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Project	**Investment Entities**
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Introduction

1. Exposure Draft ED/2011/4 *Investment Entities* (the ED) proposes prospective application of the exception from consolidation requirements and provides transition guidance for when a reporting entity applies the proposals for the first time. The purpose of this agenda paper is to analyse whether those proposals should be amended taking into account respondents' comments about the ED. This paper also discusses when the final amendments should become effective.

2. This paper:

   (a) summarises the staff recommendations;

   (b) explains the transition guidance proposed in Appendix C to the ED;

   (c) summarises respondents' comments on the proposed transition guidance in the ED;

   (d) discusses the staff analysis and recommendations for revised transition requirements; and

   (e) considers the effective date for the new requirements.

Summary of staff recommendations

3. We make the following recommendations for the transition guidance to be included within Appendix C to IFRS 10 *Consolidated Financial Statements*:

   (a) to require retrospective application of the consolidation exception for investment entities on transition, with some transition relief, which is generally consistent with the approach currently contained in Appendix C to IFRS 10, as amended in June 2012 (paragraphs 12-14 of this paper);

   (b) to allow a specific practicability exception from retrospective application that would require the investment entity requirements to be applied at the beginning of the earliest period for which retrospective application is practicable, which may be the current period (paragraphs 16-18);

   (c) to require that, for the purpose of transition, entities need only assess whether they meet the definition of an investment entity on the initial date of application of the investment entity requirements (paragraphs 19-20);

   (d) to allow investment entities to retain the previous accounting for any investees that were disposed of prior to the date of initial application of the investment entity requirements (paragraphs 21-24);

   (e) if an investment entity applies the consolidation exception retrospectively for any period(s) prior to the effective date of IFRS 13 *Fair Value Measurement*, to allow investment entities to retain the fair values used by management if these amounts are consistent with the definition of fair value previously used in IFRS (paragraphs 25-28);

   (f) to limit the requirement to present adjusted comparatives to the period immediately preceding the date of initial application of these investment entity requirements (paragraphs 29-30);

   (g) to draft transition guidance for amendments to IAS 28 *Investments in Associates and Joint Ventures* and IAS 27 *Separate Financial*

Statements that is consistent with the decisions made for the transition guidance for IFRS 10 (paragraphs 36-37);

(h) to allow first-time adopters of IFRS to apply the consolidation exception in IFRS 10 early, together with the other requirements of IFRSs 10-12, and permit limited exceptions to full retrospective application related to impracticability and IFRS 13 fair value (paragraphs 38-42); and

(i) to set an effective date for the investment entity requirements of 1 January 2014, with early adoption permitted (paragraphs 43-48).

Transition requirements proposed in Appendix C to the ED

4. The ED included the following transition requirements:

> If an entity meets the definition of an investment entity, it shall report the effect of applying this [draft] IFRS as an adjustment to retained earnings as of the beginning of the period for which this [draft] IFRS is adopted for the first time[1]. The adjustment to retained earnings represents the difference between (a) the carrying amount of the entity's controlled investees and (b) the fair value of the investees at the date of first applying the [draft] IFRS, plus any changes in the fair value of investees' net assets recognised, and remaining in, accumulated other comprehensive income.

5. The IASB is reminded that when the ED was originally drafted, the IASB had also tentatively decided to use prospective application for IFRS 10 *Consolidated Financial Statements*. This decision has since been superseded and the transition guidance in IFRS 10 now requires retrospective application, with some transition relief, as summarised in Appendix A to this paper.

[1] This is the 'date of initial application', as now defined in IFRS 10.

Respondents' comments on the proposed transition guidance in the ED[2]

6. Some respondents agreed with prospective transition, stating that retrospective transition was too onerous and would not provide useful information.

7. Many respondents, however, supported retrospective transition, with some transition relief, consistent with the transition guidance in IFRS 10. These respondents argued that retrospective application would result in comparable and useful financial information and disagreed with assertions that retrospective application would be too onerous. They noted that to qualify as an investment entity, an entity would have to be managing its investments on a fair value basis and so should have the fair value information required for retrospective application.

