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STAFF PAPER

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Project	**Post-implementation Review of IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interests in Other Entities***
Paper topic	Background—Analysis of feedback—IFRS 10

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Purpose of the paper

1. This paper provides an analysis of comment letters on questions 2 to 5 of the Request for Information on Post-implementation Review of IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interests in Other Entities* (Request for Information).

2. This paper will not be discussed in the Board session and is intended to be read as background information.

3. not used

Structure of the paper

4. This agenda paper analyses the feedback received in comment letters on the Request for Information on IFRS 10.

Feedback on Question 2(a)—power over an investee—relevant activities

Background

5. Feedback from the first phase of the Post-implementation Review identified that some stakeholders found it challenging, on occasion, to identify the relevant activities in assessing whether an investor controls an investee. Stakeholders said:

   (a) challenge can arise when two or more investors each have rights that give them the unilateral ability to direct different activities.

   (b) identifying relevant activities requires significant judgement when the relevant activities occur at different times or are conditional on future events.

   (c) the contribution of each activity to the investee's performance may change over time, this introduces additional complexity into the lifetime assessment.

6. The Request for Information asked the following questions on identifying relevant activities:

Question 2(a)
In your experience: (i) to what extent does applying paragraphs 10–14 and B11–B13 of IFRS 10 enable an investor to identify the relevant activities of an investee? (ii) are there situations in which identifying the relevant activities of an investee poses a challenge, and how frequently do these situations arise? In these situations, what other factors are relevant to identifying the relevant activities?

Question 2(a)(i)

7. Of the respondents who answered this question, most said applying paragraphs 10–14 and B11–B13 of IFRS 10 enables an investor to identify the relevant activities of an investee.

However, many of these respondents also said, in some situations, identifying relevant activities requires significant judgement and further guidance or clarification would be helpful.

Question 2(a)(ii)

8. The following three situations were identified by respondents as posing challenges when identifying relevant activities:

   (a) Two or more investors each have existing rights that give them the unilateral ability to direct different relevant activities.

   (b) Relevant activities occur at different times or are conditional on future events and are directed by two or more investors.

   (c) Identifying the relevant activities of a structured entity when it operates in a predetermined way.

Two or more investors each have existing rights that give them the unilateral ability to direct different relevant activities

9. Paragraph 13 of IFRS 10:

   > If two or more investors each have existing rights that give them the unilateral ability to direct different relevant activities, the investors that has the current ability to direct the activities that most significantly affect the returns of the investee has power over the investee.

10. Many of those respondents who said that identifying relevant activities requires significant judgement noted that a challenging situation is to identify relevant activities that most significantly affect the returns of the investee when two or more investors each have existing rights that give them the unilateral ability to direct different relevant activities. For example, the Institute of Chartered Accountants in England and Wales commented:

   > One example of where it is difficult to determine which of the relevant activities most significantly affects the returns of the investee is where the entity in question

> develops, produces and sells products as all three activities are not only significant to the success of the entity but also dependent on one another. Each activity could be directed by a different investor. Assuming there is no joint control, each investor would need to assess whether they believe their activity most significantly affects the investee's returns. This is particularly difficult, given the co-dependence.

11. A few respondents commented on the frequency of above situation—these respondents held mixed views; one preparer said the situation arises frequently while others (two national standard-setters and one accountancy body) said the situation does not arise frequently.

Relevant activities occur at different times or are conditional on future events and are directed by two or more investors

12. Many of the respondents who answered this question commented on application example 1 in paragraph B13 of IFRS 10—noting that it is challenging to identify the activity that most significantly affects the investee's returns when different relevant activities occur at different times or are conditional on future events and two or more parties have the unilateral ability to direct different relevant activities.

13. Eight respondents (including three accounting firms, two accountancy bodies and two national standard-setters) said that, in this situation, IFRS 10 is not clear if the activity that most significantly affects the investee's returns are identified by:

    (a) considering the relevant activities over the entire life of the entity; even if the entity has different stages during its lifecycle; or

    (b) considering each stage of the entity's lifecycle separately, noting that only some activities are relevant at a particular stage.

14. The Australian Accounting Standards Board commented:

> It was noted that IFRS 10 Application Example 1 states that investors need to consider the activities that most significantly affect the investee's returns. This appears to imply that these are meant to be the overall returns over the whole life of the investee. The ambiguity might arise from the use of 'current' in paragraph 13

> and whether that implies that an investor would disregard the fact that they only have decision-making rights in the next stage of the project's life.

