

STAFF PAPER

29-30 January 2014

IFRS Interpretations Committee Meeting

IFRS IC November 2013

Project	IFRS 10 <i>Consolidated Financial Statements</i>		
Paper topic	Investment Entities Amendments—Investment entity subsidiary that provides investment-related services		
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This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination. Decisions made by the IFRS Interpretations Committee are reported in *IFRIC Update*. The approval of a final Interpretation by the Board is reported in *IASB Update*.

Introduction

1. In November 2013, the IFRS Interpretations Committee (‘the Interpretations Committee’) discussed a request to clarify some issues related to the Investment Entities amendments to IFRS 10, IFRS 12 and IAS 27. One of the issues was about the accounting by an investment entity that has an investment entity subsidiary (which has investees measured at fair value) and, additionally, provides investment-related services or activities
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.

Paper structure

4. This paper is organised as follows:
 - (a) Summary of the November 2013 Interpretations Committee meeting;
 - (b) Staff analysis of the issue; and
 - (c) Staff recommendation.

Summary of the November 2013 Interpretations Committee meeting

5. At the November 2013 meeting, the Interpretations Committee noted that it is not clear how to account for a subsidiary that meets the definition of an investment entity (which has investees measured at fair value) and, additionally, provides investment-related services or activities. Accordingly, the Interpretations Committee decided to add this issue to its agenda.
6. The Interpretations Committee also observed that analysing this issue requires clarity about what services are provided, and to whom, in order to determine the scope of consolidation.
7. The Interpretations Committee directed the staff to seek a principle-based approach that was also as straightforward as possible.

Staff analysis of the issue

Consideration of types of investment-related services and activities and to whom delivered

8. As noted above, at the last meeting, some Interpretations Committee members asked us to consider types and recipients of investment related services and activities. Paragraph B85C and B85D provide description of investment-related services and activities as follows:

B85C An investment entity may provide investment-related services (eg investment advisory services, investment management, investment support and administrative services), either directly or through a subsidiary, to third

parties as well as to its investors, even if those activities are substantial to the entity.

B85D An investment entity may also participate in the following investment-related activities, either directly or through a subsidiary, if these activities are undertaken to maximise the investment return (capital appreciation or investment income) from its investees and do not represent a separate substantial business activity or a separate substantial source of income to the investment entity:

- (a) providing management services and strategic advice to an investee; and
- (b) providing financial support to an investee, such as a loan, capital commitment or guarantee.

9. We analysed the nature of the services, and to whom services are provided, for investment-related services and activities stated in paragraph B85C and B85D as follows:

	Nature of services	To whom
Investment-related services (B85C)	(examples)	• to third parties
	<ul style="list-style-type: none"> • investment advisory services; • investment management; • investment support; and • administrative services. 	• to its investors
Investment-related activities (B85D)	(if these activities are undertaken to maximise the investment return from its investees) <ul style="list-style-type: none"> • management services; • strategic advice; and • financial support. 	• to its investees

We note that the provision of these services does not preclude an entity from qualifying as an investment entity. Consequently, the services may be provided either by the investment entity or by a subsidiary that supports the investment entity (and other group entities).

Summary of IASB discussions in the light of analysis of types and recipients of investment-related services and activities

10. The Investment Entities Exposure Draft (ED), issued in August 2011 proposed that an investment entity parent shall not consolidate its subsidiaries (including those subsidiaries that are themselves investment entities), except for an operating entity subsidiary that provides investment-services or activities.
11. In redeliberations, the IASB decided to retain these proposals in the final standard, in particular in June 2012, the IASB made a tentative decision to confirm that an investment entity parent shall not consolidate any of its investment entity subsidiaries, but instead account for such investment entity subsidiaries at fair value.
12. In September 2012, the IASB made a decision to allow the definition of an investment entity to include the provision of investment-related services to third parties.

