STAFF PAPER

16 July–20 July 2012

REG IASB Meeting

Project	Investment Entities		
Paper topic	Due process considerations		
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Purpose

1. The purpose of this paper is to set out the due process steps undertaken by the IASB in completing the Investment Entities project.

Background

2. In December 2008, the IASB published an Exposure Draft ED 10 *Consolidated Financial Statements*. ED 10 proposed that reporting entities should consolidate all controlled entities, regardless of the nature of the reporting entity. Requiring consolidation of all controlled entities was consistent with the consolidation requirements of IAS 27 *Consolidated and Separate Financial Statements.*

3. However, many respondents to ED 10 questioned the usefulness of consolidated financial statements for some types of entity. Many jurisdictions, including the US and Canada, have special accounting requirements for a class of entity that is commonly referred to as an investment company—which we refer to as *investment entities*. The accounting requirements include an exemption from consolidating entities that they control. Instead, they are required to measure their net investment in those controlled entities at fair value. Those respondents asked the IASB to provide a similar exception for entities applying IFRSs.

4. The IASB has considered providing such an exemption twice before, but voted unanimously not to do so. However, in response to the feedback on ED 10 and to

find out whether the IASB and FASB could address a long-standing difference between US GAAP and IFRSs, the IASB initiated a joint project with the FASB. The boards set out to develop a definition of an investment entity that could be applied internationally—the US definition is embedded in legislation—and that could be used within IFRS as a basis for an exception from consolidation.

5. In August 2011, the IASB issued an Exposure Draft *Investment Entities* ('the ED'). The ED proposed criteria and related guidance for determining when an entity would qualify as an investment entity. The ED proposed that an investment entity would be required to measure its investments in controlled entities at fair value through profit or loss in accordance with IFRS 9 *Financial Instruments* rather than consolidating those entities.

6. The ED proposed that the exception should be limited to a reporting entity that meets the definition of an investment entity. The parent of an investment entity that is not itself an investment entity would not be able to use the exception when it presented its consolidated financial statements (ie there would be no 'roll-up' of the exception). In other words, a non-investment-entity parent would continue to consolidate all controlled entities, including those controlled by its investment entity subsidiaries.

7. For consistency within IFRSs, the ED also proposed amendments to IAS 27 *Separate Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures.*

8. The comment period for the Exposure Draft ended on 5 January 2012 and the IASB started redeliberations in May 2012.

Due process

9. The IASB's due process requirements include mandatory and non-mandatory steps that need to be undertaken before the publication of a new IFRS, or amendment to an IFRS, as is the case with the Investment Entities project. The IASB is required to explain why it has not complied with any of the non-mandatory steps (a 'comply or explain' approach).

10. In the following sections, the staff analyse whether the IASB has complied with all necessary due process steps.

Mandatory steps

Publishing an Exposure Draft

11. The IASB published the Exposure Draft ED *Investment Entities* in August 2011. Three IASB members voted against the proposals in the ED, arguing that there should be no exception to consolidation, and their alternative views were set out in the Basis for Conclusions. The ED had a comment period ending on 5 January 2012.

Reviewing comments made within a reasonable period

12. 170 Comment letters were received on the ED. The staff presented a comment letter summary to the IASB at the April 2012 meeting. Appendix A incudes a statistical analysis of the comment letters received. The IASB considered comments received during its redeliberations.

Consulting with the Advisory Council

13. Although issued as a separate Exposure Draft, the Investment Entities project is part of the Consolidation project that was discussed with the Advisory Council in June 2004, November 2004 and June 2008. The Consolidation project was also discussed in the sessions on the financial crisis in November 2008, February 2009 and June 2009.

Non-mandatory steps

Publishing a discussion document (eg a Discussion Paper)

14. The IASB did not publish a discussion document for the Investment Entities project. Discussion Papers are normally produced for a major new topic to explain the issue and to ask for early comments from constituents.

15. The amendments to IFRS 10 *Consolidated Financial Statements* proposed in this project have a relatively limited scope and the issues involved are well understood

by the IASB and its constituents. Consequently, the IASB believed that a Discussion Paper was unnecessary for this project.

Establishing working groups or other types of specialist advisory groups

16. The IASB did not establish a working group or other specialist advisory group for this project. The IASB normally only establishes a working group for its major projects. Because only a limited number of entities will be affected by this project, it was considered that feedback on the proposals could be obtained more effectively by other means (for example, outreach activities including public round tables).

