entity or other parties, it shall consolidate that subsidiary in accordance with paragraph 32. If the subsidiary that provides the investment-related services or activities is itself an investment entity, the investment entity parent shall measure the subsidiary at fair value through profit or loss in accordance with paragraph 31.

In Appendix C, paragraph C1C is added. New text is underlined.

Effective date

...

C1C *Investment Entities: Applying the Consolidation Exception (Amendments to IFRS 10 and IAS 28)*, issued in [date to be inserted after exposure] amended paragraphs 4, 32 and B85E. An entity shall apply those amendments for annual periods beginning on or after [date to be inserted after exposure] retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Earlier application is permitted. If an entity applies those amendments for an earlier period it shall disclose that fact.

Appendix [Draft] Consequential amendment to IAS 28 *Investments in Associates and Joint Ventures*

This appendix sets out an amendment to IAS 28 Investments in Associates and Joint Ventures that is a consequence of the IASB issuing Investment Entities: Applying the Consolidation Exception (Amendments to IFRS 10 and IAS 28). An entity shall apply this amendment for annual periods beginning on or after [date to be inserted]. Earlier application of Investment Entities: Applying the Consolidation Exception is permitted. If an entity applies those amendments earlier it shall apply this consequential amendment at the same time. The amended paragraph is shown with deleted text struck through and new text underlined.

IAS 28 *Investments in Associates and Joint Ventures*

Paragraph 17 is amended. Deleted text is struck through and new text is underlined.

Exemptions from applying the equity method

- 17 An entity need not apply the equity method to its investment in an associate or a joint venture if the entity is a parent that is exempt from preparing consolidated financial statements by the scope exception in paragraph 4(a) of IFRS 10 or if all the following apply:
- (a) The entity is a wholly-owned subsidiary, or is a partially-owned subsidiary of another entity and its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the entity not applying the equity method.
 - (b) The entity's debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets).
 - (c) The entity did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation, for the purpose of issuing any class of instruments in a public market.
 - (d) The ultimate or any intermediate parent of the entity produces ~~consolidated~~ financial statements available for public use that comply with IFRSs, including the requirements of IFRS 10 *Consolidated Financial Statements* to consolidate subsidiaries or measure them at fair value.

**[Draft] Amendments to
IAS 28 *Investments in Associates and Joint Ventures***

Paragraphs 27 and 36 are amended and paragraphs 36A–36B and 45A are added.
Paragraphs 26 and 35 are not amended, but have been included for ease of reference.
Deleted text is struck through and new text is underlined.

Equity method procedures

- 26 Many of the procedures that are appropriate for the application of the equity method are similar to the consolidation procedures described in IFRS 10. Furthermore, the concepts underlying the procedures used in accounting for the acquisition of a subsidiary are also adopted in accounting for the acquisition of an investment in an associate or a joint venture.
- 27 A group's share in an associate or a joint venture is the aggregate of the holdings in that associate or joint venture by the parent and its subsidiaries. The holdings of the group's other associates or joint ventures are ignored for this purpose. 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 (including the associate's or joint venture's share of the profit or loss, other comprehensive income and net assets of its associates and joint ventures), after any adjustments necessary to give effect to uniform accounting policies (see paragraphs 35 ~~and 36~~ 36B).
- ...
- 35 **The entity's financial statements shall be prepared using uniform accounting policies for like transactions and events in similar circumstances.**
- 36 Except as described in paragraph 36A, if an associate or a joint venture uses accounting policies other than those of the entity for like transactions and events in similar circumstances, adjustments shall be made to make the associate's or joint venture's accounting policies conform to those of the entity when the associate's or joint venture's financial statements are used by the entity in applying the equity method.
- 36A Notwithstanding the requirement in paragraph 36, if an entity has an interest in an associate that is an investment entity, the entity shall, when applying the equity method, retain the fair value measurement applied by that investment entity associate to its interests in subsidiaries.
- 36B If an entity is a joint venturer in a joint venture that is an investment entity, the entity shall not, when applying the equity method, retain the fair value measurement applied by that investment entity joint venture to its interests in subsidiaries. Instead, the entity shall, in accordance with paragraph 36, make adjustments to the joint venture's accounting policies to conform to the entity's accounting policies, which shall include the consolidation of all subsidiaries.
- ...

