STAFF PAPER

12-13 November 2013

IFRS Interpretations Committee Meeting

Project	**IFRS 10 *Consolidated Financial Statements***
Paper topic	Investment Entities Amendments—Investment entity subsidiary that provides investment-related services

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Introduction

1. In July 2013, the IFRS Interpretations Committee (the Interpretations Committee) received a request to clarify some issues related to the Investment Entities amendments to IFRS 10, IFRS 12 and IAS 27. One of the issues is about the accounting by an investment entity which has an investment entity subsidiary that provides investment-related services.

2. The Investment Entity amendments to IFRS 10 require an investment entity to measure its investments in subsidiaries at fair value. There is an exception to this requirement: if a subsidiary provides investment-related services or activities, the investment entity shall consolidate the subsidiary.

3. According to the submitter, in the case in which an investment entity subsidiary meets the definition of an investment entity (which has investees measured at fair value) and, additionally, provides investment-related services or activities, it is unclear whether the investment entity parent should measure that subsidiary at fair value or consolidate it. In addition, if it does consolidate, it is not clear how the investment entity parent accounts for investees; should the parent consolidate the

investment portfolio on a line-by-line basis, or should the parent measure the entire portfolio and the related third party debt held at fair value.

Paper structure

4. This paper is organised as follows:

   (a) Submission received

   (b) Extract from the Standards;

   (c) Staff analysis of the issue;

   (d) Summary of outreach conducted;

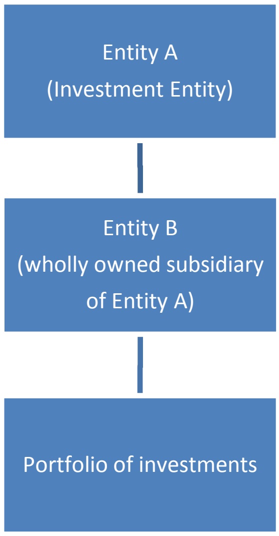
   (e) Assessment against the interpretations agenda criteria; and

   (f) Staff recommendation.

Submission received

5. IFRS 10.31 requires an investment entity to measure its investments in subsidiaries at fair value through profit or loss in accordance with IFRS 9 (IAS 39 for those entities that have not yet adopted IFRS 9). IFRS 10.BC272 explains that this requirement applies to investees who are themselves investment entities. There is one exception to this requirement: in accordance with IFRS 10.32, if a subsidiary provides services that relate to the investment entity’s investment activities, as described at IFRS 10.B85C-E, the investment entity shall consolidate that subsidiary.

6. According to the submitter, if an investment entity subsidiary (Entity B) meets the definition of an investment entity and additionally provides investment-related services, it is unclear whether the investment entity parent (Entity A) should measure the Entity B at fair value in accordance with IFRS 10.31 or consolidate Entity B in accordance with IFRS 10.32.



7. The submitter notes that there are three alternative views in practice.

(a) **View A: Entity A should measure its investment in Entity B at fair value in accordance with IFRS 10.31.** IFRS 10.32 (and related Application Guidance in paragraphs IFRS 10.B85C-E) is intended to apply to a subsidiary that *only* provides investment-related services. It does not apply when that subsidiary is also an investment entity.

(b) **View B: Entity A should consolidate Entity B in accordance with IFRS 10.32.** IFRS 10.32 (and related Application Guidance at B85C-E) is intended to apply to any subsidiary that provides investment-related services, notwithstanding that the subsidiary may also be an investment entity. Under this view, Entity A would recognise each of Entity B's investment at fair value and recognise the third party debt held by Entity B at amortised cost in its consolidated financial statements.

(c) **View C: Entity A should measure its investment in Entity B at fair value in accordance with IFRS 10.31.** IFRS 10.32 is not intended to apply to an investment entity subsidiary that provides investment-related services/activities on its own account (rather than on behalf of its investment entity parent). View C differs from View A by focusing on whether the subsidiary is providing the investment-related services to itself or to its parent.

Extract from the Standards

8. An investment entity shall measure its investments in a subsidiary at fair value, in accordance with paragraph 31.

> 31 Except as described in paragraph 32, an investment entity shall not consolidate its subsidiaries or apply IFRS 3 when it obtains control of another entity. Instead, an investment entity shall measure an investment in a subsidiary at fair value through profit or loss in accordance with IFRS 9.

9. If a subsidiary provides services that relate to the investment entity's investment activities, the investment entity shall consolidate the subsidiary, in accordance with paragraph 32.