8. Many of these respondents noted that IFRS 10 is to be applied retrospectively and they stressed that consistency with the transition provisions in IFRS 10, IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interests in Other Entities* was very important. Most respondents would be applying all of these standards, including the investment entity requirements, for the first time as a package. Correspondingly, many respondents requested that the investment entity requirements should have the same effective date as IFRSs 10-12, with some suggesting that the effective date of IFRSs 10-12 should be deferred to allow time for the investment entity guidance to be finalised (see further discussion of the effective date in paragraphs 43-48 of this paper). Additionally, because IFRS 10 contains retrospective transition provisions with transition relief and practicability exceptions, respondents suggested that similar practicability exceptions should be used for the investment entity requirements. The suggested practicability exceptions included:

    (a) a relief from retrospective transition when an entity does not have fair value information for prior periods;

    (b) a relief from determining whether an entity changed investment entity status in prior periods; and

[2] The feedback in paragraphs 6-8 was previously presented to the IASB in Agenda Paper 11 at the meeting in April 2012 and is reproduced here for ease of reference.

(c) a relief from providing IFRS 13-compliant fair value information in prior periods when an entity has fair value information that it believes is a close approximation of IFRS 13 fair value.

Staff analysis and recommendations

Prospective application

9. As explained in the Basis for Conclusions on the ED, the IASB originally proposed prospective application because, given the nature of an investment entity, retrospective application could involve looking back several years in order to determine what the fair value for multiple assets—some of which the entity may no longer hold—might have been. The IASB thought that this application was too onerous, particularly as IFRSs had not included any previous requirement to disclose the fair values of such controlled investments.

10. However, prospective application is now inconsistent with the general transition requirements of IFRS 10. These require retrospective application (subject to an impracticability exception and transition relief), with the mandatory presentation of adjusted comparative information only for the annual period immediately preceding the date of initial application.

11. Consequently, we do not recommend prospective application because we believe that the transition requirements throughout IFRS 10 should be consistent[3]. In particular, it would seem inappropriate that an investment entity may be required to consolidate a controlled investee in a comparative period and then be required to measure that investee at fair value prospectively.

Retrospective application

12. As stated in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors,* retrospective application of the requirements of a new or amended Standard generally provides the most useful information to the users of financial

[3] The IASB is reminded that the proposed exception from consolidation for investment entities will be included in IFRS 10.

statements. We are persuaded by the argument put forward by many respondents to the ED that, in order to qualify as an investment entity, an entity would have to be managing its investments on a fair value basis. Consequently, an investment entity should have fair value information for controlled investees for prior periods. We understand that, in many cases, investment entities not only have this information but are already reporting it to investors, either in notes to the financial statements or in other reports.

13. The staff believe that transition relief similar to that provided in the June 2012 amendments to IFRS 10 could address many of the concerns expressed in the ED with respect to retrospective application. The following section discusses possible reliefs from fully retrospective application.

14. We recommend retrospective application of the requirements on transition.

Question 1: Developing transition guidance based on retrospective application
Does the IASB agree with the staff recommendation to develop transition guidance based on a retrospective approach, consistent with the approach used in the existing IFRS 10 transition guidance?

Application issues relating to a retrospective application approach

15. Applying the investment entity exception to consolidation on a retrospective basis does raise some application issues, which are discussed in more detail in the following paragraphs. The recommendations in this section are, where applicable, generally consistent with the approach to transition in Appendix C to IFRS 10, as amended in June 2012.

Impracticability of identifying fair value retrospectively

16. As already noted, investment entities are expected to have historic information about the fair value of their investments in the majority of cases. This fair value will be used to replace the previous carrying amounts recognised relating to the investment entity's consolidated controlled investees. We expect that investment entities will also have access to these previous carrying amounts.

17. However, we acknowledge that it might not be practicable to identify the retrospective fair value of all controlled investees. The general transition guidance in IFRS 10 already contains an impracticability exception from full retrospective application. We believe that this impracticability exception is also suitable for use on transition by investment entities, although we do not expect its use to be widespread.

18. The staff recommend using an impracticability exception in the investment entity transition guidance. This means that if an investment entity cannot identify the historic fair value of any of its controlled investments in order to apply fully retrospectively these investment entity requirements, it shall apply the requirements for the earliest period for which it is practicable, which may be the current period.

Assessment of status prior to the date of initial application

19. The ‘date of initial application’ is defined for the purposes of IFRS 10 as the “beginning of the annual reporting period for which [IFRS 10] is applied for the first time”. This date is used to determine the population of interests that should be accounted for on transition in accordance with IFRS 10.

20. Consistently with the intention of this definition, we recommend that the date of application of these investment entity requirements should be used to determine the population of entities that are investment entities. We do not envisage that the status of entities will change frequently and so expect that the population of entities that meet the definition of an investment entity at the date of initial application, but that would fail to meet the definition at some time during the comparative period(s), would be small. Consequently, we recommend that, for the purpose of transition[4], entities need only assess whether they meet the definition of an investment entity on the date of initial application of the investment entity requirements and that this assessment is applied retrospectively. This is consistent with the timing and the application on transition of the business model assessment required by IFRS 9 *Financial Instruments* (paragraph 7.2.4).

