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Agenda ref **12D**

STAFF PAPER

January 2015

IASB Meeting

Project	**IAS 28 *Investments in Associates and Joint Ventures***		
Paper topic	Proposal for an Annual Improvement: Measuring investees at fair value through profit or loss: an investment-by-investment choice or a consistent policy choice		
CONTACT(S)	Koichiro Kuramochi	kkuramochi@ifrs.org	+44 (0)20 7246 6496

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Introduction

1. Paragraph 18 of IAS 28 *Investments in Associates and Joint Ventures* states that when an investment in an associate or a joint venture is held by, or is held indirectly through, an entity that is a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure investments in those associates and joint ventures at fair value through profit or loss. In November 2014, the IFRS Interpretations Committee ('the Interpretations Committee') discussed a request to clarify whether an entity has an investment-by-investment choice for measuring investments in those associates and joint ventures at fair value through profit or loss.

2. The Interpretations Committee recommends that the IASB should address the issue through the Annual Improvements process. It recommends that the IASB should specify that a qualifying entity may elect to measure investments in associates and joint ventures at fair value through profit or loss on an investment-by-investment basis.

Purpose of this paper

3. The objective of this paper is to:

   (a) present background information on the issue;

   (b) provide a summary of the Interpretations Committee's discussions;

   (c) set out the Interpretations Committee's rationale for recommending an Annual Improvement; and

   (d) consider the need for consequential amendments.

Background information

4. When an investment in an associate or a joint venture is held by, or is held indirectly through, a venture capital organisation etc, the entity may elect to measure investments in those associates and joint ventures at fair value through profit or loss, in accordance with paragraph 18 of IAS 28 *Investments in Associates and Joint Ventures*.

5. The Interpretations Committee received a request to clarify whether the entity is able to choose between applying the equity method, or measuring an investee at fair value through profit or loss on an investment-by-investment basis, or whether instead the accounting treatment should be applied consistently across all its investments.

6. The submitter noted that the IASB revised IAS 28 in 2011. Before the revision, measuring investees at fair value through profit or loss appeared as a scope exemption in IAS 28; however, that paragraph was moved to the body of IAS 28 as a result of the revision. The submitter claimed that before the revision in 2011, entities had an explicit option whereby they could choose to measure investees using the equity method, or measure investees at fair value through profit or loss, on an investment-by-investment basis. However, after the revision, it had become less obvious whether the entity still has the same option.

7. According to the submitter, two views exist as follows:

(View A) An entity can elect to account for investments either by the equity method or by measuring them at fair value through profit or loss on an investment-by-investment basis, because no change was discussed by the IASB or described in the guidance or Basis for Conclusions when IAS 28 was revised in 2011; or

(View B) an entity needs to measure investees at fair value through profit or loss consistently across all its investments, because the choice included in the revised IAS 28, which allows either applying the equity method or measuring the investees at fair value through profit or loss, does not specify that the choice is available to be used on an investment-by-investment basis.

Staff analysis of the issue

8. The following is a summary of the analysis presented to the Interpretations Committee in November 2014. Our full analysis was set out in Agenda Paper 16[1] for the November 2014 Interpretations Committee meeting.

9. In 2003, the IASB revised IAS 28 and introduced measuring investees at fair value through profit or loss, as a scope exemption to IAS 28. IAS 28 (2003) stated that the Standard did not apply to investments in associates held by venture capital organisations, mutual funds, unit trusts and similar entities including investment-linked insurance funds, if those investments are designated as at fair value through profit or loss (FVTPL) upon initial recognition, or if they are classified as held for trading and are consequently accounted for in accordance with IAS 39 *Financial Instruments: Recognition and Measurement.* IAS 28 (2003) states measuring investees at fair value through profit or loss as follows (emphasis added):

[1] http://www.ifrs.org/Meetings/MeetingDocs/Interpretations%20Committee/2014/November/AP16%20-%20IAS%2028%20Consistency%20in%20the%20application%20of%20the%20fair%20value%20option.pdf

> 1 This Standard shall be applied in accounting for investments in associates. However, it does not apply to investments in associates held by:
>
> (a) venture capital organisations, or
>
> (b) mutual funds, unit trusts and similar entities including investment-linked insurance funds
>
> that *upon initial recognition are designated as at fair value through profit or loss* or are classified as held for trading and accounted for in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*. Such investments shall be measured at fair value in accordance with IAS 39, with changes in fair value recognised in profit or loss in the period of the change.

10. IAS 28 was revised in 2011. The paragraph on measuring investees at fair value through profit or loss was moved to the body of IAS 28 and the wording was modified. IAS 28 (2011) reads as follows (emphasis added):

> 18 When an investment in an associate or a joint venture is held by, or is held indirectly through, an entity that is a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, *the entity may elect to measure investments in those associates and joint ventures at fair value through profit or loss* in accordance with IFRS 9.

11. We have performed outreach with the securities regulators, IFASS members, and global accounting firms. We noted that diversity in practice exists on the issue. Details of the results of the outreach can be found in in Agenda Paper 16 for the November 2014 Interpretations Committee meeting.

The Interpretations Committee's view and proposal for an Annual Improvement

12. The Interpretations Committee notes that IAS 28 (2003) allowed an entity to elect to measure investments in those associates and joint ventures at fair value through profit or loss on an investment-by-investment basis. It also noted that the IASB did not specifically discuss changing the accounting treatment when IAS 28 was revised in 2011.