> 32 Notwithstanding the requirement in paragraph 31, if an investment entity has a subsidiary that provides services that relate to the investment entity's investment activities (see paragraphs B85C–B85E), it shall consolidate that subsidiary in accordance with paragraphs 19–26 of this IFRS and apply the requirements of IFRS 3 to the acquisition of any such subsidiary.

10. An investment entity may have some non-investment assets, such as a head office property and related equipment. The fair value measurement element of the definition of an investment entity applies only to an investment entity's investments. Accordingly, an investment entity need not measure its non-investment assets at fair value.

> B85M An investment entity may have some non-investment assets, such as a head office property and related equipment, and may also have financial liabilities. The fair value measurement element of the definition of an investment entity in paragraph 27(c) applies to an investment entity's investments. Accordingly, an investment entity need not measure its non-investment assets or its liabilities at fair value.

11. BC 240 clearly states that the Board views investment-related services as an extension of the operations of the investment entity and it therefore concluded that subsidiaries that provide those services should be consolidated.

> BC240 The Board noted that an investment entity may sometimes hold an interest in a subsidiary that provides investment-related services for its investment activities. The Board did not think that the existence of such a subsidiary should prohibit an entity from qualifying as an investment entity, even if those services were substantial or were provided to third parties in addition to the entity. The Board views such services as an extension of the operations of the investment entity and therefore concluded that subsidiaries that provide those services should be consolidated.

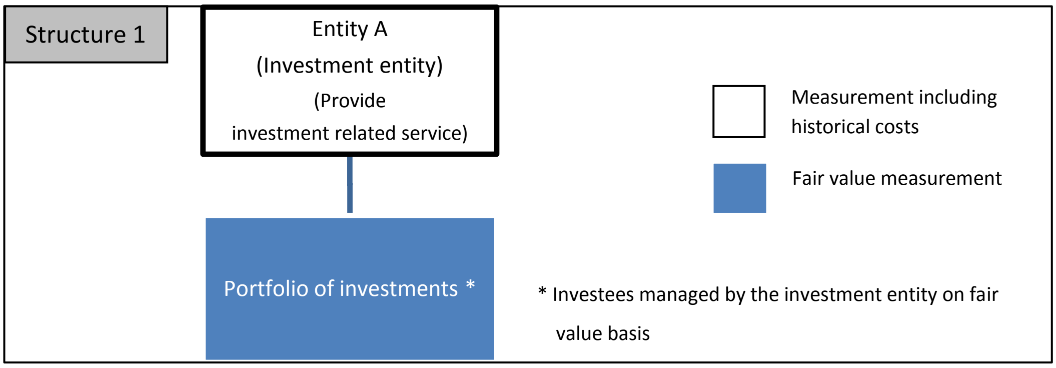
Staff analysis of the issue

Investment entities' financial statements under IFRS 10

12. Not all assets in investment entities' financial statements are measured at fair value. While investment entities measure investees and other investments at fair value, they measure non-investment assets on the basis of other applicable Standards. (These measurements include using a historical cost basis.) The following examples provide some basic illustrations of requirements.

Example structure 1

13. If an investment entity has investees but does not have any subsidiary that provides investment-related services (which means that all the investment-related services are provided by the investment entity itself), all subsidiaries (investees) are measured at fair value and the investment entity's non-investment assets are measured on the basis of other applicable Standards (these measurements include using a historical cost basis), in accordance with paragraph B85M.



Example structure 2

14. If an investment entity creates a subsidiary that is separate from its other investees and uses this subsidiary in order to provide investment-related services, the subsidiary will be consolidated in accordance with paragraph 32, while other investees are measured at fair value. The subsidiary will be consolidated because such services are viewed as an extension of the operations of the investment entity, in accordance with BC240. The financial statements of investment entity would be consistent with Example structure 1.

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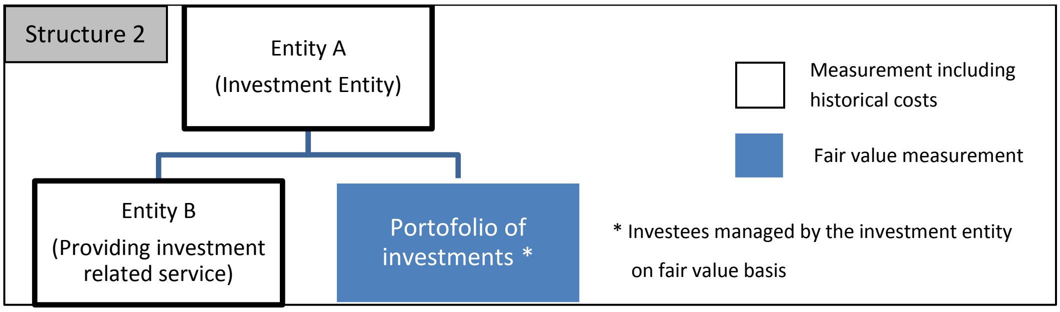

Example structure 3

15. If an investment entity creates an intermediate investment entity with portfolio and a subsidiary providing investment-related services, the intermediate investment entity and portfolio, including any third party debt, will be measured at fair value, while the subsidiary will be consolidated. The financial statements of investment entity would be consistent with Example structure 1 and 2.