[4] Reassessment of investment entity status in subsequent periods is considered in Agenda Paper 8D.

Disposal of investments prior to the date of initial application

21. The general transition requirements of IFRS 10 provide relief so that an entity is not required to make adjustments to the previous accounting for its involvement with entities if the consolidation conclusion reached at the date of initial application is the same whether applying IAS 27/SIC-12 or IFRS 10. This relief also applies to interests in investees that were disposed of before the date of initial application of IFRS 10 (IFRS 10 paragraph C3).

22. This relief is not relevant for investments still held by investment entities at the date of initial application of these amendments if the IASB agrees with the staff recommendations for retrospective application as put forward in this paper, ie if an investment entity controls an investee in accordance with both IAS 27/SIC-12 and IFRS 10, the accounting for this controlled investee does change because of the introduction of the investment entity requirements. Consequently, this relief should not be provided. However, we believe that it would be appropriate to provide this relief for investees that were disposed of before the date of initial application of these investment entity requirements. It can be argued that adjusting the comparative period(s) retrospectively for a temporary change of accounting treatment (changing from consolidation to fair value through profit or loss) until disposal would be of little relevance to users and might create undue cost for preparers.

23. Consequently, controlled investees that were previously consolidated in accordance with IAS 27/SIC-12 or IFRS 10 would remain consolidated until the date of disposal/loss of control and any gain or loss on disposal would be recognised in profit or loss in the comparative period as previously reported.

24. We acknowledge that some preparers may want to choose to apply the requirements fully retrospectively to increase comparability in those situations in which the entity already has historical fair value information. Consequently, we recommend that this relief should be optional.

Use of IFRS 13 Fair Value Measurement

25. IFRS 13 *Fair Value Measurement* is effective for annual periods beginning on or after 1 January 2013 (the same date as IFRS 10). The requirements of that IFRS apply prospectively.

26. Depending on when an entity applies the new consolidation exception for the first time, and depending on how many periods of adjusted comparatives an entity presents, all or part of the retrospective adjustment on transition may fall into a period for which IFRS 13 did not apply.

27. The IASB previously decided that IFRS 13 should be applied prospectively (in the same way as a change in accounting estimate) because a change in the methods used to measure fair value would be inseparable from a change in the fair value measurements (ie as new events occur or as new information is obtained, eg through better insight or improved judgement (IFRS 13 Basis for Conclusions paragraph BC229)). We believe that this reasoning still applies and so recommend that relief should be given from the retrospective application of IFRS 13 to fair values that had been determined previously.

28. As already noted, to qualify as an investment entity, an investor needs to manage its investments on a fair value basis. If the entity applies these amendments retrospectively for any period(s) prior to the effective date of IFRS 13, we recommend that the fair values previously used by investment entities should be retained if these amounts are consistent with the definition of fair value previously used in IFRS[5].

Comparative information

29. When clarifying how an entity should retrospectively adjust its comparative information on initial application of IFRS 10 prior to these amendments, the IASB acknowledged that presenting all adjusted comparatives would be burdensome for preparers in jurisdictions where several years of comparatives are required. Without changing the requirement to apply the recognition and measurement requirements of IFRS 10 retrospectively, the IASB decided to limit the requirement to present adjusted comparatives to the immediately preceding comparative period. This is consistent with the minimum comparative disclosure requirements contained in IAS 1 *Presentation of Financial Statements* as amended by *Annual Improvements to IFRSs 2009–2011 Cycle* (issued May 2012).

[5] The Glossary definition of fair value prior to the issue of IFRS 13 was: “The amount for which an asset could be exchanged or a liability settled, between knowledgeable, willing parties in an arm’s length transaction.”

30. Consistently with this decision, we recommend that presenting adjusted comparative information should be limited to the period immediately preceding the date of application of these investment entity requirements.

31. However, the IASB also acknowledged, in the May 2012 meeting, that users would benefit from restatement of earlier comparatives to provide more trend information and so we also recommend that an entity be permitted to present adjusted comparative information for any earlier periods presented.

32. To avoid confusion and reduce the risk of misleading users, we recommend that if an entity presents unadjusted comparative information for any earlier periods, it shall clearly identify the information that has not been adjusted, state that it has been prepared on a different basis, and explain that basis. This is also consistent with the transition requirements in IFRS 10.