15. Some of the respondents who answered this question said the reassessment requirements in paragraph 8 of IFRS 10 are consistent with both the views in paragraph 13.[1]

16. A few of the respondents who answered this question commented on the frequency of above situation—these respondents held mixed views; two accountancy bodies, one national standard-setter and one accounting firm said the situation arises frequently in their jurisdictions while one accountancy body, one accounting firm and one preparer said the situation does not arise frequently.

Identifying the relevant activities of structured entities

17. Many of the respondents who answered this question said it is challenging to identify the relevant activities of a structured entity when almost or all of its activities are predetermined at inception.

18. These respondents said as most of the activities are predetermined at inception, few activities can be identified in the operating stage of the structured entity, for example a structured entity that is designed to hold high-quality government bonds to their maturity.

19. Paragraph B51 of IFRS 10 states:

> In assessing the purpose and design of an investee (see paragraphs B5-B8), an investor shall consider the involvement and decisions made at the investee's inception as part of its design and evaluate whether the transactions terms and features of the involvement provide the investor with rights that are sufficient to give it power. …

[1] Paragraph 8 of IFRS 10 states:

> *An investor shall consider all facts and circumstances when assessing whether it controls an investee. The investor shall reassess whether it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed in paragraph 7 (see paragraphs B80–B85).*

20. Some of the respondents who answered this question, whilst agreeing with the paragraph B51 of IFRS 10, questioned to what extent an investor weighs its involvement at the inception with involvement at the operating stage in the assessment of control.

21. A few of respondents who answered this question commented on the frequency of above situation—these respondents held mixed views; one national standard-setter and one accountancy body said the situation arises frequently in their jurisdictions while one accountancy body said the situation does not arise frequently.

Feedback on Question 2(b)—power over an investee—rights that give an investor power

Background

22. In the first phase of the Post-implementation Review, some stakeholders said they found it challenging to assess whether rights held by an investor are protective.[2] Some stakeholders asked for additional guidance on how an investor reassesses its own rights and the rights of other parties (including potential voting rights) when facts and circumstances change.

[2] Protective rights are defined by IFRS 10 as *rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate*.

23. The Request for Information included the following questions on rights that give an investor power:

Question 2(b)
In your experience: (i) to what extent does applying paragraphs B26–B33 of IFRS 10 enable an investor to determine if rights are protective rights? (ii) to what extent does applying paragraphs B22–B24 of IFRS 10 enable an investor to determine if rights (including potential voting rights) are, or have ceased to be, substantive?

Question 2(b)(i)

24. Although almost all of the respondents who answered this question said applying paragraphs B26–B33 of IFRS 10 enables an investor to determine if rights are protective rights, some of these respondents said determining whether rights are protective can be challenging. The challenges noted include assessing if:

(a) rights in a franchise agreement are protective (paragraphs 25–28);

(b) veto rights are protective (paragraphs 29–31); and

(c) lender's rights are protective (paragraphs 32–35).

Franchise agreements

25. Some of the respondents who answered this question (including nine national standard-setters, four accounting firms and two accountancy bodies) said assessing whether a franchisor controls a franchise operation is complicated because of the nature of rights a franchisor can be granted in a franchise agreement and determining if these rights are

protective. Respondents said this is because paragraph B30 of IFRS 10 implies that the rights held by a franchisor are generally protective.[3]

26. These respondents observed that sometimes a franchise agreement grants a franchisor an extensive scope of rights—including the ability to direct relevant activities that significantly affect the variable return of the franchise operation. Rights granted to a franchisor may include:

    (a) setting prices;

    (b) designing of the store;

    (c) selecting suppliers;

    (d) acquiring or disposing equipment;

    (e) appointing, remunerating or terminating the employment of key management personnel; and

    (f) financing the franchise operation.

27. These respondents asked for clarification of paragraphs B29–B33 of IFRS 10, especially if the Board's intention was to imply the rights held by franchisors are generally protective.

28. A further matter observed by a national standard-setter was that paragraph B30 of IFRS 10 has been applied by analogy to argue that rights held by investors are protective when assessing control without the existence of a franchise agreement.

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[3] Paragraph B30 of IFRS 10 states:

Generally, franchisors' rights do not restrict the ability of parties other than the franchisor to make decisions that have a significant effect on the franchisee's returns. Nor do the rights of the franchisor in franchise agreements necessarily give the franchisor the current ability to direct the activities that significantly affect the franchisee's returns.

