



European Financial Reporting Advisory Group ■

Exposure Draft ED /2014/02 *Investment Entities: Applying the Consolidation Exception* (Proposed amendments to IAS 28 and IFRS 10)

EFRAG's Final Comment Letter - Feedback to constituents

October 2014

Introduction

Objective of this feedback statement

On 1 October 2014, EFRAG published its final comment letter on Exposure Draft *Investment Entities: Applying the Consolidation Exception - Proposed amendments to IAS 28 and IFRS 10* (the ED).

This feedback statement summarises the main comments received by EFRAG on its draft comment letter and explains how those comments were considered by the EFRAG Technical Expert Group (EFRAG TEG) during its technical discussions leading to the publication of EFRAG's final comment letter.

Background to the ED

On 11 June 2014, the IASB published the ED with a request for comments by 15 September 2014. The proposed amendments aim to clarify three issues about the application of the requirement for investment entities to measure subsidiaries at fair value rather than consolidating them.

The issues were initially reported to and discussed by the IFRS Interpretations Committee, which recommended the IASB to amend IFRS 10 *Consolidated Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures* to clarify the application of the consolidation exception in IFRS 10 in order to reduce creating diversity in practice.

In the ED, the IASB proposed to:

- amend IFRS 10 to confirm that the exemption from preparing consolidated financial statements set out in paragraph 4(a) of IFRS 10 continues to be available to a parent entity that is a subsidiary of an investment entity,

even when the investment entity measures its subsidiaries at fair value (**first proposal**);

- amend IFRS 10 to clarify that the requirement for an investment entity to consolidate a subsidiary, instead of measuring it at fair value, applies only to those subsidiaries that act as an extension of the operations of the investment entity parent, and do not themselves qualify as investment entities (**second proposal**); and
- amend IAS 28 to:
 - require a non-investment entity investor to retain, when applying the equity method, the fair value measurement applied by an investment entity associate to its interests in subsidiaries; and
 - clarify that a non-investment entity investor that is a joint venturer in a joint venture that is an investment entity cannot, when applying the equity method, retain the fair value measurement applied by the investment entity joint venture to its interests in subsidiaries (**third proposal**).

Further details are available on the related EFRAG's [project page](#) and on the IASB's [project page](#).

EFRAG's draft comment letter

On 21 July 2014, EFRAG published its [draft comment letter](#) on the proposals with a comment period ending on 5 September 2014. In the draft comment letter EFRAG agreed that the identified issues needed clarification and welcomed the IASB's efforts to address them.

EFRAG tentatively supported the first two proposals. However, on the third proposal, EFRAG disagreed with the proposal that a non-investment entity investor in a joint venture, that qualifies itself as an investment entity, when applying equity accounting cannot retain the fair value measurement of the investment entity joint venture's interests in subsidiaries. In EFRAG's view, fair value measurement of an investment entity's investments provides the most useful information and should be retained by a non-investment entity investor when applying the equity method to its investment entity investees. Moreover, EFRAG did not agree that the IASB should reach a different conclusion for the application of the equity method by an investor in an investment entity associate or joint venture.

Comments received from respondents

Thirteen comment letters were received from respondents and considered by EFRAG TEG in its discussions. A further comment letter was brought to EFRAG's attention after EFRAG TEG had discussed and approved its final comment letter. The comment letters are available on the related EFRAG's [project page](#).

The comment letters that have been considered by EFRAG TEG came from national standard-setters (nine), professional and business organisations (three) and one European regulator.

Overall, the majority of respondents supported EFRAG's tentative position on all three amendments. However, some respondents raised significant concerns related to a possible loss of relevant information as a result of the first and the second proposal. On the first proposal four respondents did not support the proposed amendments and on the second proposal five respondents disagreed.

EFRAG's final comment letter

EFRAG issued the [final comment letter](#) on 1 October 2014. In summary EFRAG:

- Confirmed its tentative decision on the first proposal. EFRAG also noted that the possible interaction between the proposed amendment and the EU Accounting Directive needed to be further investigated.
- Changed its tentative position on the second proposal and disagreed with the IASB's proposal. EFRAG agreed with the concerns raised by some respondents that the application of the proposals will result in a significant loss of relevant information for some investing structures (for example, found in private equity entities).
- Confirmed its tentative decision on the third proposal.

EFRAG's discussion of the concerns reported by some respondents on the first and second proposals, are explained in the detailed analysis of the responses received.

Detailed analysis of the main issues, comments received and changes made to EFRAG's final comment letter

Exemption from Preparing Consolidated Financial Statements

EFRAG's tentative position in its draft comment letter

EFRAG tentatively supported the IASB proposal. EFRAG believed that, from a cost-benefit perspective, the exemption from preparing consolidated financial statements should be available for all intermediate parent entities that meet the criteria in paragraph 4(a)(i-iii) of IFRS 10. Moreover, EFRAG believed that when an investment entity parent measures its subsidiaries at fair value, these subsidiaries are appropriately represented within the parent entity's financial statements and, together with the required disclosures under IFRS, the parent entity provides useful information.

EFRAG also supported a proposed consequential change to paragraph 17(d) of IAS 28.

Comments received from respondents

The majority of respondents supported EFRAG's position. Some respondents, however, disagreed with that position and raised concerns that the proposed amendment will likely result in a significant loss of relevant information for some groups of users of the intermediate parent's financial statements. In their view, the current disclosure requirements in IFRS are insufficient to compensate users for the missing information.

These respondents argued that users such as banks, suppliers, customers, employees and government entities have different interests than the investors in intermediate parent entity and might neither be adequately informed about the financial position and the performance of the subsidiary nor have the opportunity to object to the intermediate parent presenting consolidated financial statements.

