STAFF PAPER

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IFRS Interpretations Committee Meeting

IFRS IC November 2013

Project	**IFRS 10 *Consolidated Financial Statements***
Paper topic	Investment Entities Amendments—The interaction between the investment entity amendments and the exemption from preparing consolidated financial statements requirements in IFRS 10

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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 relates to the interaction between the investment entity amendments and the exemption from preparing consolidated financial statements requirements in IFRS 10 *Consolidated Financial Statements*.

2. The issue is whether the exemption set out in paragraph 4 (a) of IFRS 10 is available to entities that, as a result of the Investment Entities amendments, are measured at fair value in the consolidated financial statements of the parent entity. Specifically, the issue presented to the Interpretations Committee is whether an intermediate parent (that is not an investment entity) can use the exemption from preparing consolidated financial statements if it is reflected at fair value in its investment entity parent's financial statements.

3. IFRS 10 requires a parent entity to present consolidated financial statements. However, paragraph 4 of IFRS 10 provides an exemption that a parent need not

present consolidated financial statements if the entity meets the criteria in paragraph 4(a) of IFRS 10. One of the criteria is “its ultimate or any intermediate parent produces consolidated financial statements that are available for public use and comply with IFRSs”.

Paper structure

4. This paper is organised as follows:

    (a) Summary of the November 2013 IFRS IC 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 staff presented an analysis of the issue and proposed to amend paragraph 4 (a) (iv) of IFRS 10 so that an intermediate parent, which is reflected at fair value in its investment entity parent’s financial statements, is exempted from presenting consolidated financial statements if an intermediate parent meets all the criteria in paragraphs 4 (a) (i), (ii) and (iii).

6. The Interpretations Committee observed that an intermediate parent that does not provide investment-related services is included in its investment entity parent’s financial statements at fair value, and not through a line-by-line consolidation. The Interpretations Committee members questioned whether it was appropriate for such an intermediate parent to qualify for the exemption from the requirement to prepare consolidated financial statements if the intermediate parent was not itself an investment entity. Many Interpretations Committee members thought that intermediate parents that have subsidiaries should only be exempted from presenting consolidated financial statements if the intermediate parents’ accounts are reflected in the ultimate parent’s consolidated financial statements on a line-by-line basis.

Staff analysis of the issue

Paragraph 4 of IFRS 10: stakeholders benefited from presenting consolidated financial statements of intermediate parents.

7. We conducted a further analysis of the consequences of applying the exemption from the requirement to present consolidated financial statements for investment entities structures. More specifically, we analysed which users would benefit if intermediate parents (that were not investment entities) were to present consolidated financial statements.

8. Paragraph 4 of IFRS 10 states the exemption for presenting consolidated financial statements as follows:

> 4 An entity that is a parent shall present consolidated financial statements. This IFRS applies to all entities, except as follows:
>
> (a) a parent need not present consolidated financial statements if it meets all the following conditions:
>
> (i) it is a wholly-owned subsidiary or is a partially-owned subsidiary of another entity and all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements;
>
> (ii) its debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);
>
> (iii) it did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; and
>
> (iv) its ultimate or any intermediate parent produces consolidated financial statements that are available for public use and comply with IFRSs.
>
> (b) post-employment benefit plans or other long-term employee benefit plans to which IAS 19 Employee Benefits applies.
>
> (c) an investment entity need not present consolidated financial statements if it is required, in accordance with paragraph 31 of this IFRS, to measure all of its subsidiaries at fair value through profit or loss.

In order to apply the exemption of paragraph 4 (a), entities need to meet all four criteria listed at paragraph 4 (a) (i), (ii), (iii) and (iv). Accordingly, an intermediate parent (that is not an investment entity) should meet all of the following three criteria in addition to criterion 4 (a) (iv):

- all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the intermediate parent (that is not an investment entity) not presenting consolidated financial statements;
- the intermediate parent (that is not an investment entity)'s debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets); and
- the intermediate parent did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market.

9. We noted that the shareholders of the investment entity parent would use fair value-based information. Accordingly, if additional information is intended to be presented to shareholders of the investment entity parent, the information should be based on fair value, instead of on historical cost.

10. We also noted that minority shareholders of the intermediate parent may benefit from historical cost-based consolidated financial statements. However, we note that paragraph 4 (a) (i) specifically addresses the needs of minority shareholders separately; those minority shareholders can demand that the intermediate parent prepares consolidated financial statements. In addition, we noted that the exemption can only be used by non-listed entities that are not in the process of filing, in accordance with paragraphs 4 (a) (ii) and (iii).

11. We also considered the needs of users other than shareholders. We noted that the *Conceptual Framework* names "existing and potential investors, lenders and other creditors" as the primary users of general purpose financial reports.

> OB5 Many existing and potential investors, lenders and other creditors cannot require reporting entities to provide information directly to them and must rely on general purpose financial reports for much of the financial information they need. Consequently, they are the primary users to whom general purpose financial reports are directed.

12. Accordingly, we consider that lenders (eg banks) and other creditors (eg suppliers) of intermediate parents would potentially benefit from intermediate parents presenting historical cost-based consolidated financial statements.

Cost and benefit of presenting historical cost-based consolidated financial statements of intermediate parents.