Veto rights

29. A few of the respondents who answered this question (including five national standard-setters) said it is unclear, in assessing control, how an entity incorporates:

(a) veto rights over relevant activities held by the entity itself; and

(b) veto rights over relevant activities held by other investors.

30. These respondents said sometimes an entity holds veto rights over the relevant activities giving the entity the right to block operational decisions, such as approval of the budget or appointment of key management. However, these veto rights do not give the investor the right to direct the relevant activities albeit the investor is passively directing activities by virtue of being able to block these activities.

31. Consequently, these respondents asked whether an investor can control an investee by holding only veto rights over the relevant activities, or conversely, whether an investor cannot control an investee by holding only veto rights over the relevant activities.

Lender's rights

32. A few of the respondents who answered this question said it is challenging to decide whether rights held by lenders and initially assessed as protective change when an investee breaches covenants set out in a borrowing agreement.

33. The IFRS Interpretations Committee (Interpretations Committee) issued an Agenda Decision *IFRS 10* Consolidated Financial Statements—*Effect of protective rights on an assessment of control* in September 2013. The Agenda Decision states that a breach of a covenant that results in rights becoming exercisable may constitute a change to one or more of the three elements of control. The Interpretations Committee noted that, however, a reassessment may or may not result in a change to the outcome of the assessment of control, depending on the individual facts and circumstances.

34. These respondents said the reassessment of control is challenging when the lender does not exercise these rights and the previous controlling party continues to direct relevant activities.

35. One national standard-setter suggested introducing a consolidation exemption to IFRS 10 in the circumstance in which a lender obtains control due to a breach of covenant; in their view consolidation of investees in this circumstance causes confusion in capital market communication.

Other

36. Two national standard-setters and one accounting firm commented on a common misunderstanding (also observed in some outreach meetings) regarding the relationship between protective and substantive rights; that is protective rights are non-substantive rights, and substantive rights are not protective rights. For example, Grant Thornton International Ltd commented:

> We believe confusion exists between determining substantive rights (ie rights that the holder has the practical ability to exercise) and protective rights. Our view is that a protective right is by nature a right whose purpose is to protect the economic interests of the shareholders without preventing another shareholder from directing the activities of an investee. Considering this, a right that gives the holder the power to veto a decision for merging the entity with another for instance might be a protective right, but in other circumstances it might be considered a substantive right if the holder has the ability to effectively block such a decision when a merger is planned.

Question 2(b)(ii)

37. Almost all of the respondents who answered this question said applying paragraphs B22–B24 of IFRS 10 enables an investor to determine if rights (including potential voting rights) are, or have ceased to be, substantive. However, a few respondents said assessing whether potential voting rights are substantive is, in some circumstances, challenging. Circumstances identified as challenging include:

(a) when the holder of potential voting rights might be willing to pay a higher price because of potential synergies. Respondents ask if the synergies need to be considered in assessing whether an exercise or conversion price is in-or-out of the money;

(b) the exercise of the potential voting rights is contingent on events outside the control of the parties to the agreement, for example approval from a government authority; and

(c) potential voting rights that only become exercisable in the event of a deadlock.

Feedback on Question 2(c)—power over an investee—control without a majority of the voting rights

Background

38. Feedback in the first phase of the Post-implementation Review identified the assessment of control when an investor has less than a majority of the voting rights can be challenging and lead to inconsistent outcomes. Stakeholders specifically referred to the situation described in IFRS 10 paragraph B42(a) in which an investor with less than a majority of the voting rights has the practical ability to direct an investee's relevant activities unilaterally because of the size of the investor's voting rights relative to the size and dispersion of the other shareholdings.

39. The Request for Information included the following questions on control without a majority of the voting rights:

Question 2(c)
In your experience: (i) to what extent does applying paragraphs B41–B46 of IFRS 10 to situations in which the other shareholdings are widely dispersed enable an investor that does not hold a majority of the voting rights to make an appropriate assessment of

whether it has acquired (or lost) the practical ability to direct an investee's relevant activities?

(ii) how frequently does the situation in which an investor needs to make the assessment described in question 2(c)(i) arise?

(iii) is the cost of obtaining the information required to make the assessment significant?

Question 2(c)(i)

40. Most of the respondents who answered this question said applying paragraphs B41–B46 of IFRS 10 enables an investor without the majority of the voting rights to make an appropriate assessment of whether it has acquired (or lost) the practical ability to direct an investee's relevant activities unilaterally. Albeit, some of these respondents said in these situations the control assessment can be challenging.