Holding public hearings and undertaking field tests

17. The IASB did not undertake field tests to assess the practicality of the proposals because one of the criteria necessary for a reporting entity to be an investment entity is that it must be managing its investments on a fair value basis. Accordingly, the only new measurement requirement from the guidance, namely replacing consolidation with fair value measurement, will be readily available to the reporting entities that qualify for the exception. More fundamentally, because this is an exception to the principle of control, the IASB is providing relief from what some see as a reporting burden.

18. The IASB also received feedback on the proposals through the following channels:

    (a) comment letters on the ED;

    (b) extensive outreach activities. Since the publication of the ED, the staff and IASB members have met with over 100 individuals, including meetings with preparers, users, auditors and regulators. The staff and IASB members have met with constituents from Africa, Asia, Europe, North America, South America and Oceania; and

    (c) five public round tables held in early 2012 in Toronto, London, Norwalk and Kuala Lumpur, attended by over 70 participants.

Summary

19. The staff assessment is that the IASB has met all of the mandatory due process steps and performed sufficient additional steps to ensure that the IASB has sufficient information to support its decisions in this project.

Question 1
Is the IASB satisfied that the IASB has: (a) performed all mandatory due process steps? (b) performed sufficient additional due process steps?

Re-exposure

20. Paragraph 47 of the *IASB Due Process Handbook* sets out the following guidance on determining whether re-exposure is necessary:

> In considering the need for re-exposure, the IASB
> - identifies substantial issues that emerged during the comment period on the exposure draft that it had not previously considered
> - assesses the evidence that it has considered
> - evaluates whether it has sufficiently understood the issues and actively sought the views of constituents
> - considers whether the various viewpoints were aired in the exposure draft and adequately discussed and reviewed in the basis for conclusions on the exposure draft.

21. The IASB has retained the basic concepts exposed in the proposed amendments to IFRS 10. However, some refinements have been made to respond to comments received on the Exposure Draft. The more significant of those are:

    (a) The ED proposed six criteria that must be met if an entity is to qualify as an investment entity. You have tentatively decided to replace these criteria with a definition of an investment entity and factors to be considered.

    (b) The ED stated that an investment entity's only substantive activities should be investing for capital appreciation, investment income or both. You have tentatively decided that an investment entity's only substantive activities are investing for capital appreciation or capital appreciation and investment income. Consequently an entity that is investing for investment income only would not qualify as an investment entity.

(c) You have decided to retain the fair value option in IAS 28 for venture capital organisations, mutual funds, unit trusts and similar entities that are not investment entities. The ED had proposed the removal of this option.

22. At this meeting the staff have recommended:

(a) retrospective application of the consolidation exception with some transitional relief (Agenda Paper 8F). The ED proposed prospective application; and

(b) an effective date of 1 January 2014 and to permit early adoption (Agenda Paper 8F).

23. The IASB should also note the following:

(a) Some jurisdictions that have been applying IFRSs (and correspondingly requiring all entities, including those entities that would qualify as investment entities, to consolidate their controlled investees) expressed strong disagreement with the proposal—Australia and New Zealand, for example. Those respondents think that creating an exception to consolidation undermines the principle of control, creates the potential for accounting abuse and reduces the usefulness of the financial statements. These concerns reflect those expressed in the alternative views set out in the ED. Other jurisdictions, such as Canada and many European countries, are strong supporters of the proposals. They argue that, for investment entities, using fair values for controlled investments is more relevant and provides better comparability with the fair values used to measure non-controlled investments held for the same business purpose. The IASB decisions made in redeliberations (see subparagraphs (b)-(d) below) about how broad the exception should be and not to allow a roll-up of the exception to a non-investment-entity parent have been fundamental in developing the amendments to

IFRS 10 and should help to address some of the concerns of those opposed to the exception.

(b) You have reaffirmed the decision in the ED that the exception from consolidation that is used for the controlled investees of an investment entity subsidiary should not be extended to the non-investment-entity parent of that investment entity. Many respondents to the ED requested that this exception to consolidation should be extended to non-investment-entity parents.

(c) You have reconfirmed the decision in the ED that to qualify as an investment entity, a reporting entity must not provide substantive investment related services to third parties. Consequently, a number of private equity entities will not qualify for the exception from consolidation.