13. Before the introduction of the Investment Entities amendments, an intermediate parent that has an ultimate parent that is an investment entity parent that consolidated all investees was exempt from presenting consolidated financial statements except in cases in which minority shareholders disagree, debt or equity shares were publicly traded or the entity was in the process of filing its financial statements to regulators.

14. If intermediate parents of investment entities are required to present consolidated financial statements, we consider that the following stakeholders would particularly benefit:

    - banks that have significant lending to the intermediate parent; and
    - suppliers that have significant receivable from the intermediate parent.

    However, we think that these users receive only limited information about the intermediate parent through the consolidated financial statements of the ultimate parent under ordinary consolidated financial statements. Accordingly, it is not clear if these users' needs must be specifically addressed for investment entity structures by presenting consolidated financial statements of the intermediate parents. In addition, in our experience, a bank that provides significant lending to an entity will normally have the ability to require certain periodic reporting to the bank as a condition of the loan, therefore if a bank thought that consolidated financial statements of the intermediate parent were needed, we would expect that, in many circumstances, it could demand these as part of the conditions of lending. We also noted that supplier may use credit rating information in practice.

15. In addition, if we require all intermediate parents that are subsidiaries of investment entities to present consolidated financial statements, we consider that intermediate parents in (any combination of) the following circumstances would be automatically required to present historical cost-based consolidated financial statements:

- wholly owned intermediate parents (that are not investment entities);
- partially owned intermediate parents, for which minority shareholders do not require historical cost-based consolidated financial statements and therefore would not object to the application of the exemption from preparing consolidated financial statements;
- intermediate parents that do not have any borrowing from banks; and
- intermediate parents that do not have significant liability to creditors.

It is not clear whether users would benefit from the presentation of consolidated financial statements in these circumstances.

16. We consider that requiring all intermediate parents to present consolidated financial statements could incur significant additional costs. We wonder whether the additional cost is justifiable compared with the additional benefit We are particularly concerned whether the benefits the IASB expected from the Investment Entities amendments would be undermined by requiring all intermediate parents to prepare consolidated financial statements. We note the following statements in the Basis for Conclusions (emphasis added):

> BC309 <u>The Board expects that the introduction of the exception to consolidation will result in significant compliance cost savings for preparers</u>, particularly on an ongoing basis. This expectation is based on the feedback the Board has received from respondents to the Investment Entities ED and conversations with entities that are expected to qualify as investment entities.

> BC314 In general, these amendments will provide improved information about the fair values of investments and the way in which the fair value is measured. Such information could reduce the cost of analysis by providing information more directly to users of financial statements. However, in many cases, investment entities already provide investors with fair value information, although this is often done in an alternative report rather than in the financial statements. This serves to emphasise that <u>the main benefit of the changes is a reduction in costs to preparers because it eliminates what they see as a cumbersome reporting requirement that has little value.</u>

Staff recommendation

17. Given the additional analysis performed in this paper, we continue to think that the exemption from preparing consolidated financial statements set out in paragraph 4 (a) should be available to an intermediate parent entity that is a subsidiary of an investment entity but that is not an investment entity itself. In reaching this conclusion, we take note of the conditions set out in paragraph 4 (a) (i), (ii) and (iii) that we think provide appropriate protection to the primary users of the intermediate parent's financial statements.

18. We therefore recommend that an amendment is made to IFRS 10 that addresses the applicability of the exemption in paragraph 4 (a) to an intermediate parent entity that is a subsidiary of an investment entity. We think this can be made through Annual Improvements to clarify the applicability of the exemption.

Questions for the Interpretations Committee

1. Does the Interpretations Committee agree that intermediate parents that are subsidiaries of investment entities should be eligible for the exemption from preparing consolidated financial statements in accordance with paragraph 4 (a) of IFRS 10?
2. If the answer to Question 1 is 'Yes', does the Interpretations Committee agree with making a clarification through Annual Improvements is consistent with this conclusion?
3. If the answer to Question 1 and 2 are '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 (if intermediate parents are not required to present consolidated financial statements only when it meets the criteria in accordance with the paragraph 4 (a) (i), (ii) or (iii) of IFRS 10)

The proposed amendment to IFRS 10 is presented below.

Amendment to IFRS 10 *Consolidated Financial Statements*

Paragraph 4 (a) (iv) is amended. Paragraphs 4 (a) (i), (ii), (iii), (b) and (c) have been included for ease of reference but are not proposed for amendment.

Scope

4 An entity that is a parent shall present consolidated financial statements. This IFRS applies to all entities, except as follows:

(a) a parent need not present consolidated financial statements if it meets all the following conditions:

(i) it is a wholly-owned subsidiary or is a partially-owned subsidiary of another entity and all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements;

(ii) its debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);

(iii) it did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; and

(iv) its ultimate or any intermediate parent produces consolidated financial statements **<u>or produces financial statements that are prepared in accordance with paragraph 31 of this IFRS</u>** that are available for public use and comply with IFRSs.

(b) post-employment benefit plans or other long-term employee benefit plans to which IAS 19 Employee Benefits applies.

(c) an investment entity need not present consolidated financial statements if it is required, in accordance with paragraph 31 of this IFRS, to measure all of its subsidiaries at fair value through profit or loss.