An investment entity parent's accounting for an investment entity subsidiary (June 2012 meeting)

13. In its June 2012 meeting, the IASB tentatively decided that an investment entity should be required to measure all controlling financial interests in another investment entity at fair value, rather than consolidating those subsidiaries.
14. When the tentative decision was made in the June 2012 meeting, an entity was not allowed to qualify as an investment entity if it provided substantive investment-related services to third parties.
15. With regard to this decision, BC 272 states as follows:

BC272 The Investment Entities ED proposed that an investment entity would measure all of its subsidiaries at fair value (except for those subsidiaries providing investment-related services), even those investees who were themselves investment entities. Some respondents questioned this proposal and suggested that at least some investment entity subsidiaries should be consolidated (for example, wholly-owned investment entity subsidiaries that are created for legal, tax or regulatory purposes). However,

the Board thinks that fair value measurement of all an investment entity's subsidiaries (except for those subsidiaries providing investment-related services or activities) would provide the most useful information and therefore decided to retain this proposal. The Board considered requiring an investment entity to consolidate only those investment entity subsidiaries that are formed for legal, tax or regulatory purposes, but decided against this because there is no conceptual basis for distinguishing between different investment entity subsidiaries. Moreover, the Board thinks that it would be very difficult to distinguish between an investment entity subsidiary formed for a specific legal, tax or regulatory purpose and those that are set up only for other business reasons.

Investment-related services to third parties (September 2012 meeting)

16. In its September 2012 meeting, the IASB decided to allow an entity to qualify as an investment entity even if it provided significant investment-related services to third parties. We noted that the IASB considered that the investment-related services provided to third parties are simply an extension of the investment entity's activities. IBC239 and BC240 state as follows (emphasis added):

BC239 The *Investment Entities* ED did not allow an entity to qualify as an investment entity if it provided substantive investment-related services to third parties. While some respondents agreed with this, others argued that an investment entity should be allowed to provide such services to third parties. They argued that the provision of these investment-related services to third parties is simply an extension of the investment entity's investing activities and should not prohibit an entity from qualifying as an investment entity. The Board agreed with these arguments, concluding that the provision of such services is within the business model of an investment entity. Although such an entity may earn fee income from the provision of investment-related

services, its sole business purpose is still investing for capital appreciation, investment income, or both (whether that is for itself, for its investors or for external parties).

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.

17. We noted that paragraph B85E requires consolidation of a subsidiary that provides the investment-related services or activities as follows:

B85E If an investment entity has a subsidiary that provides investment-related services or activities, such as those described in paragraphs B85C–B85D, to the entity or other parties, it shall consolidate that subsidiary in accordance with paragraph 32.

Conclusions on analysis of types and recipients of investment-related services and activities

18. We think that the consequences of the IASB’s decisions at its June 2012 meeting are to require fair value measurement of all investment entity subsidiaries and the consolidation of non-investment entity subsidiaries that provide investment-related services within the group. At that stage in the development of the amendments, the IASB had only agreed that an investment entity could provide investment-related services to its investors and investment-related activities to its investees. We therefore conclude from the IASB’s discussion that an investment entity subsidiary that also provides investment-related services to its investors and

investment-related activities to its investees should be accounted for at fair value. We note that these services and activities are common services and activities that most investment entities will be engaged in. We also note that the IASB did not make any exceptions to these requirements. However, we noted that the accounting for an investment entity subsidiary that provides investment-related services to third parties was not explicitly discussed, because the IASB did not agree to allow an entity to provide those services and meet the definition of an investment entity until the later meeting (September 2012).

We summarises our analysis as follows:

	To whom	Subsidiary that provides service is an investment entity	Subsidiary that provides service is <u>not</u> an investment entity
Investment-related services (B85C)	• to third parties	Not discussed	Consolidation
	• to its investors	No consolidation (Fair value accounting)	
Investment-related activities (B85D)	• to its investees		

As a result of this analysis, we think that the basis of accounting for investment subsidiaries that provide services to third parties has not been discussed.