(d) In a number of areas, you have made tentative decisions that are different from the decisions made by the FASB (including the definition of an investment entity). However, the staff note that, although this is a joint project with the FASB, the scope and objective of the two boards for the project are different. The FASB's definition of an investment entity will be used to determine whether an entity is within the scope of the FASB's comprehensive guidance for investment companies. The IASB's definition will be used to determine whether an entity qualifies for an exception to consolidation.

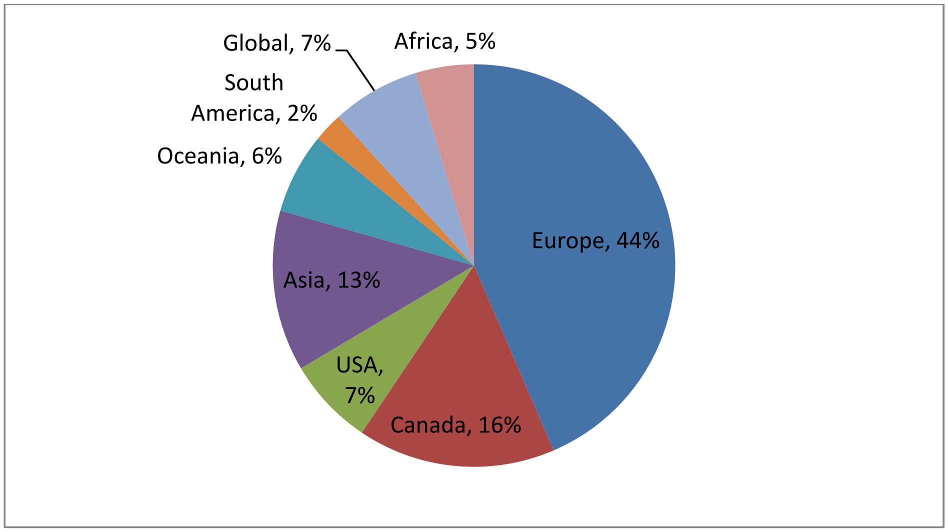
Question 2
Does the IASB think that any of the amendments require re-exposure?

24. Appendix B to this paper sets out the due process steps followed by the IASB in this project to date. A copy of this paper will be provided to the Due Process Oversight Committee.

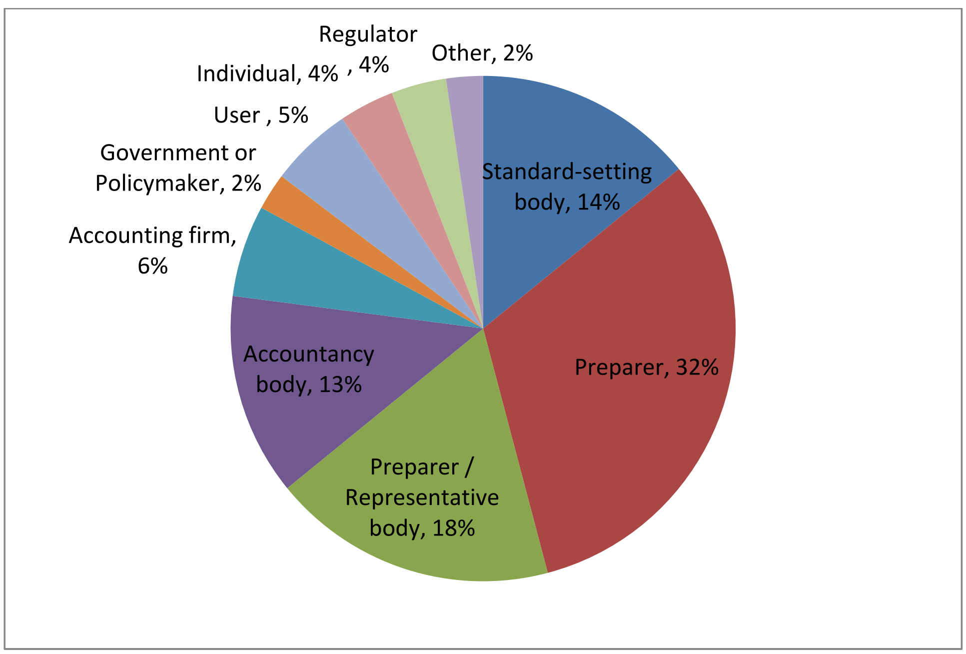
Question 3
The staff recommend that the IASB should proceed to ballot the investment entity requirements. a) Does the IASB agree? b) Do any board members plan to dissent from the investment entity requirements?

