

# The IASB proposes additional guidance on the investment entity exception

## What you need to know

- ▶ The IASB has issued an exposure draft proposing amendments to IFRS 10 and IAS 28 to clarify application of the investment entity exception under IFRS 10.
- ▶ The ED addresses three issues: i) the exemption from preparing consolidated financial statements for a subsidiary of an investment entity; ii) the accounting by an investment entity parent for an investment entity subsidiary that also provides investment services; and iii) the application of the equity method by a non-investment entity investor to an investment entity joint venture or associate.
- ▶ The effective date has not yet been decided, but early application would be permitted.
- ▶ Comments are due by 15 September 2014.

## Highlights

On 11 June 2014, the International Accounting Standards Board (IASB) issued an exposure draft, (ED) *Investment Entities: Applying the Consolidation Exception (proposed amendments to IFRS 10 and IAS 28)*, which proposes amendments to IFRS 10 *Consolidated Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures*. The amendments address issues that have arisen in relation to the investment entity exception under IFRS 10:

- ▶ **Exemption from preparing consolidated financial statements:** the ED proposes to clarify that the exemption from presenting consolidated financial statements applies to an intermediate non-investment entity parent that is a subsidiary of an investment entity parent.
- ▶ **A subsidiary that provides services that relate to the parent's investment activities:** the ED proposes that an investment entity parent would measure at fair value through profit or loss an investment entity subsidiary that also provides investment services to its parent.
- ▶ **Application of the equity method by a non-investment entity investor to an investment entity joint venture or associate:** the ED proposes to clarify that a non-investment entity investor that has an interest in an investment entity associate, retains the fair value measurement that the associate applies to its interests in subsidiaries, when applying the equity method. The ED also proposes that a non-investment entity investor that has an interest in an investment entity joint venture would not retain the fair value measurement that the joint venture applies to its interests in subsidiaries, when applying the equity method.

The ED proposes to clarify three application issues with the investment entity exception to consolidation.

## Exemption from preparing consolidated financial statements

A common practice issue that has arisen is whether the exemption from presenting consolidated financial statements in paragraph 4(a)(iv) of IFRS 10 is available to an intermediate non-investment entity parent that is a subsidiary of an investment entity parent (provided the other conditions in paragraph 4(a)(i)-(iii) of IFRS 10 are met).

An intermediate non-investment entity parent that is a subsidiary of an investment entity would be exempt from preparing consolidated financial statements.

The IASB observed that, when an investment entity parent measures its interest in subsidiaries at fair value, the disclosures required under IFRS 12 *Disclosure of Interests in Other Entities*, IFRS 7 *Financial Instruments: Disclosures* and IFRS 13 *Fair Value Measurement* provide sufficient relevant information to the users of its financial statements, in the absence of 'traditional' consolidated financial statements. The IASB noted that, just because the parent is classified under current IFRS 10 as an investment entity, the intermediate parent (that is not classified as an investment entity) should not have to incur new costs to prepare consolidated financial statements. Therefore, the proposed amendments to IFRS 10 would clarify that the exemption from preparing consolidated financial statements is available to an intermediate parent entity that is a subsidiary of an investment entity parent.

The ED also proposes to amend paragraph 17 of IAS 28, to provide an exemption from applying the equity method for entities that are subsidiaries of an investment entity parent, and which, in turn, hold interests in associates and joint ventures.

## 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 investment in a subsidiary at fair value. As a narrow exception to this principle, 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 IFRS Interpretations Committee was asked how to account for a subsidiary of an investment entity parent when the subsidiary meets the definition of an investment entity and provides investment services: should the investment entity parent measure this subsidiary at fair value or consolidate it?

The proposed amendments to IFRS 10 would require an investment entity to measure all of its investment entity subsidiaries at fair value, even if they also provide investment services.

The proposed amendments also would clarify that an investment entity would be required to consolidate a subsidiary only when the subsidiary does not itself qualify as investment entity and the subsidiary's main purpose is to provide support services that relate to the investment entity's investment activities.

### How we see it

Determining the fair value of an investment entity subsidiary may present practical challenges and could also result in a loss of information about the investment services activities.

## Application of the equity method by a non-investment entity investor to an investment entity joint venture or associate

Under IFRS 10, a non-investment entity parent of an investment entity cannot retain (or 'roll up') the fair value measurement applied by the investment entity to its interests in its subsidiaries. The non-investment entity parent must instead consolidate all subsidiaries in the group.

Since IAS 28 does not contain an equivalent provision 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, questions arise as to whether the non-investment entity investor should retain the fair value measurement that is applied by its investment entity joint venture or associate.

The proposed amendments to IAS 28 would clarify that when a non-investment entity investor applies the equity method to its investment in an investment entity associate, the investor must retain the fair value measurement that is applied by its investment entity associate to interests in its subsidiaries.

Conversely, when a non-investment entity investor applies the equity method to its investment in an investment entity joint venture, the investor must not retain the fair value measurement that is applied by its investment entity joint venture to interests in its subsidiaries.

In arriving at the proposal, the IASB noted that, conceptually, the fair value accounting by both investment entity associates and joint ventures should be unwound prior to the equity method being applied by the non-investment entity investor. However, an investor in an associate does not control the investment, and the IASB observed that the investor may experience difficulty in obtaining the information required to unwind the fair value accounting in practice. A joint venturer, however, has joint control over its joint venture and, therefore, should have the ability to obtain the information necessary to adjust the financial statements of the joint venture.

Different accounting would apply depending on whether the investment entity is an associate or a joint venture.

### How we see it

The proposed clarifications of the investment entity principles and accounting in IFRS 10 and IAS 28 would be helpful in assisting constituents to apply the standards more consistently.

## Transition

These amendments would be applied retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Early application would be permitted.

## Next steps

The comment period closes on 15 September 2014. We encourage stakeholders to provide feedback to the IASB in the form of a comment letter, to contribute to a well-rounded and robust discussion of the issues by the IASB.

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ED None

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