Question 2: Transition guidance

Does the IASB agree with the staff recommendations to:

a) Require retrospective application for all investees, subject to the existing impracticability exception (paragraphs 16-18)?

b) Require, for the purposes of transition, the assessment of investment entity status only at the date of initial application of the investment entity requirements (paragraphs 19-20)?

c) Allow investment entities to retain the previous accounting for investees disposed of in the comparative period(s) (paragraphs 21-24)?

d) Allow the use of fair value that is consistent with fair value as defined by IFRS prior to the effective date of IFRS 13 (paragraphs 25-28)?

e) Limit the requirement to present adjusted comparatives to the annual period immediately preceding the date of application of these investment entity requirements, with any unadjusted comparatives being clearly identified (paragraphs 29-32)?

Amendments to other IFRSs

33. The IASB have decided that, as well as accounting for controlled investees at fair value through profit or loss, an investment entity shall also measure its

investments in associates and joints ventures in the same way. Consequently, amendments are needed to reflect this decision in IAS 28 *Investments in Associates and Joint Ventures*.

34. Similarly, the IASB also decided to require an investment entity that prepares separate financial statements to measure its investments in subsidiaries, joint ventures and associates at fair value through profit or loss. Amendments are therefore also needed to IAS 27 *Separate Financial Statements*.

35. We recommend that the transition requirements in these IFRSs, related to the investment entity requirements, should be drafted to be consistent with the transition guidance in IFRS 10 discussed in the preceding paragraphs. In each case, we recommend that the presentation of adjusted comparatives should be limited to only the annual period immediately preceding the date of initial application of these investment entity requirements, again for consistency with existing transition requirements.

IAS 28 Investments in Associates and Joint Ventures

36. The ED proposed prospective application of the fair value measurement requirement to be consistent with the transition proposed for the main ED. However, if the IASB accepts the staff recommendations for retrospective application, the staff further recommend that the consequential amendment to IAS 28 should reflect this decision.

IAS 27 Separate Financial Statements

37. The ED proposed prospective application of the fair value measurement requirement to be consistent with the transition proposed for the main ED. However, if the IASB accepts the staff recommendations for retrospective application, the staff further recommend that the consequential amendment to IAS 27 should reflect this decision.

Question 3: Transition guidance for consequential amendments
Does the IASB agree with the staff recommendations to draft transition guidance for amendments to IAS 28 *Interests in Associates and Joint ventures* and IAS 27 *Separate Financial Statements* that is consistent with the decisions made for the transition guidance for IFRS 10?

IFRS 1 First-time adoption of International Financial Reporting Standards

38. At its meeting in May 2012, the IASB agreed that the general transition requirements of IFRS 10 should not be applied to first-time adopters of IFRS. It was noted that the general IFRS 1 concept requires an opening IFRS statement of financial position at the date of transition to IFRS. Consequently, the requirements of IFRS 10 need to be applied fully retrospectively, with adjustments reflected at the date of transition to IFRS.

39. The requirements proposed in the investment entities project will introduce an exception from consolidation that requires a particular accounting treatment to be applied, ie an investment entity must measure its investments in its subsidiaries, joint ventures and associates at fair value through profit or loss. This would provide a consistent, IFRS-compliant starting point for first-time adopters if the transition requirements are required to be applied at the date of transition to IFRS. This would improve comparability and provide more relevant information for users.

40. However, we acknowledge that for some first-time adopters, the same practicability restrictions apply when trying to identify historic fair value. We therefore recommend that IFRS 1 should be amended to allow an investment entity first-time adopter to apply the impracticability exception and the IFRS 13 exception outlined in paragraphs 16-18 and 25-28 above. This would provide similar relief to the deemed cost exceptions already contained within IFRS 1 at paragraphs D5-D8 and D15.

41. In order to identify the population of first-time adopters within the scope of the investment entity requirements, we recommend that the date of transition to IFRS should be used. This is consistent with the existing requirements in IFRS 1 relating to the timing and the application on transition of the business model assessment required by IFRS 9 (IFRS 1 paragraph B8).

42. We also recommend that if the consolidation exception is adopted early, a first-time adopter should also apply all of IFRS 10, IFRS 11 and IFRS 12 at the same time. This will improve comparability and provide a more consistent starting

point for accounting for interests in other entities at the date of transition and is consistent with the existing requirements of IFRS 10-12 to adopt these Standards at the same time.