13. The Interpretations Committee notes from its discussions that the most common interpretation of the wording of the current Standards will be that an entity is required to consistently elect to measure investments in those associates and joint ventures at fair value through profit or loss, because:

    (a) consistent application of an accounting policy is required, in accordance with paragraph 13 of IAS 8, unless other IFRSs *specifically* require or permits different treatments; and

    (b) paragraph 18 of IAS 28 does not *specifically* require or permit an exception to the consistent application of an accounting policy.

14. Because of the absence of any discussion by the IASB about changing the requirements when this Standard was revised in 2011, the Interpretations Committee thinks that this change in the wording was unintended.

15. The Interpretations Committee considers that entities should be *specifically* allowed to elect to measure investments in those associates and joint ventures at fair value through profit or loss on an investment-by-investment basis.

16. On the basis of its discussions, the Interpretations Committee recommends that the wording of paragraph 18 of IAS 28 should be amended in an Annual Improvement to specify that a qualifying entity may elect to measure investments in associates and joint ventures at fair value through profit or loss on an investment-by-investment basis.

Consequential amendment in relation to application of the equity method by a non-investment entity investor to an investment entity investee

17. In December 2014, the IASB issued relief[2] to non-investment entity investors in investment entity associates and joint ventures. This relief permits, but does not require, a non-investment entity investor to retain the measurement at fair value through profit or loss that was applied by an investment entity associate or joint venture for their subsidiaries when the non-investment entity investor applies the equity method.

18. Because this relief permits, instead of requiring, a non-investment entity investor to retain the measurement at fair value through profit or loss applied by an investment entity associate or joint venture, we consider that a similar question could arise for this accounting choice; ie is the choice available on an investment-by-investment basis?

19. We note that the reason for allowing a non-investment entity investor to retain the measurement at fair value through profit or loss applied by any of its investment entity associates or joint ventures to their subsidiaries was because of concerns about the potentially significant practical difficulties or additional costs that may arise for an entity in unwinding the measurement at fair value through profit or loss that had been applied by the investment entity associate or joint venture.

20. When discussing the issues and considering whether to make the retention of fair value a choice rather than a requirement, the Board took note of arguments that there could be circumstances in which the information to unwind measurement at the fair value through profit or loss is available and thus a free choice should be permitted.

21. We think that although the Board did not specifically discuss whether the choice should be available on an investment-by-investment basis, we think that applying the choice on this basis would be consistent with the Board's discussions.

22. Accordingly, we recommend that the Annual Improvement should also amend the wording of paragraph 36A of IAS 28 to *specify* that a non-investment entity has

[2] *Investment Entities: Applying the Consolidation Exception* (Amendments to IFRS 10, IFRS 12 and IAS 28).

an investment-by-investment choice for retaining the measurement at fair value through profit or loss applied by any of its investment entity associates and joint ventures to their subsidiaries.

Transition

23. We propose that the Annual Improvement should be applied retrospectively, because a change from applying the equity method to measuring an investment in an associate or joint ventures at fair value results in a change in the measurement basis. A change in the measurement basis applied is a change in an accounting policy, in accordance with paragraph 35 of IAS 8.

24. We consider that the retrospective application of this Annual Improvement is not onerous. The option to measure investments in associates and joint ventures at fair value through profit or loss is available only to a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds. If an entity qualifies as a venture capital organisation, etc, we expect that the entity would already have the necessary fair value information for management purposes.

25. With respect to the additional amendment relating to the accounting by a non-investment entity investor in an investment entity associate or joint venture, we note that the amendment issued in December is required to be applied retrospectively. Consequently retrospective application of this further amendment would be appropriate.

IFRS 1 First-time Adoption of International Financial Reporting Standards

26. We looked at whether amendments should be proposed to IFRS 1 for first-time adopters in relation to this Annual Improvement. However, we note that the nature of this Annual Improvement does not affect first-time adoption of IFRS. Consequently, we do not think that specific relief is needed in IFRS 1 for this amendment.

Assessment against the interpretations agenda criteria

27. The following table sets out the assessment of the proposed amendments against the criteria for Annual Improvements. The conclusion of this assessment is that the proposed amendments meet the criteria to be included within Annual Improvements.

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.** The fair value option for an associate or joint venture is widely applied and may 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 amend paragraph 18 of IAS 28, to specify that application of the fair value option is available on an investment-by-investment basis. Similarly we think that an equivalent amendment should be made to paragraph 36 of IAS 28 in respect of investment entity associates and joint ventures.
that can be resolved efficiently within the confines of existing IFRSs and the *Conceptual Framework for Financial Reporting*.	**Yes.** Amendments to IAS 28 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.** Amendments to IAS 28 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.** The issue is an unintended consequence of the changes to IAS 28 in 2011, and adds clarity to the investment entity amendments published in December 2014.
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.** The issue is mere correction of an unintended consequence, so it will not be so fundamental that the IASB will have to meet several times to conclude.

Questions for the IASB

1. Does the IASB agree with the Interpretations Committee's recommendation that this issue should be resolved by an Annual Improvement?

2. Does the IASB agree that a similar amendment should be made in relation to application of the equity method by a non-investment entity investor to an investment entity associate or joint venture?

3. Does the IASB agree with the proposed transition requirements and our conclusion that no specific additional relief is required for first-time adoption?