Australian Government

Australian Accounting Standards Board

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Mr Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
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Dear Hans

AASB comments on IASB Exposure Draft ED/2014/2
Investment Entities: Applying the Consolidation Exception

The Australian Accounting Standards Board (AASB) welcomes the opportunity to provide comments on ED/2014/2 *Investment Entities: Applying the Consolidation Exception*. In formulating its comments, the AASB sought and considered the views of Australian constituents through comment letters and other consultation. The comment letters received are published on the AASB's website.

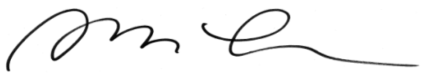
The AASB supports the IASB's efforts to address diversity in practice arising from the implementation of *Investment Entities* (Amendments to IFRS 10, IFRS 12 and IAS 27). However, the AASB has concerns with two of the proposals in ED/2014/2. In particular, the AASB is concerned with the proposal to provide an exemption from preparing consolidated financial statements to an intermediate parent, which is a subsidiary of an investment entity, if the intermediate parent is not itself an investment entity. The AASB also does not agree with the proposal 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.

The AASB would also like to highlight, as a larger issue that affects the presentation of all investment entity subsidiaries, that presenting the fair value of an investment entity subsidiary as a single line item in the financial statements without information about the fair values of the underlying investments of the subsidiary could be viewed by some as not providing useful information for decision-making. The AASB notes that a better approach could be the one considered by the IASB in paragraph BC8(a) of ED/2014/2. This could be an issue for the IASB to consider in the longer term in monitoring the implementation of the *Investment Entities* amendments.

The AASB's responses to the specific matters for comment in ED/2014/2 are included in the Appendix to this letter.

If you have queries regarding any matters in this submission, please contact Kala Kandiah (kkandiah@aasb.gov.au).

Yours sincerely



Angus Thomson
Acting Chair

APPENDIX

AASB comments on IASB ED/2014/2 *Investment Entities: Applying the Consolidation Exception*

Question 1— Exemption from preparing consolidated financial statements
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?

The AASB questions whether it is appropriate for an intermediate parent to qualify for the exemption from the requirement to prepare consolidated financial statements if the intermediate parent is not itself an investment entity. The IASB had decided to provide an exception to consolidation for investment entities because of their unique business model. The IASB also viewed that a non-investment entity does not have this unique business model as it has other substantial activities besides investing, or does not manage substantially all of its assets on a fair value basis (refer to paragraph BC278 of IFRS 10 *Consolidated Financial Statement).* Consequently, the AASB views that exempting a non-investment entity intermediate parent from preparing consolidated financial statements could result in the loss of relevant information for decision making by the users of the financial statements of the intermediate parent.

The AASB also notes that the exemption for intermediate parent entities was previously provided because the combination of information available in the consolidated financial statements of a 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 (refer to paragraph BC3 of the ED). Such safeguards would not be available for users of a non-investment entity intermediate parent's financial statements if the proposals in Question 1 applied as a non-investment entity intermediate parent would be fair valued in the investment entity parent's financial statement and no consolidated information would be available higher up in the group. Consequently, the AASB considers that a non-investment entity intermediate parent ought to produce consolidated financial statements in cases when consolidated financial statements are not available higher up in the group.

The AASB is also concerned that the proposed exemption could increase structuring opportunities to hide leverage or loss-making activities if an intermediate non-investment parent entity were able to avoid consolidation by having an ultimate investment entity parent.

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

The AASB can accept the proposals in to paragraph 32 on the basis that they are consistent with the IASB's previous decision not to create an exception to the fair value measurement requirements for all subsidiaries that are themselves investment entities.

The AASB acknowledges that the assessment of the main purpose of a subsidiary that is both an investment entity and provides support services that relate to the investment entity parent's investment activities could require considerable judgement. The AASB can accept the IASB's views in paragraph BC9(b) of the ED that if an subsidiary 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 a subsidiary should be fair valued and not consolidated under the limited exception in paragraph 32 of IFRS 10.

The AASB would also like to highlight, as a larger issue that affects the presentation of all investment entity subsidiaries, that presenting the fair value of an investment entity subsidiary as a single line item in the financial statements without information about the fair values of the underlying investments of the subsidiary could be viewed by some as not providing useful information for decision-making. The AASB notes that a better approach could be the one considered by the IASB in BC8(a) of the ED. This could be an issue for the IASB to consider in the longer term in monitoring the implementation of the *Investment Entities* amendments.

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?

The AASB does not agree with the proposals in relation to investors in associates and joint ventures. The AASB considers that a non-investment entity investor should apply the equity method to the group financial statements of an investment entity investee (be it an associate or joint venture) without any adjustments to unwind the fair value measurement of the investee's interests in subsidiaries. The AASB considers that this is consistent with the guidance in paragraph 27 of IAS 28 *Investments in Associates or Joint Ventures* as investments in subsidiaries by an investment entity associate or joint venture are not 'like transactions or events' compared with investments in subsidiaries by a non-investment entity investor. This is because an investment entity associate or joint venture invests in subsidiaries with an investment entity objective, which is different from the objective of a non-investment entity investor when it invests in subsidiaries. The AASB considers that the assessment of 'like transactions and events' is different when applying the equity method compared to the process of consolidation because associates and joint ventures are not being consolidated as part of the investor's group.

The AASB notes that paragraph BC34 of IFRS 11 *Joint Arrangements* states: "… the Board observed that the term 'net assets' in the definition of joint ventures aimed to portray that the joint venturers have rights to an investment in the arrangement …" and paragraph BC35 of IFRS 11 states: "… the Board clarified that the unit of account of a joint arrangement is the activity that two or more parties have agreed to control jointly …Consequently, the term 'joint venture' refers to a jointly controlled activity in which the parties have an investment." In other words, the unit of account for a joint venture is the investment as a whole and not the underlying assets and liabilities of the joint venture.

The AASB also notes that in paragraph BC41 of IFRS 11, the IASB "… concluded that, except for specific circumstances that are addressed in IAS 28 (as amended in 2011), the equity method is the most appropriate method to account for joint ventures because it is a method that accounts for an entity's interest in the net assets of an investee". Therefore, the AASB considers that introducing a different approach of applying the equity method to an associate compared to a joint venture would not be aligned with the underlying view in IFRS 11. Consequently, the same approach to the equity method should be applied by both associates and joint ventures and this approach should be to retain the fair value measurement by an investment entity associate or joint venture of its underlying interests in subsidiaries. This would be consistent with an investor accounting for its interest in ‘net assets’ of an investment entity associate or joint venture

The AASB also considers that the IFRS 10 guidance for unwinding the fair value measurement of investment entity interests in subsidiaries in the consolidated financial statements of a non-investment entity parent is not relevant when considering the application of the equity method. This is because the equity method is about accounting for an investment whereas consolidation is the process of aggregating the assets, liabilities, income and expenses for the purposes of presenting the members of a group as a single economic entity.