Effective date and transition

...

45A *Investment Entities: Applying the Consolidation Exception (Amendments to IFRS 10 and IAS 28)*, issued in [date to be inserted after exposure], amended paragraphs 27 and 36 and added paragraphs 36A-36B. An entity shall apply those amendments for annual periods beginning on or after [date to be inserted after exposure] retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Earlier application is permitted. If an entity applies those amendments for an earlier period, it shall disclose that fact.

Approval by the Board of *Investment Entities: Applying the Consolidation Exception* (Proposed amendments to IFRS 10 and IAS 28) published in June 2014

The Exposure Draft *Investment Entities: Applying the Consolidation Exception* was approved for publication by the sixteen members of the International Accounting Standards Board.

Hans Hoogervorst	Chairman
Ian Mackintosh	Vice-Chairman
Stephen Cooper	
Philippe Danjou	
Martin Edelmann	
Jan Engström	
Patrick Finnegan	
Amaro Luiz de Oliveira Gomes	
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Patricia McConnell	
Takatsugu Ochi	
Darrel Scott	
Mary Tokar	
Chungwoo Suh	
Wei-Guo Zhang	

Basis for Conclusions on the Exposure Draft *Investment Entities: Applying the Consolidation Exception* (Proposed amendments to IFRS 10 and IAS 28)

This Basis for Conclusions accompanies, but is not part of, the proposed amendments.

Exemption from preparing consolidated financial statements

- BC1 Paragraph 4(a) of IFRS 10 *Consolidated Financial Statements* provides an exemption from presenting consolidated financial statements for a parent entity that meets specified criteria. One criterion is that ‘its ultimate or any intermediate parent produces consolidated financial statements that are available for public use and comply with IFRS’.
- BC2 The IFRS Interpretations Committee (the ‘Interpretations Committee’) was asked whether the exemption set out in paragraph 4(a) of IFRS 10 should remain available to a parent entity that is a subsidiary of an investment entity parent (but is not itself an investment entity), if the conditions set out in paragraph 4(a)(i)–(iii) of IFRS 10 are met but the investment entity parent does not consolidate any of its subsidiaries. Instead, the investment entity parent prepares financial statements in which its subsidiaries are measured at fair value in accordance with paragraph 31 of IFRS 10.
- BC3 The IASB observed that the exemption for intermediate parent entities was previously provided because the cost of requiring each intermediate parent entity within a group to prepare consolidated financial statements could be burdensome in cases in which the conditions in paragraph 4(a) of IFRS 10 are met. In such cases, the IASB previously decided that the combination of information available in the consolidated financial statements of the higher level parent and the separate financial statements of the intermediate parent entity, together with the conditions in paragraph 4 of IFRS 10, provide sufficient safeguards for the users of the intermediate parent’s financial statements.
- BC4 The IASB observed that, when an investment entity measures its interest in a subsidiary at fair value, the disclosures required by IFRS 12 *Disclosure of Interests in Other Entities* are supplemented by those required in IFRS 7 *Financial Instruments: Disclosures* and IFRS 13 *Fair Value Measurement*. Accordingly, the IASB decided that this combination of information provides sufficient grounds to retain the existing exemption from presenting consolidated financial statements for subsidiaries of investment entities that are themselves parent entities. Removing the exemption so that any subsidiary of an investment entity that prepares IFRS financial statements would have to present consolidated financial statements in such circumstances could result in significant additional costs, without commensurate benefit. The IASB noted that this is contrary to its intention in providing the consolidation exception to investment entities in order to provide relevant information and reduce costs, as described in paragraphs BC309 and BC314 of IFRS 10.
- BC5 Accordingly, the IASB proposes to amend IFRS 10 to confirm that the exemption from preparing consolidated financial statements, as set out in paragraph 4(a) of IFRS 10, continues to be available to a parent entity that is a subsidiary of an

