Project	**Joint Ventures**
Topic	**Sweep issues on IAS 28 *Investments in Associates* - Clarification on partial use of fair value amendment**

Purpose of this paper

1. The purpose of this paper is to ask the Board to make a decision as to clarify the measurement exception at group level for investments in an associate held at fair value through profit or loss by a venture capital organisation.

Background

2. This issue was initially discussed within the *Annual Improvements* process. An amendment to IAS 28 was approved for finalisation by the Board on 10 February 2010. The amendment was to enable a parent entity to measure part of the investment in an associate at fair value in its consolidated financial statements when that part is designated as at fair value through profit or loss in accordance with the scope[1] exclusion in paragraph 1 of IAS 28.

3. Following the main Board meeting in February 2010, because the *Joint Arrangements* project addresses consequential amendments to IAS 28, the amendment on the partial use of fair value was removed from the *Annual*

[1] The staff notes that the new standard on *Joint Arrangements* amends the venture capital scope exclusion/exemption of IAS 28 as a consequential amendment. Part of the change is to re-characterise the scope exclusion as a measurement exemption. Therefore the amendment permitting the partial use of fair value will no longer refer to the 'scope exclusion'.

Improvements process. Instead, the amendment is to be published simultaneously to the consequential amendments to IAS 28.

Issues brought about by the amendment to IAS 28

4. While writing the consequential amendments to IAS 28 to include the amendment, the staff identified the following sweep issues:

   (a) Is significant influence needed at the level of the venture capital organisations or mutual funds, unit trusts and similar entities including investment-linked insurance funds, or only at group level in order to qualify for the exception at group level?

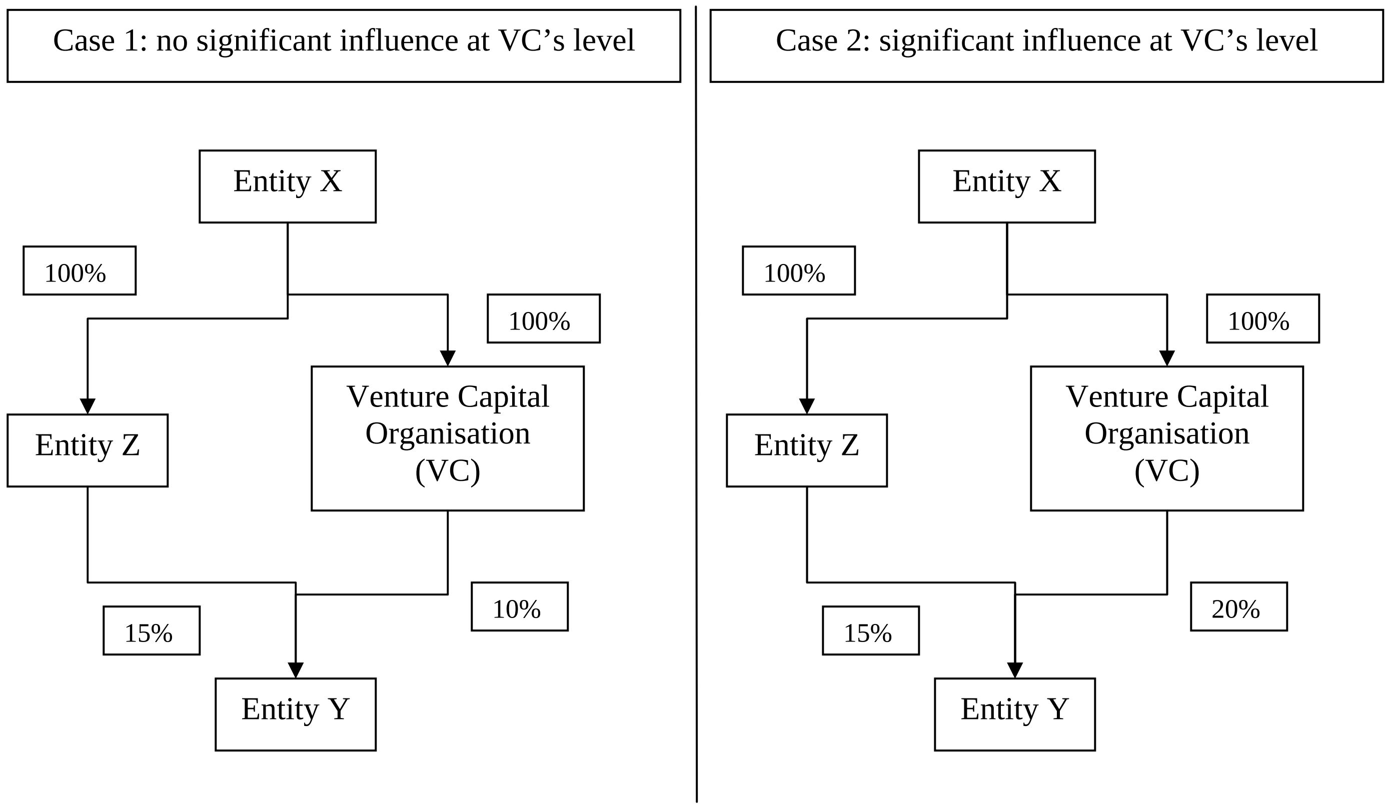
   (b) Should the use of fair value through profit or loss be a requirement in the financial statements of the venture capital organisations or mutual funds, unit trusts and similar entities including investment-linked insurance funds to retain the use of fair value at group level?

