Project	**Annual Improvement Project – 2008-2010 cycle - Comment letter analysis**
Topic	**IAS 28 *Investments in Associates* – Partial use of fair value for measurement of associates**

Introduction

1. In the *Annual Improvements* exposure-draft published in August 2009, the Board addressed an issue relating to the partial use of fair value for measurement of associates.

2. The objective of this paper is:

   (a) To provide background information on the issue,

   (b) To analyse the comment letters we received, and

   (c) To recommend the IFRIC not to change the proposed amendment.

Background

3. This issue was discussed at the IASB Board meeting in June 2009, and the issue was set out in agenda paper reference 13A and can be found on the public website[1].

4. The proposed amendment intends to clarify instances in which an investor, at a consolidated level, has an investment in an associate (investee), a part of which is held by a subsidiary that is any entity that qualifies for the scope exemption of

[1] http://www.iasb.org/Meetings/IASB+Board+Meeting+20+May+2009.htm

paragraph 1 of IAS 28 *Investments in Associates*, while the other part of the investment is held by another group subsidiary.

5. Circumstances may arise when the accounting for the investee by each subsidiary is different. For example:

   (a) Subsidiary A has significant influence over the investee but qualifies for the exemption in paragraph 1 of IAS 28 and measures the investment at fair value through profit or loss. Subsidiary B also has significant influence over the same investee but applies equity accounting; or

   (b) Subsidiary A has significant influence over the investee but qualifies for the exemption in paragraph 1 of IAS 28 and measures the investment at fair value through profit or loss. Subsidiary B does not have significant influence over the same investee and accounts for its investment as an available for sale (AFS) asset at fair value through OCI.

6. The question is whether different measurement bases can be retained in the consolidated financial statements.

7. The Board noted two views exist in current practice.

   (a) The first view identifies all direct and indirect interests held in the associate by either the parent or any of its subsidiaries and then applies IAS 28 to the entire investment in the associate.

   In accordance with this view, there is only one investment in the associate and it should be accounted for as one unit. If not all of the investment qualifies for the scope exemption in paragraph 1 of IAS 28, the entire investment would be accounted for in accordance with IAS 28.

   (b) The second view identifies all direct and indirect interests held in the associate, but then requires use of the scope criteria in IAS 28 to determine the proper accounting treatment for different portions of the investment, consistent with the business purposes for which those portions may be held.

8. The Board agreed with the second view and concluded that once an entity determines it has significant influence it shall apply the provisions of IAS 28. If a portion of the investment in the associate qualifies for the scope exclusion in accordance with paragraph 1, the entity shall apply the scope exclusion only to the portion to which the scope exclusion applies. The remaining investment in the associate shall be accounted for in accordance with this Standard.

Analysis of comments received

9. The Board received 70 comment letters on the 2009 Annual Improvements of which 57 commented on the subject of this paper.

10. The comment letters breakdown as follows:

Yes:	34
Yes, but expressed comments:	17
No:	6
Total:	57

Staff analysis in response to the comments raised

Unit of account

11. One constituent[2] believes the proposed clarification raises the following question: is the portion subject to the exemption to be taken into account in determining whether significant influence exists?

12. This constituent gives the following example to illustrate their question. A group holds two subsidiaries:

[2] DTT CL 23

(a) S1 is a venture capital organisation and holds 29% and

(b) S2 is an investor and holds 1% only accounted for as held for trading.

13. The proposed amendment would require the group in its consolidated financial statements to account for the 1% under the equity method when this is contrary to its economic purpose (held for trading) and to account for the 29% at fair value through profit or loss, in accordance with the IAS 28 exemption.

14. The commenter then questions whether the assessment of significant influence be made excluding the investment portions to which the scope exclusion applies.

15. The staff acknowledges that excluding a portion of the investment held at group level from the significant influence assessment is not the intent of the Board. Any change in the way of determining significant influence would go beyond *Annual Improvements*.