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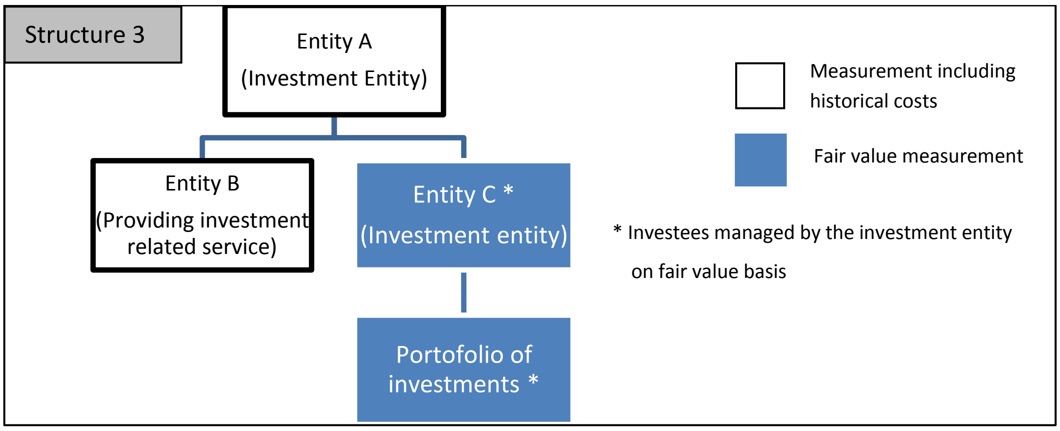

Structure of the issue

16. The issue is if an investment entity subsidiary meets the definition of an investment entity (which means that the subsidiary has investees) and provides

investment-related services, should the investment entity consolidate the subsidiary?

17. We think that comparability of financial statements should be achieved, among investment entities with different structures but with the same substance. Accordingly, we think that the financial statements of this structure should be consistent with Example structure 1, Example structure 2 and Example Structure 3. In other words, non-investment assets held by the subsidiary should be measured on the basis of other applicable Standards (measurements including historical cost basis) and investees under the subsidiary should be measured at fair value.

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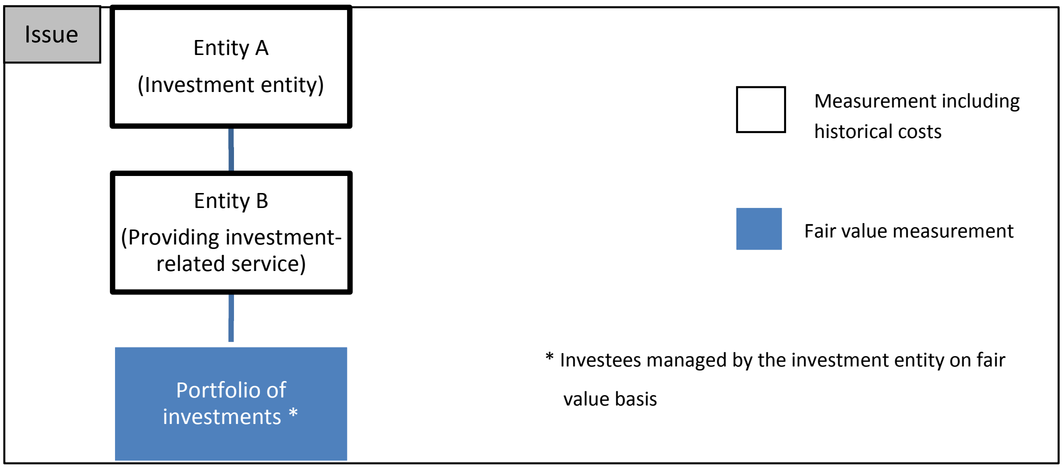

18. The submitter had different 3 views in respect of this structure. We do not support View A or View C. Investment-related services can be provided by the investment entity parent or through investment entity subsidiary. In addition, this investment entity subsidiary may or may not have its own investees. We think it is important to achieve comparability of financial statements of investment entities in different structures if the substance is the same.