41. Paragraph B42 of IFRS 10 requires an investor, when assessing if voting rights are sufficient to give it power, to consider all facts and circumstances, and provides a list of matters to be considered. Many of the respondents who answered this question identified challenges relating to the matters identified in paragraph B42 of IFRS 10 including:

(a) the size of investor's shareholding and dispersion of other shareholdings. Some respondents said the application examples provided in IFRS 10 are simplistic because:

(i) sometimes the investor's shareholding is significantly lower than 48%; and

(ii) other shareholdings are not as dispersed as described in the application examples.

(b) how to determine voting patterns:

(i) if there is no historical voting pattern as an entity is newly established or there has been a significant change in shareholding structure (for example, after an initial public offering); and

(ii) if at future shareholder meetings different agenda items, for example, are to be discussed in contrast to previous meetings.

(c) how many years of historical voting is needed to be considered a voting pattern.

Question 2(c)(ii)

42. Respondents' views on how frequently the situation in which an investor needs to make the assessment described in question 2(c)(i) were evenly distributed between: frequently, sometimes and infrequently.

Question 2(c)(iii)

43. Of the respondents who answered question 2(c)(iii), many (including seven national standard-setters, three accounting firms and two preparers) said the cost of obtaining the information is not significant; while slightly fewer respondents (including four national standard-setters and three preparers) said the cost is significant.

44. Respondents that said the cost of obtaining relevant information is not significant noted information such as the share register or historical voting patterns are normally maintained and readily available.

45. Respondents that said the cost of obtaining the relevant information is significant noted:

(a) significant judgment is required therefore the assessment is time-consuming; and

(b) monitoring changes in other shareholdings is burdensome.

Feedback on Question 3(a)—the link between power and returns—principals and agents

Background

46. In the first phase of the Post-implementation Review, some stakeholders said it can be challenging to determine whether a decision maker is acting as a principal or an agent—for example assessing whether the decision maker's exposure to variable returns is consistent with being an agent.

47. The Request for Information included the following questions on determining whether a decision maker is a principal or an agent:

Question 3(a)
In your experience: (i) to what extent does applying the factors listed in paragraph B60 of IFRS 10 (and the application guidance in paragraphs B62–B72 of IFRS 10) enable an investor to determine whether a decision maker is a principal or an agent? (ii) are there situations in which it is challenging to identify an agency relationship? If yes, please describe the challenges that arise in these situations. (iii) how frequently do these situations arise?

Question 3(a)(i)

48. Almost all of the respondents who answered this question said applying the factors listed in paragraph B60 of IFRS 10 (and the application guidance in paragraphs B62–B72 of IFRS 10) enable an investor to determine whether a decision maker is a principal or an agent. However, many of them commented that making such assessment in some circumstances requires significant judgement and can be challenging.

Question 3(a)(ii)

49. Paragraph B60 of IFRS 10 states:

> A decision maker shall consider the overall relationship between itself, the investee being managed and other parties involved with the investee, in particular all factors below, in determining whether is an agent:
>
> (a) the scope of its decision-making authority over the investee.
>
> (b) the rights held by other parties.
>
> (c) the remuneration to which it is entitled in accordance with the remuneration agreement(s).
>
> (d) the decision maker's exposure to variability of returns from other interests that it holds in the investee.
>
> Different weightings shall be applied to each of the factors on the basis of particular facts and circumstances.

Application examples 13–16 in paragraph B72 of IFRS 10 illustrate how to consider the above factors in identifying agency relationship.

50. Most of the respondents who answered question 3(a) said that, in some circumstances, assessing whether the remuneration and the decision maker's exposure to variability of return (paragraph B60(c) and B60(d) of IFRS 10) is compatible with being an agent poses challenges.

51. Many of the respondents who answered question 3(a) commented that while application examples 13–16 of IFRS 10 are useful, implicit 'bright lines' have developed in practice to help determine whether a decision maker acts as an agent. For example, BDO IFR Advisory Limited, commented:

> Common fact patterns are already included in IFRS 10 in examples 13-16, however, we have observed instances where practice has developed to interpret the numerical figures in these examples as 'quasi-rules' in certain jurisdictions.
>
> The numerical exposure to variable returns that can be derived from these examples range from 22% to 37% of the profits of the fund. We have observed regulators and entities applying these numerical examples strictly, where any exposure below 22% for a fund manager (or other type of investor) is determined to be insufficient

exposure to variable returns, whereas anything beyond 37% is determined to result in sufficient exposure to variable returns. The range between 22-37% is often considered to be a 'grey zone', which is open to judgement and the development of accounting policies.