investment entity that measures its subsidiaries at fair value. The IASB also proposes to make a consequential amendment to paragraph 17 of IAS 28 *Investments in Associates and Joint Ventures* for the same reasons. Paragraph 17 of IAS 28 uses the same criteria as paragraph 4(a) of IFRS 10 to provide an exemption from applying the equity method for entities that are subsidiaries and that hold interests in associates and joint ventures.

A subsidiary that provides services that relate to the parent's investment activities

BC6 Paragraph 31 of IFRS 10 requires an investment entity to measure its investment in a subsidiary at fair value, except when paragraph 32 of IFRS 10 applies. Paragraph 32 of IFRS 10 requires an investment entity to consolidate a subsidiary that provides services that relate to the investment entity's investment activities. The Interpretations Committee was asked how to apply paragraph 32 of IFRS 10 when a subsidiary of an investment entity itself meets the definition of an investment entity *and* provides services that relate to the parent's investment activities. The Interpretations Committee agreed that the wording in paragraph 32 of IFRS 10 is unclear as to whether the investment entity parent should measure that investment entity subsidiary at fair value or consolidate it. Consequently, it asked the IASB to consider this issue. Subsequently, the IASB decided that the wording in paragraph 32 of IFRS 10 and the related application guidance in paragraph B85E of IFRS 10 should be amended to more clearly define when the limited exception in paragraph 32 of IFRS 10 applies.

BC7 In deciding the best way to clarify this issue, the IASB considered its decisions made in the initial deliberations on the investment entities amendments. The IASB noted that it had decided to:

- (a) require an investment entity parent to measure all of its subsidiaries, including those that are investment entities, at fair value, rather than consolidate them.
- (b) create a limited exception to the requirement that an investment entity shall measure all of its subsidiaries at fair value. The consequence of that exception is to require the investment entity to consolidate an operating subsidiary that provides services that support the investment entity's investment activities.
- (c) allow an entity to qualify as an investment entity even if it provides investment-related services to third parties.

The IASB noted that the decision to allow the services to be provided to third parties was taken after the decisions regarding accounting for subsidiaries described in paragraph BC7(a)–(b). The decisions in paragraph BC7(a)–(b) were made at a point in the deliberations when investment entities would have been prohibited from providing substantive investment-related services to third parties.

BC8 When considering the clarification of paragraph 32 of IFRS 10, the IASB noted that it had not explicitly considered, in its deliberations on the original

investment entity amendments, a fact pattern in which an investment entity parent has an investment entity subsidiary that also provides investment-related services to third parties. Consequently, the IASB and the Interpretations Committee considered two alternative approaches to how an investment entity parent could account for an investment entity subsidiary that provides investment-related services to third parties:

- (a) require an investment entity parent to consolidate an investment entity subsidiary that provides investment-related services to third parties. In this consolidation, the parent would account for each line item in the subsidiary using uniform accounting policies, which would include measuring the subsidiary's investments in controlled investees at fair value.
- (b) require an investment entity parent to measure an investment entity subsidiary that provides investment-related services to third parties at fair value.