16. Some constituents[3] disagree with the proposed amendment. Since consolidated financial statements are intended to present the group as a single economic entity, they question the compliance of the proposed clarification with the general principle within IFRSs of assessing accounting treatment at the reporting entity level. In addition, they stress the tension at group level between reflecting the business model and assessing significant influence for the investment as a whole. Therefore, they favour the view that the unit of account is the whole investment and should not be split for accounting purposes depending on the economics for holding the investment at the subsidiary level.

17. The staff acknowledges this view was considered by the Board who favoured the business model accounting.

18. Some constituents[4] point out an inconsistency with the proposed amendment to IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* where

[3] Accounting Standard Board (ASB) CL 2, Dubai Financial Services Authority CL 25, BP CL 34, Dutch Accounting Standards Board CL 11, Association for Financial Markets in Europe (AFME) CL 41

[4] Italian Standard Setter CL 35, Bundesverband Offentlicher Banken Deutschlands CL 9

the whole investment is designated as held for sale. The unit of account there is the whole investment.

19. The staff believes that IFRS 5 and IAS 28 do not serve the same purpose. The proposed amendment to IFRS 5 reflects the expected change in the reporting entity's entire relationship with the associate. That is, significant influence will be lost for the remaining investment.

Transition requirements

20. Some constituents[5] note that the transition requirements are silent on how to apply the transition amendment. They therefore question whether the proposed amendment is to be applied prospectively or retrospectively. Some[6] assume application on transition would be retrospective in line with paragraph 19(b) of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

21. The staff believes that if transition rules are silent, then retrospective application is required in accordance with IAS 8.

Other comments

22. Some constituents[7] suggest a similar amendment be made to IAS 31 *Interests in Joint Ventures*.

23. The staff notes that IAS 31 has the same scope exception as IAS 28 and proposes a choice of two accounting methods for interest in joint ventures. Therefore the staff agrees with this comment with a view to enhance consistency between the standards.

24. Some constituents[8] also question how to apply the scope criteria and whether and when transfers may be made between the portion accounted for based on the

[5] European Financial Reporting Advisory Group (EFRAG) CL 49, DTT CL 23
[6] Accounting Standard Board (ASB) CL 2
[7] South African Institute of Chartered Accountants (SAICA) CL 29, Mazars CL 51, BDO CL 53

equity method and the portion accounted for at fair value through profit or loss. They feel application guidance is needed.

25. The staff notes that paragraphs 18 and 19 of IAS 28 provide guidance in situations where an entity ceases to have significant influence over an associate. Any further guidance would be in the nature of a standalone amendment rather than *Annual Improvements*.

26. However, when significant influence is retained at group level, the staff believes that the effect of transfers between the portion accounted for based on the equity method and the portion accounted for at fair value through profit or loss should also impact profit or loss for the period to reflect the underlying change in the business model.

Staff recommendation

27. Based on the analysis above, the staff recommends the proposed amendment be finalised without changes.

28. In addition, the staff suggests the same amendment be made to IAS 31 *Interests in Joint Ventures.* The staff understands this modification would need to be included in the next *Improvement to IFRSs* cycle in order to follow the due process. However, the staff is aware that by that time, the exposure draft on Joint Ventures is likely to have been published. Therefore, the staff suggests the IFRIC recommends the change be made to the exposure draft on Joint Ventures.

29. Appendices A and B reflect inclusion of the Basis for Conclusions for the *Improvements to IFRSs* in the relevant section of the Basis for Conclusions of IAS 28.

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[8] AIISAA-The Ultimate KPO CL 1, The Accounting Committee (AC) of Chartered Accountants Ireland CL 36

Questions to the IFRIC

Question 1 – Staff recommendation
Does the IFRIC agree with the staff recommendation in paragraph 29 not to propose changes to the proposed amendment?

Question 2 – Additional amendment
Does the IFRIC agree with the staff recommendation in paragraphs 30 to amend IAS 31 as part of the next *Annual Improvements*?

Appendix A – Proposed drafting of final amendment

A1. This appendix includes the proposed drafting of the final amendment. It is based on the text included in the Bound Volume as of 1 January 2009. New text is underlined and deleted text is struck through.

Amendment to IAS 28 *Investments in Associates*

Paragraphs 1A and 41E are added.