Alternatives for accounting for an investment entity subsidiary that provides investment-related services to third parties

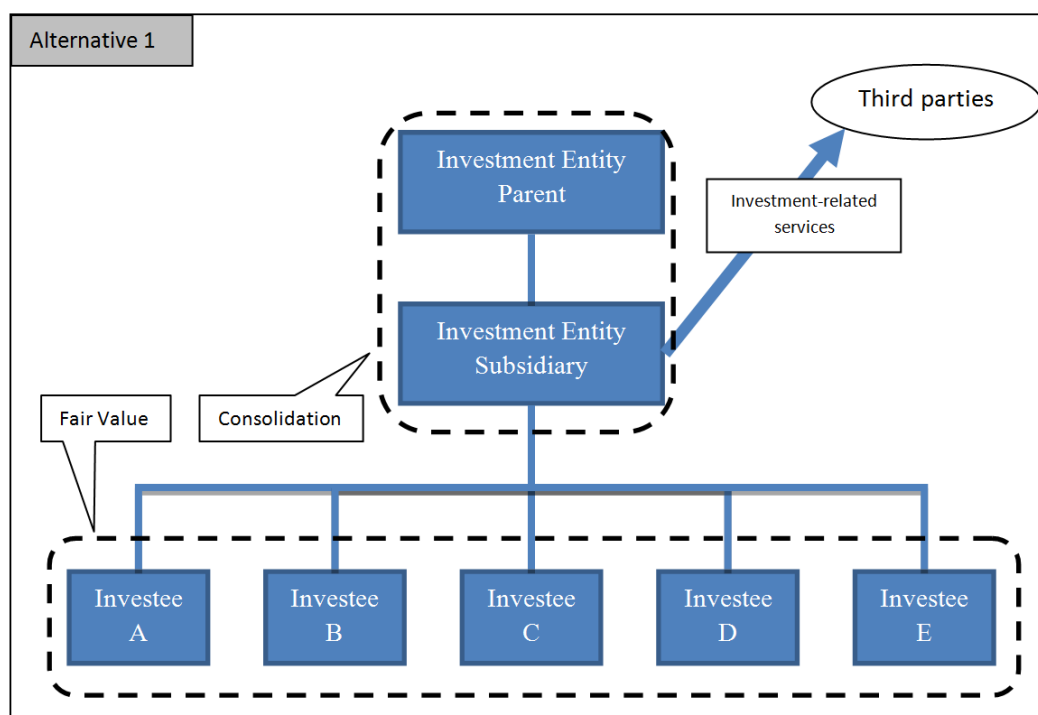
19. We considered how an investment entity parent should account for an investment entity subsidiary that provides investment-related services to third parties. We clarified the following two alternatives:

Alternative 1: require an investment entity parent to consolidate an investment entity subsidiary that provides investment-related services to third parties. In addition, require fair value measurement for its portfolio of investments.

Alternative 2: require an investment entity parent to measure an investment entity subsidiary at fair value, even if the investment entity subsidiary provides investment-related services to third parties. This would be the same accounting as

is required for investment entity subsidiary which provides investment related services to its investors and investees (see paragraph 18).