52. In contrast to the views of respondents in paragraph 51 some of the respondents who answered question 3(a) requested more examples to help identify agency relationships:

    (a) in industries other than fund management or assets management sectors; and

    (b) in more complicated circumstances as they considered the current examples simplistic.

53. Many of the respondents who answered question 3(a) said additional support is needed to assess the factors in paragraph B60(c) and B60(d) of IFRS 10, including:

    (a) how to weigh the magnitude of, and the variability associated with, a decision maker's interests;

    (b) how to weigh the return from other interests that a decision maker holds in the investee and the return from the remuneration;

    (c) whether and how to reflect the possibility of occurrence of future events or achieving future performance; and

    (d) whether the fee earned by a decision maker should be included on a gross (the actual fee received) or net basis (the margin earned after deducting the costs of providing the service).

Question 3(a)(iii)

54. Of the respondents who answered question 3(a), few indicated how frequently these challenging situations arise. However, some of these respondents commented that

determining whether a decision maker acts a principal or an agent are common in the financial industry.

Feedback on Question 3(b)—the link between power and returns—non-contractual agency relationships

Background

55. In the first phase of the Post-implementation Review, some stakeholders said it can be challenging to prove or disprove that an investor and other parties have an agency relationship in the absence of a contractual arrangement (a de facto agency relationship).

56. The Request for Information included the following questions on identifying non-contractual agency relationship:

Question 3(b)
In your experience: (i) to what extent does applying paragraphs B73–B75 of IFRS 10 enable an investor to assess whether control exists because another party is acting as a de facto agent (ie in the absence of a contractual arrangement between the parties)? (ii) how frequently does the situation in which an investor needs to make the assessment described in question 3(b)(i) arise? (iii) please describe the situations that give rise to such a need.

Question 3(b)(i)

57. Responses to question 3(b)(i) are mixed. Those respondents that said applying paragraphs B73–B75 of IFRS 10 enables an investor to assess whether control exists because another party is acting as a de facto agent acknowledged that this is an area where significant

judgement is required. In contrast, other respondents asked for additional guidance on what factors to consider when assessing de facto agency relationships.

Question 3(b)(ii)

58. Many of the respondents who answered this question said they do not need to assess de facto agency relationships frequently.

Question 3(b)(iii)

59. Most of the respondents who answered this question referred to a situation in which an investor needs to assess whether a related party (most commonly controlled by the same parent of the investor) to an investee acts as a de facto agent on behalf of the investor. For example, International Organization of Securities Commissions commented:

> In many arrangements one might suspect that one party is likely to vote in the same way as another investor, but the other investor may not have the power, economically or contractually, to compel them to do so. While it is relatively common for related parties to both invest in the same entity, one investor may not have sufficient economic power over the other to conclude that it is able to control its votes, even when the two investors in practice vote together. There may even be an unwritten intention between two parties to vote together at the time of investment, but without an economic requirement it is unclear how such an informal understanding would grant one investor power over another investor's votes.

60. These respondents requested additional guidance to help an investor assess whether control exists because another party is acting as a de facto agent, for example what considerations should be given to assess the relationship between an investor and its related party when there is no contractual arrangement.

Staff summary of questions 2 and 3—control assessment

61. Many respondents answering questions 2 and 3 of the Request for Information, have acknowledged the need for judgment and have highlighted that in complex arrangements applying judgement and making the control assessment can, itself, be challenging. Some of these respondents have highlighted the importance of additional application guidance and illustrative examples to assist with the control assessment when circumstances are complex.

Feedback on Question 4(a)—investment entities—criteria for identifying an investment entity

Background

62. In the first phase of the Post-implementation Review, some stakeholders said the definition of investment entities may not be sufficiently robust. These stakeholders asked for clarification on some aspects of the definition.

63. The Request for Information included the following questions on the definition of an investment entity:

Question 4(a)
In your experience: (i) to what extent does applying the definition (paragraph 27 of IFRS 10) and the description of the typical characteristics of an investment entity (paragraph 28 of IFRS 10) lead to consistent outcomes? If you have found that inconsistent outcomes arise, please describe these outcomes and explain the situations in which they arise. (ii) to what extent does the definition and the description of typical characteristics result in classification outcomes that, in your view, fail to represent the nature of the entity in a relevant or faithful manner? For example, do the definition and the

description of typical characteristics include entities in (or exclude entities from) the category of investment entities that in your view should be excluded (or included)? Please provide the reasons for your answer.