Question 4: Transition guidance for first-time adopters
Does the IASB agree with the staff recommendations: a) To require retrospective application for all investees, subject to an impracticability exception and IFRS 13 exception? b) To require the assessment of investment entity status at the date of transition to IFRS? c) To allow first-time adopters to apply the consolidation exception in IFRS 10 early, together with the other requirements of IFRSs 10-12?

Effective date

43. IFRS 10 is effective for annual periods beginning on or after 1 January 2013. Ideally, the effective date for the investment entity requirements would be the same. However, it is likely that these requirements will not be finalised until late Q3 or early Q4. It therefore seems unreasonable to require entities to apply them with such a short lead time.

44. Consequently, we recommend a mandatory effective date of annual periods beginning on or after 1 January 2014. This will allow more than a year between publication and implementation. Because the document will be relatively short, this should help facilitate translation within a shorter time period. In addition, the proposed changes have been well publicised and the staff will ensure that the IFRS website is kept up to date with the decisions of the IASB to enable entities to start their preparations before the final amendments are published.

45. We acknowledge that a 1 January 2014 effective date will result in a gap between publication and effective date that is shorter than our normal target period of 18 months, but we believe it is important to minimise the gap to improve comparability between those entities that early adopt and those that choose not to. Moreover, we do not expect many investment entities to have difficulty in

adopting the amendments because, as previously noted, they should already have the fair value information required for transition.

Early adoption

46. Whichever date is selected, we strongly recommend that the IASB should allow earlier application of the investment entity requirements. The IASB previously proposed permitting early application in the ED, as long as an entity also adopts all of IFRS 10, IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interests in other Entities* at the same time.

47. IFRSs 10-12 are mandatorily effective from 1 January 2013. Some entities will need to consolidate some of their investments for the first time because of the changes introduced by IFRS 10. If early application was not allowed, the IASB would effectively be requiring investment entities to consolidate controlled investments for a short period of time before requiring them to deconsolidate those investees to comply with the new consolidation exception. This would reduce comparability and create additional costs that the staff believe are not outweighed by the benefits.

48. In addition, the consolidation exception is being introduced because, for investment entities, fair value information is considered to be more relevant to users than consolidation. It is therefore reasonable to allow investment entities to provide this information early.

Question 5: Effective date
Does the IASB agree to: (a) set an effective date of 1 January 2014 for the final amendments? (b) permit early adoption?

Appendix A

Summary of the transition guidance in Appendix C to IFRS 10 Consolidated Financial Statements

1. The following summarised extracts are relevant to the transition guidance recommended by the staff in the main body of this paper. The paragraph numbers used equate to those used in the transition guidance of IFRS 10 but the wording has been modified for brevity.

C2 An entity shall apply this IFRS retrospectively, in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, except as specified in paragraphs C2A–C6.

C2A An entity need only present the quantitative information required by paragraph 28(f) of IAS 8 for the annual period immediately preceding the date of initial application of this IFRS.

C3 At the date of initial application (ie the beginning of the annual period for which this IFRS is applied for the first time), an entity is not required to make adjustments to the previous accounting when the consolidation conclusion does not change on transition to IFRS 10. This also applies to interests in investees that were disposed of before the date of initial application of IFRS 10.

C5 If, at the date of initial application, an investor concludes that it will no longer consolidate an investee that was consolidated in accordance with IAS 27 and SIC-12, the investor shall measure its interest in the investee at the amount at which it would have been measured if the requirements of this IFRS had been effective when the investor became involved with, or lost control of, the investee. The investor shall adjust the immediately preceding period retrospectively. When the date that the investor became involved with, or lost control of, the investee is earlier than the beginning of the immediately preceding period, the investor shall recognise, as an adjustment to equity at the beginning of the immediately preceding period, any difference between:

(a) the previous carrying amount of assets, liabilities and non-controlling interests; and

(b) the recognised amount of the investor's interest in the investee.

C5A If measuring the interest in the investee in accordance with paragraph C5 is impracticable (as defined in IAS 8), an investor shall apply the requirements of this paragraph C5 at the beginning of the earliest period for which application of this IFRS is practicable, which may be the current period.

References to the 'immediately preceding period'

C6A Notwithstanding the references to the 'immediately preceding period' in paragraphs C4–C5A, an entity may also present adjusted comparative information for any earlier periods presented but is not required to do so. If an entity does present adjusted comparative information for any earlier periods, all references to the 'immediately preceding period' in paragraphs C4–C5A shall be read as the 'earliest adjusted comparative period presented'.

C6B If an entity presents unadjusted comparative information for any earlier periods, it shall clearly identify the information that has not been adjusted, state that it has been prepared on a different basis, and explain that basis.