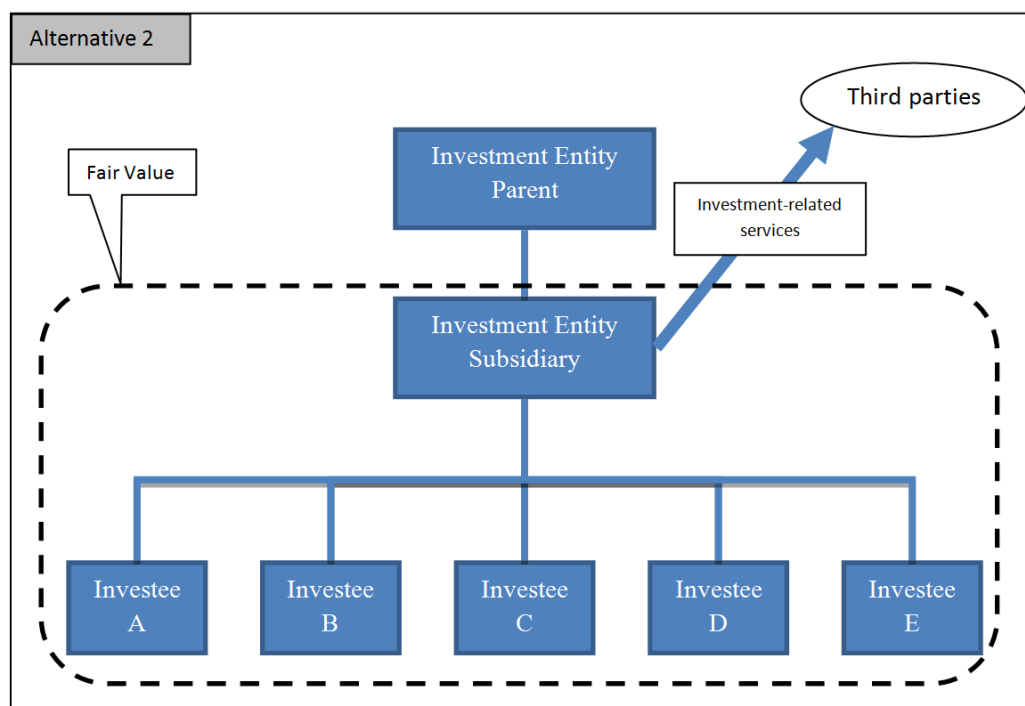
Alternative 1: require an investment entity parent to consolidate an investment entity subsidiary that provides investment-related services to third parties. In addition, require fair value measurement for its portfolio of investments.



- Alternative 1 would require an investment entity parent to consolidate an investment entity subsidiary that provides investment-related services to third parties.

We think that these consolidated financial statements provide useful information to users. The consolidated balance sheet shows the fair value of portfolio of investments, while other assets and liabilities that are held by the investment entity subsidiary would be consolidated. In addition, investment-related services revenues from third parties and expenses incurred in investment entity subsidiary are presented on the income statement.

Alternative 2: require an investment entity parent to measure an investment entity subsidiary at fair value, even if the investment entity subsidiary provides investment-related services to third parties



21. Alternative 2 would require an investment entity parent to measure an investment entity subsidiary at fair value, even if the investment entity subsidiary provides investment-related services to third parties. As a result, investment entity subsidiary would be measured at fair value, aggregated with the fair value of portfolio of investee, and presented as a single line item on the financial statement of investment entity parent.
22. We noted that this alternative is consistent with the decision made in the June 2012 IASB meeting for investment entities subsidiaries, including those that provide investment related services to its investors and activities to its investees.

Information about prevalence

23. We understand that it would be rare in practice that a subsidiary would both provide investment-related service to third parties and qualify as an investment entity and hold investees. We conducted outreach before the finalisation of the amendment and noted that an investment entity subsidiary that provides

investment-related services to third parties is typically an operating subsidiary that is not itself an investment entity and does not hold a portfolio of investees.

Staff recommendations

Guidance on accounting for investment entity subsidiary that also provide investment-related services to third parties

24. Although we think that Alternative 1 may provide more useful information to users, we understand that it is uncommon for a subsidiary of an investment entity to both provide investment-related services to third parties and qualify as an investment entity. Consequently we do not think that making an amendment to permit/require alternative 1 would meet the agenda criteria of the Interpretations Committee. We also think that it is better to maintain the simplicity of the Standard rather than introducing an additional complication that would deal only with circumstances that are rare in practice. We therefore recommend that these investment entity subsidiaries are accounted for in the same way as all other investment entity subsidiaries, ie at fair value (alternative 2).