Question 4(a)(i)

64. Most of the respondents who answered this question said applying the definition and the description of the typical characteristics of an investment entity leads to consistent outcomes. However, many of these respondents raised practical challenges in determining whether an entity qualifies as an investment entity.

Exit strategy

65. Paragraph B85F of IFRS 10, which expands on paragraph 27 of IFRS 10, states that an entity's investment plans provide evidence of its business purpose; that is an investment entity does not plan to hold its investments indefinitely. Furthermore paragraph B85F states an investment entity shall have an exit strategy documenting how it plans to realise capital appreciation from substantially all of its equity investments and non-financial asset investments.

66. Many of the respondents (including nine national standard-setters and three accounting firms) who answered this question expressed concern on how to apply the exit strategy element of the definition of investment entities. In summary, these respondents found it challenging to qualify or disqualify an entity as an investment entity because:

    (a) it is unclear what evidence is needed to determine if an entity has an exit strategy, that is:

        (i) what degree of documentation an entity needs to demonstrate it has an exit strategy;

        (ii) whether the fact that an investee has a limited life implies the investor has an exit strategy; and

(iii) whether an entity with a conditional exit strategy can qualify as an investment entity.

(b) it is unclear whether an entity that plans to hold its investments for long periods (for example 99 years) is disqualified from being an investment entity.

Business purpose

67. Paragraph B85D of IFRS 10 states:

> 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;
>
> …

68. Many of the respondents who answered this question said that it is unclear the extent of involvement in the activities of an investee would prevent an entity from qualifying as an investment entity. In relation to involvement in the activities of an investee, many of the respondents who answered this question referred to an entity that invests in real estate funds. The entity might be involved in active management of the funds, such as lease negotiations, property refurbishments and development activities, etc.

Fair value measurement

69. Paragraph B85K of IFRS 10 states:

> …
>
> In order to demonstrate that it meets this element of the definition, an investment entity:
>
> (a) provides investors with fair value information and measures substantially all of its investments at fair value in its financial statements whenever fair value is required or permitted in accordance with IFRSs;

…

70. Some of the respondents who answered this question said an entity's business purpose can be to invest funds solely for returns from capital appreciation, investment income, or both even if the entity holds a portfolio of fixed term debt instruments which represents a significant part of its investments. The debt instruments are measured at amortised cost in accordance with IFRS 9 *Financial instruments*. These respondents believe an entity should be identified as an investment entity even if it holds debt instruments carried at amortised cost.

Feedback on Question 4(b)—investment entities—subsidiaries that are investment entities

Background

71. In the first phase of the Post-implementation Review, some stakeholders said requiring an investment entity to measure at fair value an investment in a subsidiary that is itself an investment entity (instead of requiring the entity to consolidate the assets and liabilities of the subsidiary) results in loss of information.

72. The Request for Information included the following questions on subsidiaries that are investment entities:

Question 4(b)
In your experience: (i) are there situations in which requiring an investment entity to measure at fair value its investment in a subsidiary that is an investment entity itself results in a loss of information? If so, please provide details of the useful information that is missing and explain why you think that information is useful.

(ii) are there criteria, other than those in paragraph 32 of IFRS 10, that may be relevant to the scope of application of the consolidation exception for investment entities?

Question 4(b)(i)

73. Some of the respondents who answered this question supported the consolidation exception for investment entities and said fair value information is the most relevant information for investment entities. However, most of the respondents who answered this question said requiring an investment entity to measure at fair value its investment in a subsidiary that is itself an investment entity results in a loss of information. These respondents include 14 national standard-setters, eight preparers, seven accounting firms, seven accountancy bodies and five regulators.

74. Many of the respondents who said measuring at fair value a subsidiary that is itself an investment entity results in loss of information referred to financial information on:

   (a) investments held by the intermediate subsidiary—for example, information on fair value and on changes in the fair value of these investments; and

   (b) other assets and liabilities held by the intermediate subsidiary, such as cash balances and borrowings.

75. Some of the respondents who said there is a loss of information referred to financial information about investment-related services provided by the intermediate subsidiary—for example, revenue and the cost of the service.

76. Some of the respondents who said there is a loss of information also said they have observed voluntary disclosure or alternative performance measures being used to address the loss of information described in paragraphs 74 and 75. For example, Australian Accounting Standards Board commented that:

> The Australian securities regulator, the Australian Securities Exchange (ASX) requires listed investment entities to provide the ASX with the financial statements

> of the investees and must also make those available to their shareholders on request.