Significant influence at the level of the venture capital organisation[2]

5. The staff understands confusion is triggered by the amendment on the partial use of fair value discussed on 10 February 2010. The discussion referred to a venture capital organisation that fulfilled the 'scope exclusion' in current IAS 28. Some believe that fulfilling the scope exclusion implicitly means that the investment at stake needs to be an associate of the venture capital organisation.

[2] In the following, 'venture capital organisation' stands for 'venture capital organisations or mutual funds, unit trusts and similar entities including investment-linked insurance funds'.

6. The following diagrams intend to illustrate the issue at stake:



In both cases, VC holds its investment in entity Y at fair value through profit or loss.

7. Requiring significant influence over the investee at the level of the venture capital organisation would have the following effect. In case 1, the group wouldn't be allowed to retain the fair value measurement in its consolidated financial statements, whereas it would be allowed to in case 2. The staff believes there is no rationale for such a different measurement basis when the investment as a whole is in both cases an associate of the group.

8. The staff believes that introducing, in the group's consolidated financial statements, a different measurement basis for investments in associates held by venture capital organisations depending on their shares in the investee would impair comparability.

9. In the context of the consequential amendments to IAS 28 re-characterising the scope exclusion as a measurement exemption, the staff believes that it is appropriate to clarify that significant influence over the investee is not required at the level of the venture capital organisation to measure the investment at fair value through profit or loss at group level.

Requirement to measure the investment at fair value through profit or loss in the financial statements of the venture capital organisation

10. The partial use of fair value amendment was discussed based on the grounds that the appropriate accounting treatment for different portions of the investment should be consistent with the business purposes for which those portions may be held.

11. Some believe that for the group to be allowed to retain the measurement basis in the venture capital organisation consistent with the business purpose of the investment, the venture capital organisation should be required to designate the investment at fair value through profit or loss in its own financial statements.

12. The staff notes that the wording that was previously reviewed by the IFRS Interpretations Committee and the Board for the partial use of fair value amendment to the standard is silent as to the level at which the business purpose should be assessed, ie consolidation or venture capital organisation level.

13. However, the staff acknowledges that in practice, several situations may arise, for example:

    (a) The venture capital organisation might not prepare IFRS financial statements: although the venture capital organisation’s management might analyse that the business purpose should lead to account for the investment at fair value through profit or loss, local accounting regulations might not allow such an accounting treatment in the venture capital organisation’s own financial statements.

(b) The venture capital organisation might prepare IFRS financial statements but might choose to classify the investment as AFS in accordance with IAS 39 in its own financial statements.

14. In both of these situations, requiring designation of the investment at fair value through profit or loss in the venture capital organisation's financial statements would prevent the group from measuring the portion of the investment held by the venture capital organisation at fair value in its consolidated financial statements. The staff believes this would not reflect the economic reality in the group financial statements and would impair comparability between groups.

15. The staff is of the opinion that the predominant principle is the appropriate determination of the business purpose from the group's view. Requiring a specific accounting in the financial statements of the venture capital organisation would contradict the business purpose rationale in the cases when the venture capital organisation either does not prepare IFRS financial statements or is not permitted to reflect the business purpose in its accounts due to local laws and regulations.

16. In addition, the staff believes that the intent when discussing the partial use of fair value at consolidation level rather than equity accounting was for the Board to allow a choice[3] at group level in the accounting for investments held by venture capital organisations. Therefore the staff is of the opinion that this flexibility should be carried forward.

17. Therefore the staff supports the view that the group should be entitled with no restriction to elect for the fair value through profit or loss measurement of the portion of the investment held by a venture capital organisation.

[3] The current scope exclusion in IAS 28 is a policy choice and not a requirement.

Staff recommendation

18. The staff recommends that the consequential amendments to IAS 28 include the clarification that significant influence over the investee is not required at the level of the venture capital organisation in order to measure the investment at fair value through profit or loss at group level. The staff also recommends that the amendment clarify that the exemption is available based on the business purposes for holding the investment and not restricted by the financial reporting basis used in the venture capital organisation's own financial statements.

19. The staff believes this clarification of the amendment on the partial use of fair value does not modify the transition requirement for that amendment. Therefore the staff recommends the transition requirement discussed be retained. An entity will be required to apply the amendment retrospectively in accordance with paragraph 19(b) of IAS 8 *Accounting policies, Changes in Accounting Estimates and Errors*.

Questions to the Board

Question – Staff recommendation
Does the Board agree with the staff recommendation to clarify that significant influence over the investee is not required at the level of the venture capital organisation to measure the investment at fair value through profit or loss at group level? Does the Board agree that it should not be required that the venture capital organisation account for its investment at fair value through profit or loss in its own financial statements?