BC9 The IASB chose to require an investment entity parent to measure an investment entity subsidiary providing investment-related services to third parties at fair value. The IASB noted that this alternative would be most consistent with its decisions made in the deliberations on the original investment entities exception to consolidation:

- (a) It would be consistent with the decision to require an investment entity parent to measure all of its subsidiaries, including investment entity subsidiaries, at fair value. When it made this decision in the original investment entity deliberations, the IASB noted that this proposal was supported by the majority of constituents who commented on the issue in the Exposure Draft ED/2011/4 *Investment Entities* and is consistent with the basis for the investment entities exception, which is that fair value measurement is the most relevant measurement for all of an investment entity's subsidiaries. As discussed in paragraph BC272 of IFRS 10, the IASB also noted that, although some requests were made to allow an investment entity parent to consolidate an investment entity subsidiary in particular circumstances, the IASB decided against that. This was because there is no conceptual basis for such a distinction and, therefore, it would be too difficult to develop operational guidance to create such a distinction.
- (b) It would be consistent with the decision to require an investment entity to consolidate only those subsidiaries performing services that support the investment entity parent's investment activities. This requirement was intended to be a limited exception, capturing only subsidiaries that support the investment entity parent's investment activities as an extension of the operations of the investment entity. If an entity qualifies as an investment entity, its business purpose is to invest funds solely for returns for capital appreciation, investment income or both. This means that performing investment-related services that support the investment entity parent's investment activities cannot be its main activity. Consequently, such an entity would not qualify for the limited exception in paragraph 32 of IFRS 10.

- BC10 When the IASB decided that providing investment-related services to third parties would not prevent an entity from qualifying as an investment entity, it did so because, in circumstances in which the purpose of the entity is consistent with that of an investment entity, such services would typically constitute an extension of the investment entity's core investment activities. It recognised that investment entities could benefit from synergies with the core investment activities by earning fee income from providing the same investment-related services to third parties.
- BC11 However, the definition of an investment entity requires that the purpose of the entity is to invest solely for capital appreciation, investment income (such as dividends, interest and rental income) or both (see paragraph B85B of IFRS 10). Consequently, an entity whose main purpose is to provide investment-related services in exchange for consideration from third parties has a business purpose that is different from the business purpose of an investment entity. This is because the entity's main activity is earning fee income in exchange for its services. In contrast, for an entity that qualifies as an investment entity, such fee income, which could be substantial in amount, will be derived from its core investment activities, which are designed for earning capital appreciation, investment income or both.
- BC12 In developing the proposed amendments, the IASB confirmed its earlier decision that the exception in paragraph 32 of IFRS 10 was intended to apply only to those situations in which the subsidiary provides services that relate to the investment entity parent's investment activities as an extension of the operations of the investment entity parent. The IASB also decided to confirm that this decision is unchanged when the same services are provided to third parties in order to take advantage of the synergies available. Consequently, if a subsidiary provides investment-related services as an extension of the investment entity's core activities, then the subsidiary would qualify for the limited exception in paragraph 32 of IFRS 10. Otherwise, the subsidiary will be measured at fair value in accordance with paragraph 31 of IFRS 10.
- BC13 Accordingly, the IASB proposes to amend IFRS 10 to clarify that:
- (a) an investment entity shall measure all of its investment entity subsidiaries at fair value; and
 - (b) the limited exception to the requirement for an investment entity parent to measure all subsidiaries at fair value applies only to those subsidiaries whose main purpose is to provide support services for the investment entity parent's investment activities (which may include providing investment-related services to third parties). As such, these subsidiaries act as an extension of the operations of the investment entity parent.

Application of the equity method by a non-investment entity investor to an investment entity investee

- BC14 The exception to the consolidation requirement was introduced to reflect the unique business model of investment entities. However, the IASB was concerned that a non-investment entity parent could achieve different accounting outcomes by holding subsidiaries directly or indirectly through an investment

entity, as described in paragraphs BC278–BC280 of IFRS 10. The IASB was also concerned about the potential complexity of the accounting that could arise. Consequently, paragraph 33 of IFRS 10 prohibits a non-investment entity parent of an investment entity from retaining the fair value measurement of subsidiaries that is applied by the non-investment entity parent’s investment entity subsidiaries. Instead, the non-investment entity parent shall consolidate all entities that it controls, both directly and indirectly.