Consolidation of investment entity subsidiary that provides investment-related service

19. The question is whether the current Standards provide enough guidance for the accounting treatment above. Paragraph 32 states:

> 32 Notwithstanding the requirement in paragraph 31, if an investment entity has a subsidiary that provides services that relate to the investment entity's investment activities (see

> paragraphs B85C–B85E), it shall consolidate that subsidiary in accordance with paragraphs 19–26 of this IFRS and apply the requirements of IFRS 3 to the acquisition of any such subsidiary.

20. We think that the paragraph is not clear as to how entity B should be accounted for. We note that View B in the submission suggests consolidation of Entity B on a line-by-line basis but using fair value measurement for investees. The submitter states that "*Under this view, Entity A would recognise each of Entity B's investment at fair value and the third party debt held by Entity B at amortised cost in its consolidated financial statements.*" However, we note that there could be various interpretations of how to consolidate investees. For example, third party debt held by Entity B may need to be measured at fair value, because it would have been measured at fair value if Entity B did not provide any investment-related services. We note that there could be four different views on accounting for Entity B:

    - Consolidation of Entity B and Portfolio of investments (line by line consolidation of every controlled investee).
    - Consolidation of Entity B. Fair value measurement of Portfolio of investments.
    - Consolidation of non-investment assets and liabilities of Entity B. Fair value measurement of investment related assets and liabilities of Entity B and Portfolio of investments.
    - Fair value measurement of Entity B and Portfolio of investments.

21. Given these different interpretations of the requirements to consolidate a subsidiary that provides services that related to investment activities, we think that the Interpretation Committee should take this issue onto its agenda.

Summary of outreach conducted

22. We asked IOSCO, ESMA and national standard-setters to provide information on the issue raised in the submission:

(a) *Q1. How common are each of these issues? If these are common, could you provide us with information that the Interpretations Committee could use to assess how widespread the issues are?*

(b) *Q2. In your view, is there diversity in practice in interpreting each issue? Please describe the predominant approach that you observe in practice.*

Responses from regulators and national standard-setters

23. We received responses from the following 14 jurisdictions: Europe (4), Asia (3), Americas (3), Oceania (1), Africa (1) and International (2).

24. Most of the respondents stated that they have limited experience of the Investment Entities Amendments, because entities are not required to apply the amendments until the annual period on or after 1 January 2014. However, most of the respondents with experience of the issue are aware of it and expected that the issue would cause diversity in practice.

Predominant approach followed in jurisdictions

25. Although we have received only a limited response on the predominant approach followed in jurisdictions, most of those who did respond supported View B in the submission.

Assessment against the interpretations agenda criteria

Agenda criteria	
We should address issues (5.16):	
that have widespread effect and have, or are expected to have, a material effect on those affected.	**Yes.** Entities are not required to apply the amendments until the annual period on or after 1 January 2014. Accordingly, the issue is not common in all jurisdictions at this point. However, on the basis of our analysis on the outreach, we expect that this issue could be widespread and would have a material effect on those affected.
where financial reporting would be improved through the elimination, or reduction, of diverse reporting methods.	**Yes.** We think that financial reporting would be improved through the elimination of different interpretations of consolidation of a subsidiary that provides investment-related services of an investment entity.
that can be resolved efficiently within the confines of existing IFRSs and the *Conceptual Framework for Financial Reporting*.	**Yes.** It is a clarification of accounting on the particular in structure of an investment entity when applying IFRS 10.
In addition:	

Agenda criteria	
Is the issue sufficiently narrow in scope that the Interpretations Committee can address this issue in an efficient manner, but not so narrow that it is not cost-effective for the Interpretations Committee to undertake the due process that would be required when making changes to IFRSs (5.17)?	**Yes.** The issue only relates to a part of the Investment Entity amendments.
Will the solution developed by the Interpretations Committee be effective for a reasonable time period (5.21)? (The Interpretations Committee will not add an item to its agenda if the issue is being addressed in a forthcoming Standard and/or if a short-term improvement is not justified).	**Yes.** The issue is not being addressed in a forthcoming Standard because the Investment Entities amendments were issued in 2012.

Staff recommendation

26. We recommend that the Interpretations Committee should take this issue onto its agenda.

27. We think it is clear that an investment entity subsidiary that does not provide investment-related service should be accounted for at fair value in the investment entity's financial statements. We also think it is also clear that the investment entity parent should consolidate an investment entity subsidiary that provides investment-related service on a line-by-line basis, because such service is an extension of the operations of the investment entity. However, we think it is not clear how to account for a subsidiary that is both an investment entity subsidiary and provides investment-related services.

Questions for the Interpretations Committee
Does the Interpretations Committee agree with the staff's recommendation that this issue should be added to its agenda?