Guidance on accounting for investment entity subsidiary that also provide investment-related services and activities

25. We have concluded above that all investment entity subsidiaries should be accounted for at fair value. However, we are aware that it is not necessarily clear in the Standard that this is the case. Consequently, we propose that this accounting should be clarified through Annual Improvements. We made an assessment against the Annual Improvements criteria in Appendix B.

Questions for the Interpretations Committee

- 1 Does the Interpretations Committee agree with the staff's recommendation that we should not require consolidation of the investment entity subsidiary that provides investment related services to third parties?
- 2 Does the Interpretations Committee agree with the staff's recommendation that an annual improvement should be made to clarify that all investment entity subsidiaries should be measured at fair value?

3 If the answer to Question 2 is 'Yes', does the Interpretations Committee have any comments on the proposed wording for the amendment in Appendix A?

Appendix A—Proposed wording for Amendment to IFRS 10

The proposed amendment to IFRS 10 is presented below.

Amendment to IFRS 10 *Consolidated Financial Statements*

Paragraph 32 and B85E are amended. Paragraphs 31, 33, B85C and B85D have been included for ease of reference but are not proposed for amendment.

Investment entities: exception to consolidation

- 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.
- 32** Notwithstanding the requirement in paragraph 31, if an investment entity has a subsidiary that provides investment-related services or activities ~~services that relate to the investment entity's investment activities~~—(see paragraphs B85C–B85E), and the subsidiary is not an investment entity, 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.
- 33** A parent of an investment entity shall consolidate all entities that it controls, including those controlled through an investment entity subsidiary, unless the parent itself is an investment entity.

Appendix B

Application guidance

[...]

Determining whether an entity is an investment entity

[...]

Business purpose

[...]

- B85C** An investment entity may provide investment-related services (eg investment advisory services, investment management, investment support and administrative services), either directly or through a subsidiary, to third parties as well as to its investors, even if those activities are substantial to the entity.
- B85D** An investment entity may also participate in the following investment-related activities, either directly or through a subsidiary, if these activities are undertaken to maximise the investment return (capital appreciation or investment income) from its investees and do not represent a separate substantial business activity or a separate substantial source of income to the investment entity:
- (a) providing management services and strategic advice to an investee; and
 - (b) providing financial support to an investee, such as a loan, capital commitment or guarantee.

B85E If an investment entity has a subsidiary that provides investment-related services or activities, such as those described in paragraphs B85C–B85D, to the entity or other parties, and the subsidiary is not an investment entity, it shall consolidate that subsidiary in accordance with paragraph 32. If the subsidiary that provides such investment-related services or activities is itself an investment entity, the investment entity parent shall measure the subsidiary at fair value through profit or loss in accordance with IFRS 9.

Appendix B— 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, investment entity subsidiaries, by nature, provide investment related services or activities and we expect that this issue would be widespread and could 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 it is necessary to clarify that all investment entity subsidiaries should be accounted for at fair value.
that can be resolved efficiently within the confines of existing IFRSs and the <i>Conceptual Framework for Financial Reporting</i> .	Yes. Annual improvements to IFRS 10 can resolve the issue.
In addition:	
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. Annual improvements to IFRS 10 can resolve the issue.
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 does not relate to a current or planned IASB project.
In addition to the implementation and maintenance criteria, an AIP should (6.11, 6.12):	
Replace unclear wording Provide missing guidance Correct minor unintended consequences, oversights or conflict	Yes. It is to replace unclear wording.
Not change an existing principle or propose a new principle	No. It does not change an existing principle or propose a new principle.
Not be so fundamental that the IASB will have to meet several times to conclude (6.14)	No. It is to replace unclear wording, accordingly, it will not be so fundamental that the IASB will have to meet several times to conclude.