Furthermore, some respondents highlighted a potential conflict between the proposal and the EU Accounting Directive (2013).

EFRAG's final position

In its final comment letter EFRAG remained supportive of the IASB's proposal.

EFRAG discussed the concerns reported by some respondents related to loss of information for some users. These concerns have been included in EFRAG's final comment letter.

In arriving at a final position, EFRAG pointed out that it is common for providers of finance to require consolidated financial statements to be produced as a condition of lending, if it is relevant to that lending decision. Other users such as suppliers, customers or employees tend to have rights restricted to the legal entity only and therefore are more concerned about separate financial statements. EFRAG therefore concluded that any loss of information would be limited in practice.

Overall, EFRAG continued to believe that the cost savings for preparers resulting from the exception from consolidation would outweigh the costs for users and any potential loss of information in some cases.

EFRAG also noted to the IASB that a possible interaction between the proposed amendment and the EU Accounting Directive (2013) needs to be investigated further.

A subsidiary that provides services that relate to the parent's investment entities

EFRAG's tentative position in its draft comment letter

EFRAG tentatively supported the IASB's proposals and agreed that the requirement for an investment entity to consolidate a subsidiary, instead of measuring it at fair value, should apply only to those subsidiaries that act as an extension of the operations of the investment entity parent and do not themselves qualify as investment entities.

EFRAG believed that when the subsidiary is an investment entity, the main principle in IFRS 10 to measure all of the subsidiaries of an investment entity at fair value should apply.

Comments received from respondents

The majority of respondents supported EFRAG's tentative position.

However, five respondents disagreed with the IASB proposal (and therefore with EFRAG) and argued that not consolidating a subsidiary that provides investment-related services and that is also an investment entity will result in a loss of important information for users about the group's performance and leverage. This is because the underlying performance (investment-related services and related expenses) and the debt held by the subsidiary to fund this performance would be aggregated and disclosed in a single fair value number. Furthermore, the proposal would result in a loss of comparability given that transactions that are economically similar would be accounted for in a different way depending on the group structure.

These respondents considered that where a subsidiary acts both as an extension of the operations of the investment entity parent and is an investment entity in its own right, the most relevant information would be through consolidation of the subsidiary and measuring the underlying investments at fair value. Such an approach will result in more comparable information across investment entity groups irrespective of where, within the groups, operations are performed or debt issued.

EFRAG's final position

Although EFRAG agreed that the proposal will result in an appropriate outcome in some cases, EFRAG was convinced by the respondents' arguments (that disagreed with the proposal), that in other cases, the proposal would result in a significant loss of information as significant activities related to investment related services would be incorporated into a single fair value measurement of that subsidiary.

EFRAG understood from these respondents' that it is not uncommon for subsidiaries of an investment entity to both hold an investment portfolio and provide services that are an extension of the higher level investment entity parent. Such subsidiaries may also issue debt on behalf of the group to partly fund the investment portfolio. An example of such situations would be multi-layer structures which are common in many private equity arrangements.

EFRAG further acknowledged that given the wide range of group structures typically found in 'investment entity' groups, the proposal is likely to result in different outcomes for similar transactions.

These concerns led to EFRAG changing its position in its final comment letter. EFRAG recommended to the IASB to undertake further work to ensure that activities that are extensions of the operations of the parent entity are not subject to fair value measurement if they are undertaken by an investment entity subsidiary. It was important that an entity that undertakes both investment and operational activities provide relevant information on both those activities. EFRAG noted that should the IASB go ahead with the proposal, the IASB should consider developing disclosure that will ensure that users do not lose relevant information.

Applying Equity Accounting to Investment Entity Investees

EFRAG's tentative position in its draft comment letter

EFRAG agreed with the IASB's first proposal (to retain the fair value for an investment in an investment entity associate) but disagreed with the second proposal (not to retain fair value for an investment in an investment entity joint venture).

EFRAG did not believe that the IASB should reach different conclusions for the application of the equity method by an investor in an investment entity associate or joint venture, on the basis that until now IAS 28 requires the same application of the equity method for all equity-accounted for investees.

Comments received from respondents

All respondents broadly agreed with EFRAG's tentative position.

One respondent questioned the use of equity method term in the context of the proposal. In the view of this respondent it would be more appropriate to refer to fair value as a measurement basis instead of relating it to the equity method. Another respondent noted that, in its view, any differences in the application of the equity method should be drawn between interests in investment entities and interests in non-investment entities and not between some associates and joint ventures.

EFRAG's final position

Given the strong support of respondents, EFRAG's final position in its final comment letter was largely unchanged.

List of respondents

The Institute of Chartered Accountants in England and Wales (ICAEW)

Autorité des Normes Comptables (ANC)

Instituto de Contabilidad y Auditoría de Cuentas (ICAC)

The Swedish Financial Reporting Board (SFRB)

Federation of European Accountants (FEE)

Accounting Standards Committee of Germany (ASCG)

Dutch Accounting Standards Board (DASB)

European Private Equity & Venture Capital Association (EVCA)

Association pour la participation des entreprises françaises à l'harmonisation comptable internationale, Association française des entreprises privée, Mouvement des Entreprises de France (ACTEO, AFEP, and MEDEF)

European Securities and Markets Authority (ESMA)

Polish Accounting Standards Committee (PASC)

Financial Reporting Council (FRC)

Organismo Italiano Contabilità (OIC)

German Insurance Association (GDV) – [not considered by EFRAG TEG as received in EFRAG's comment mail box after approval of EFRAG's final comment letter]