77. 3i Group plc said:

> We feel the fair value approach applied effectively obscures the performance of the investments held and associated transactions in these investment entities, therefore resulting in loss of information for the user as it is less transparent with the performance of these investment entities recognised as a single fair value number.
>
> …
>
> Our investors and stakeholders want to review the performance of our business against the fair value of our portfolio companies as it provides the user with the most relevant and useful information to assess performance, this cannot be done easily when presented under the investment entity exception of IFRS 10.To maintain transparency in our report and aid our users understanding we include a separate non-GAAP "Investment basis" Statement of comprehensive income, financial position and cash flow. This is an alternative performance measure and is simply a "look through" of IFRS 10 to present the underlying performance of the Group and a more understandable view of performance for the user.

78. Additionally, some of the respondents who said there is a loss of information said some intermediate subsidiaries, such as subsidiaries established solely for legal, tax or regulatory purposes, should be consolidated rather than measured at fair value. They acknowledged that the Board has previously considered this matter and did not identify a conceptual basis or a practical way to distinguish between different types of subsidiaries that are investment entities. These respondents suggested additional disclosure requirements for these intermediate subsidiaries.

Question 4(b)(ii)

79. A few respondents answered question 4(b)(ii). These respondents are not aware of criteria other than those in paragraph 32 of IFRS 10, that may be relevant to the scope of application of the consolidation exception for investment entities.

Staff's summary on question 4—investment entities

80. Most respondents answering question 4(a) of the Request for Information said that in some situations it can be challenging to apply the definition of an investment entity. Respondents to question 4(b) raised concern about the loss of information when an investment entity measures at fair value a subsidiary that is itself an investment entity.

Feedback on Question 5(a)—accounting requirements—change in the relationship between an investor and an investee

Background

81. In the first phase of the Post-implementation Review, some stakeholders said IFRS Standards should provide greater detail on how to account for a transaction, event or circumstance that alters the relationship between an investor and an investee.

82. Some stakeholders, in the first phase, disagreed with the requirement to remeasure a retained interest (for example, an investment in an associate) at fair value after control is lost.

83. The Request for Information included the following questions:

Question 5(a)
In your experience: (i) how frequently do transactions, events or circumstances arise that: (a) alter the relationship between an investor and an investee (for example, a change from being a parent to being a joint operator); and (b) are not addressed in IFRS Standards? (ii) how do entities account for these transactions, events or circumstances that alter the relationship between an investor and an investee?

(iii) in transactions, events or circumstances that result in a loss of control, does remeasuring the retained interest at fair value provide relevant information? If not, please explain why not, and describe the relevant transactions, events or circumstances.

Question 5(a)(i) & (ii)

84. Respondents noted situations that are not addressed in IFRS Standards in which:

(a) a subsidiary becomes a joint operation (paragraphs 85–89);

(b) sale or contribution of assets to an associate or a joint venture (paragraphs 90–91); and

(c) a joint venture changes to a joint operation (paragraphs 92–93).

A subsidiary becomes a joint operation

85. One type of transaction noted by many respondents to question 5(a)(i) was the change from being a parent entity to a joint operator. Such transactions include:

(a) contributing an existing subsidiary to form a joint operation in which the investor has joint control or is a party to the joint operation without having joint control; or

(b) selling a portion (for example 50%) of a subsidiary with the transaction resulting in a formation of a joint operation.

86. These respondents observed two accounting approaches in practice and expressed different views on whether the retained interest in the joint operation needs to be remeasured. These divergent views reflect a conflict that exists between the requirements in IFRS 10 and IAS 28 *Investments in Associates or Joint Ventures*:

(a) paragraph B98 of IFRS 10 requires an entity to remeasure its retained interest upon loss of control; and

(b) paragraphs B34–B35 of IFRS 11 specifies that an entity recognises gains or losses on the sale or contribution of assets to a joint operation only to the extent of the other parties' interests in the joint operation.

87. The Interpretations Committee discussed whether an entity should remeasure its retained interest in the assets and liabilities of a joint operation when the entity loses control of a business, or an asset or group of assets that is not a business. An Agenda Decision was issued in July 2016 *IFRS 11* Joint Arrangements *and IFRS 10* Consolidated Financial Statements—*Accounting for loss of control transactions*.

88. The Interpretations Committee concluded that the accounting for the two types of transactions should be considered concurrently by the Board. Consequently, the Interpretations Committee decided not to add this issue to its agenda, instead, to recommend that the Board considers the issue at the same time the Board further considers the accounting for the sale or contribution of assets to an associate or a joint venture, which is referred to in paragraph 90.