Appendix A: Statistical analysis of comment letters

A1. The following pie chart depicts the geographical split of the 170 comment letter respondents:



A2. The following pie chart splits the 170 comment letter by respondent type:



Appendix B

Confirmation of Due Process Steps followed in the finalisation of the Investment Entities amendments to IFRS10

The following table sets out the due process steps followed by the IASB in the development of the Investment Entities amendments to IFRS 10

Due Process Protocol

Project: Investment Entities

Stage: Finalisation

Date of this version: 5 July 2012

Step	*Required/Optional*	*Metrics or evidence*	*Protocol for and evidence provided to DPOC*	*Actions*
Consideration of information gathered during consultation				
IASB posts all comment letters received in relation to the Exposure Draft on the project pages.	Required if request issued	Letters posted on project pages	IASB reports on progress as part of the quarterly report at Trustee meetings, including summary statistics of respondents.	**170 comment letters received – all posted on IASB website** **Progress to be reported at next Trustee meeting**
Round tables between external participants and members of the IASB.	Optional	Number of meetings held	DPOC receives a report on outreach activities	**Update on this project was included in regular reports to the DPOC.** **Five public round tables were held in early 2012 in Toronto, London, Norwalk and Kuala Lumpur, attended by over 70 participants**

Step	*Required/Optional*	*Metrics or evidence*	*Protocol for and evidence provided to DPOC*	*Actions*
Board meetings held in public, with papers available for observers. All decisions are made in public session.	Required	Number of meetings held to discuss topic. Project website contains a full description with up-to-date information on the project. Meeting papers posted in a timely fashion. Number of meetings with Consultative Group and confirmation that critical issues have been reviewed with Consultative Group	IASB discusses progress on major projects, in relation to the due process being conducted, with DPOC. IASB review with DPOC its due process over project life cycle, and how any issues regarding due process have been/are being addressed. DPOC meets with the Advisory Council to understand perspectives of stakeholders. DPOC reviews and responds to comments on due process as appropriate.	**The IASB discussed the project at its April 2012, May 2012 and June 2012 meetings. The IASB intends to discuss the project at its July 2012 meeting.** **All board meetings have been held in public** **Staff papers have been made available in advance of the IASB meeting on the IASB's website** **The project website contains a full description with up-to-date information on the project.** **Because only a limited number of entities will be affected by this project, the IASB did not create a consultative group to discuss the project.**
Analysis of likely effects of the forthcoming IFRS or major amendment, for example, costs or on-going associated costs.	Required	Publication of effect analysis	IASB reviews with DPOC results of effect analysis and how it has considered such findings in proposed IFRS. IASB provides a copy of the effect analysis to the DPOC at the point of standard's publication.	**The IASB has paid particular attention to identifying the type of entity that would be able to use this exception. This is the key to assessing the effect of the proposal on financial reporting. In particular, because this is a new exception, the financial statements of entities not qualifying as investment entities will not be affected.**

Step	*Required/Optional*	*Metrics or evidence*	*Protocol for and evidence provided to DPOC*	*Actions*

Step	*Required/Optional*	*Metrics or evidence*	*Protocol for and evidence provided to DPOC*	*Actions*
Finalisation				
Need for re-exposure of standard considered	Required	An analysis of the need to re-expose is considered at a public IASB meeting, using the agreed criteria	IASB discusses its thinking on the issue of re-exposure with the DPOC	**The need for re-exposure will be discussed at the July 2012 IASB meeting.**
IASB sets an effective date for standard, considering the need for effective implementation, generally providing at least a year.	Required	Effective date set, with full consideration of implementation challenges	The IASB discusses any proposed shortening of the period for effective application with the DPOC	**A paper considering the effective date of the proposed amendments will be presented at the July 2012 IASB meeting.**
Due process steps reviewed by IASB	Required	Summary of all due process steps discussed by the IASB before an IFRS is issued.	DPOC receives summary report on due process steps before an IFRS is issued.	**A paper reviewing the due process steps will be presented at the July 2012 IASB meeting**