Scope

1A If an entity determines in accordance with paragraphs 6-10 of this Standard that it has significant influence in an associate, the entity shall apply this Standard. If a portion of the investment in the associate qualifies for the scope exclusion in accordance with paragraph 1, the entity shall apply the scope exclusion only to the portion to which the scope exclusion applies. The remaining investment in the associate shall be accounted for in accordance with this Standard.

Effective date and transition

41E Paragraph 1A was added by Improvements to IFRSs issued in April 2010. An entity shall apply the amendment for annual periods beginning on or after 1 January 2011. Earlier application is permitted. If an entity applies the amendment for an earlier period it shall disclose that fact.

Basis for Conclusions on amendment to IAS 28 *Investments in Associates*

Paragraphs BC6A-BC6C are added.

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

Scope exclusion: investments in associates held by venture capital organisations, mutual funds, unit trusts and similar entities

BC6A The Board received a request to clarify whether different measurement bases can be applied to portions of an investment in an associate when part of the investment is designated at initial recognition as at fair value through profit or loss in accordance with the scope exemption in paragraph 1 of the IAS 28. Paragraph 6 of IAS 28 is clear that the determination of significant influence includes both direct and indirect holdings. However, IAS 28 is silent on whether both those investments included in the scope of IAS 28 and those investments excluded from the scope of IAS 28 should be considered in establishing the existence of significant influence and the group's share in the associate.

BC6B The Board noted two views exist in current practice. The first view identifies all direct and indirect interests held in the associate by either the parent or any of its subsidiaries and then applies IAS 28 to the entire investment in the associate. In accordance with this view, there is only one investment in the associate and it should be accounted for as one unit. If not all of the investment qualifies for the scope exemption in paragraph 1 of IAS 28, the entire investment would be accounted for in accordance with IAS 28. The second view identifies all direct and indirect interests held in the associate, but then requires use of the scope criteria in IAS 28 to determine the proper accounting treatment for different portions of the investment, consistent with the business purposes for which those portions may be held.

BC6C The Board agreed with the second view and concluded that once an entity determines it has significant influence it shall apply the provisions of IAS 28. If a portion of the investment in the associate qualifies for the scope exclusion in accordance with paragraph 1, the entity shall apply the scope exclusion only to the portion to which the scope exclusion applies. The remaining investment in the associate shall be accounted for in accordance with this Standard.

Appendix B – Proposed drafting edits from Exposure Draft

B1. This appendix includes the proposed drafting edits from the proposed amendment included in the exposure draft of proposed Improvements to IFRSs published in August 2009. This appendix presumes all changes proposed in the exposure draft were accepted and only shows incremental changes newly recommended by the staff based on an analysis of the comment letters received. Incremental new text is double underlined and incremental deleted text is double struck through.

Amendment to IAS 28 *Investments in Associates*

Paragraphs 1A and 41E are added.

Scope

1A **If an entity determines in accordance with paragraphs 6-10 of this Standard that it has significant influence in an associate, the entity shall apply this Standard. If a portion of the investment in the associate qualifies for the scope exclusion in accordance with paragraph 1, the entity shall apply the scope exclusion only to the portion to which the scope exclusion applies. The remaining investment in the associate shall be accounted for in accordance with this Standard.**

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BC~~1~~6A The Board received a request to clarify whether different measurement bases can be applied to portions of an investment in an associate when part of the investment is designated at initial recognition as at fair value through profit or loss in accordance with the scope exemption in paragraph 1 of the IAS 28. Paragraph 6 of IAS 28 is clear that the determination of significant influence includes both direct and indirect holdings. However, IAS 28 is silent on whether both those investments included in the scope of IAS 28 and those investments excluded from the scope of IAS 28 should be considered in establishing the existence of significant influence and the group's share in the associate.

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BC~~3~~6C The Board agreed with the second view and concluded that once an entity determines it has significant influence it shall apply the provisions of IAS 28. If a portion of the investment in the associate qualifies for the scope exclusion in accordance with paragraph 1, the entity shall apply the scope exclusion only to the portion to which the scope exclusion applies. The remaining investment in the associate shall be accounted for in accordance with this Standard.