- BC15 However, IAS 28 does not contain an equivalent explicit statement related to the application of the equity method by a non investment entity investor for its investments in associates or joint ventures that are investment entities.
- BC16 The Interpretations Committee was asked whether an entity that is not an investment entity should, when applying the equity method of accounting for its investment in an associate or a joint venture that is an investment entity, retain the fair value measurement that is applied by that associate or joint venture to its subsidiaries or, instead, ‘unwind’ that treatment and apply consolidation procedures.
- BC17 The IASB and the Interpretations Committee noted that when an investment in an associate or a joint venture is held by, or is held indirectly through, an entity that is a venture capital organisation, a mutual fund, a unit trust or similar entities including investment-linked insurance funds (a ‘VC entity’), the investor can apply the existing fair value option in IAS 28 in order to measure the investment entity associate or joint venture at fair value. When an investment in an associate or a joint venture is held by, or is held indirectly through, an entity that is not a VC entity, the entity is not permitted to apply the fair value option and, instead, applies the equity method to those investees.
- BC18 The IASB noted that the scope of the amendment in *Investment Entities* (Amendments to IFRS 10, IFRS 12 and IAS 27), issued in October 2012, was restricted to providing an exception to the consolidation of subsidiaries for investment entity parents. The IASB did not intend to change existing practice under IAS 28, because investment entity investors could already apply the fair value option in IAS 28 as an alternative to using the equity method for investments in associates and joint ventures, as described in paragraph BC283 of IFRS 10. Consequently, it was not considered necessary to amend IAS 28 as a result of issuing the amendments to IFRS 10 that introduced the consolidation exception.
- BC19 The IASB noted that paragraphs 35–36 of IAS 28, which require the use of uniform accounting policies, would apply for an entity and its investment entity associates or joint ventures. For a non-investment entity with interests in investment entity associates and joint ventures, this would mean that the subsidiaries of those investment entity associates and joint ventures should be consolidated into the financial statements of those associates and joint ventures prior to the equity method being applied. The IASB noted that this is conceptually consistent with the requirement in IFRS 10 for a non-investment entity parent to consolidate subsidiaries held through an investment entity subsidiary.

- BC20 Some Interpretations Committee and IASB members raised concerns about the potentially significant practical difficulty for an entity in unwinding the fair value measurement used by an investment entity associate or a joint venture for their interests in subsidiaries. Some IASB members noted that the degree of practical difficulty is different depending on whether the investee is an associate or a joint venture. A joint venturer has joint control over its joint venture and, consequently, should have the ability to obtain the accounting information needed to adjust the financial statements of the investment entity joint venture to consolidate its subsidiaries in order to apply the equity method, compared with investors that only have significant influence over investment entity associates.
- BC21 The IASB also discussed the structuring risks highlighted in paragraph BC280 of IFRS 10 and noted that an investor's ability to achieve different accounting outcomes by holding investments through an investment entity investee is different depending on whether the investee is an associate or a joint venture. This is because a joint venturer has joint control of its joint venture, whereas an investee has only significant influence over an associate. Consequently, an investor in an associate cannot control the investment (or divestment) decisions of the associate and, therefore, would not be indifferent to structuring its investments through a joint venture instead of through an associate.
- BC22 The IASB noted that there are currently no differences in how IAS 28 is applied to an investment in an associate and a joint venture. However, the IASB decided that the different practical difficulties, and the different levels of risk relating to achieving different accounting outcomes by holding investments through an investment entity investee, provide a basis for differentiating between an associate and a joint venture when applying the equity method in this particular case.
- BC23 Accordingly, the IASB proposes to amend IAS 28 by:
- (a) requiring a non-investment entity investor to retain, when applying the equity method, the fair value measurement that is applied by an investment entity associate to its interests in subsidiaries; and
 - (b) clarifying that a non-investment entity investor that is a joint venturer in a joint venture that is an investment entity cannot, when applying the equity method, retain the fair value measurement that is applied by the investment entity joint venture to its interest in subsidiaries.