89. Only a few of the respondents who raised the change from being a parent entity to a joint operator commented on how frequently these transactions arose and the responses were mixed.

Sale or contribution of assets to an associates or a joint ventures

90. Many of the respondents to question 5(a)(i) expressed concern on the indefinitely deferred *Amendments to IFRS 10 and IAS 28 Sale or Contribution of Assets between an Investor and its Associate or Joint Venture*. As diversity remains in practice, these respondents asked the Board to add the amendments issued in September 2014 to its work plan.

91. Only a few of these respondents commented on frequency; and all respondents said the sale or contribution of assets to an associate or a joint venture occurs frequently.

A joint venture to a join operation

92. Some of the respondents to question 5(a)(i) noted IFRS Standards do not specifically address a change in the classification of a joint arrangement; that is from a joint venture to a joint operation or vice versa.

93. A few of these respondents commented on frequency while one respondent said it occurs frequently another said it occurs occasionally.

Other transactions, events or circumstances

94. Other transactions, events or circumstances that were raised by respondents to question 5(a)(i) include:

(a) changes in ownership interest without losing control. A few respondents expressed concern on diversity in practice regarding whether and how goodwill needs to be reallocated between equity interest attributable to the parent and non-controlling interest and the subsequent impact on impairment assessment of the goodwill.

(b) additional acquisition of ownership interest without changes in the status of significant influence or joint control.

(c) changes from a joint operator to a party to a joint operation without having joint control.

Summary

95. A few respondents suggested the Board develops more comprehensive principles for all types of transactions, events or circumstances that result in change in the relationship between an investor and an investee by conducting a holistic review of these transactions.

Question 5(a)(iii)

96. Many of the respondents who answered this question said that remeasuring the retained interest at fair value provides relevant information for transactions, events or circumstances that result in a loss of control.

97. Respondents (including respondents from Japan, Latin America and two preparers in extractive sector) who disagreed with the remeasurement said remeasuring the retained interest at fair value does not provide relevant information because:

    (a) it appears to be counterintuitive to remeasure the retained interest as if it had been sold to third parties when the retained interest remains unchanged before and after a transaction;

    (b) remeasuring the retained interest at fair value is not useful for users in assessing the prospects for future net cash inflows and management's stewardship of the entity's economic resources; and

    (c) recognising the remeasurement gain or loss in profit or loss does not provide useful information when the retained interest is a financial instrument measured at fair value through other comprehensive income; that is the day one gain is recognised in profit or loss and subsequent measurements are recognised in other comprehensive income.

Feedback on Question 5(b)—accounting requirements—partial acquisition of a subsidiary that does not constitute a business

Background

98. In the first phase of the Post-implementation Review, some stakeholders were unsure how an investor should account for a transaction in which an investor acquires control of a subsidiary that does not constitute a business, as defined by IFRS 3 *Business*

Combinations. In particular, stakeholders want to understand whether the investor should recognise non-controlling interest for equity not attributable to the parent.

99. The Request for Information included the following questions on partial acquisition of a subsidiary that does not constitute a business:

Question 5(b)
In your experience: (i) how do entities account for transactions in which an investor acquires control of a subsidiary that does not constitute a business, as defined in IFRS 3? Does the investor recognise a non-controlling interest for equity not attributable to the parent? (ii) how frequently do these transactions occur?

Question 5(b)(i)

100. Almost all of the respondents who answered this question said an entity:

(a) applies paragraph 2(b) of IFRS 3 to recognise assets acquired and liabilities assumed by allocating the cost to the individual identifiable assets and liabilities on the basis of their relative fair values at the date of purchase; and

(b) recognises non-controlling interest for the equity not attributable to the parent.

101. However, many of the respondents who answered this question said there is diversity in how to measure the non-controlling interest at the date of purchase. These respondents observed several approaches to measuring non-controlling interest:

(a) proportionate share of the fair values of the identifiable net assets;

(b) proportionate share of the recognised amounts of the identifiable net assets which could differ from (a), for example, in the event of a bargain purchase; or

(c) fair value of the non-controlling interest.

102. Some of these respondents said diversity has been observed on whether the transaction costs should be recognised in profit or loss or not.

Question 5(b)(ii)

103. The views of respondents were divided on whether partial acquisition of a subsidiary that does not constitute a business occurs frequently or infrequently.

Staff's summary on question 5—accounting requirements

104. Many respondents responding to the question 5(a) have requested further guidance on how to account for some transactions that change in the relationship between an investor and an investee. However, mixed views were expressed on the frequency of these transactions.