European Securities and Markets Authority

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EFRAG
Françoise Flores
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Belgium

The IASB's ED 2014/2: *Investment Entities - Applying the Consolidation Exception (Proposed amendments to IFRS 10 and IAS 28)*

Dear ~~Ms Flores~~, DEAR FRANCOISE,

The European Securities and Markets Authority (ESMA) thanks you for the opportunity to contribute to EFRAG's due process regarding the Exposure Draft ('ED') *2014/2: Investment Entities - Applying the Consolidation Exception (Proposed amendments to IFRS 10 and IAS 28)*. We are pleased to provide you with the following comments with the aim of improving the transparency and decision usefulness of financial statements and the enforceability of IFRSs.

Like EFRAG, ESMA welcomes the IASB's decision to clarify certain issues previously submitted to the IFRS Interpretation Committee relating to the application of the consolidation exception by amending IFRS 10 – *Consolidated Financial Statements* and IAS 28 – *Investments in associates and Joint Ventures*.

ESMA supports the proposed amendments related to the scope of consolidation and the additional clarification in IFRS 10. However, ESMA is of the view that the scope exemption set out in paragraph 4(a) of IFRS 10 should not be available to a non-investment parent entity that is a subsidiary of an investment entity which measures its subsidiaries at fair value in accordance with paragraph 31 of IFRS 10 if that parent entity would be the parent of an operating company.

Regarding proposed amendments to IAS 28, ESMA believes, like EFRAG, that a non-investment entity investor should retain the fair value measurement applied by both its investment entity associates and joint ventures when applying the equity method to those investees. Similar to EFRAG's comment, ESMA does not see any conceptual reason to require different applications of the equity method to associates and joint ventures in the circumstances described in the ED.

Our detailed comments on the ED are set out in the Appendix I to this letter. Please do not hesitate to contact us should you wish to discuss all or any of the issues we have raised.

Yours sincerely,

Steven Maijoor
Chair
European Securities and Markets Authority

Appendix I – ESMA's detailed answers to the questions in the ED 2014/2: *Investment Entities - Applying the Consolidation Exception (Proposed amendments to IFRS 10 and IAS 28)*

Question 1 – Exemption from preparing consolidated financial statements
The IASB proposes 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 in accordance with paragraph 31 of IFRS 10. Do you agree with the proposed amendment? Why or why not?

1. Issuers with securities listed on regulated markets and under the supervision of securities regulators will not be affected by the proposed clarification set out in paragraph 4(a) of IFRS 10 as the exemption from preparing consolidated financial statements is not available to them. Nonetheless, ESMA assessed the proposed clarification from a more general perspective.

2. ESMA agrees with the general consolidation exemption for intermediate parents currently included in paragraph 4(a) of IFRS 10 as we believe that the combination of the information available in the consolidated financial statements of the group at the higher level parent and the separate financial statements of the intermediate parent entity provide sufficient safeguards for the users of the intermediate parent's financial statements.

3. However, ESMA does not believe that, as mentioned in the proposed paragraph BC 4, the combination of information required by IFRS 7 – *Financial Instruments: Disclosures*, IFRS 12 – *Disclosure of Interests in Other Entities* and IFRS 13 – *Fair Value Measurement* on the one hand, and information provided in the separate financial statements on the other hand provide sufficient grounds to retain the consolidation exemption for subsidiaries of investment entities that are themselves parent entities but do not fulfill the definition of an investment entity. Furthermore, in most cases, consolidated financial statements are prepared for internal use and, as such, the additional costs might not be significant.

4. Regarding the eligible criteria 4(a)(i) for an entity to use the consolidation exemption, we believe that users of financial statements, in particular non-investors, such as suppliers, customers and employees, might neither be adequately informed about the financial position and performance of the concerning subsidiary nor have the opportunity to object to the parent not presenting consolidated financial statements. Furthermore, ESMA does not agree that preparation of consolidated financial statements would result in significant additional costs, as consolidated financial statements will be required for the adequate management of such a non-investment entity subsidiary and its group.

5. Therefore, ESMA is of the opinion that the exemption set out in paragraph 4(a) of IFRS 10 should not be available to a non-investment parent entity that is a subsidiary of an investment entity which measures its subsidiaries at fair value in accordance with paragraph 31 of IFRS 10 if that parent entity would be the parent of an operating company.

Question 2 – A subsidiary that provides services that relate to the parent's investment activities

The IASB proposes to amend IFRS 10 to clarify the limited situations in which paragraph 32 applies. The IASB proposes 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. The main purpose of such a subsidiary is to provide support services that relate to the investment entity's investment activities (which may include providing investment-related services to third parties). Do you agree with the proposed amendment? Why or why not?

6. ESMA supports the proposed amendment to clarify in paragraph 32 of IFRS 10 that the exemption for an investment entity parent to measure all subsidiaries at fair value does not apply only to a subsidiary that is not itself an investment entity and whose main purpose is to provide services that relate to the investment entity's investment activities.

Question 3 – Application of the equity method by a non-investment entity investor to an investment entity investee

The IASB proposes to amend IAS 28 to:

(a) 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

(b) 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. Do you agree with the proposed amendments? Why or why not?

7. ESMA understands the rationale provided in BC20 that non-investment entities might face practical difficulties in unwinding the fair value measurement, and that an investor with significant influence might face more practical difficulties in obtaining the accounting information needed to use uniform accounting policies when applying the equity method, than investors with joint control. However, ESMA does not believe that the practical difference in the relationship between the investor and investee

justifies the introduction of a distinction in the application of the equity method by a non-investment entity investor with regard to investment entity associates and joint ventures.

8. Moreover, ESMA believes that fair value measurement applied to investment entity associates or joint ventures by a non-investment entity investor provides useful information. Therefore, ESMA is of the opinion that fair value measurement should be retained by a non-investment entity investor when applying the equity method to its associates and joint ventures that are investment entities. Consequently, ESMA disagrees with the IASB's proposal regarding the application of the equity method by a non-investment entity joint venturer to its investment entity joint venture(s).

9. Shall the IASB decide to maintain the proposed distinction in the application of the equity method, ESMA would welcome more conceptual reasons to justify the different accounting treatment. For example, some of the more technical points from the IFRS Interpretations Committee agenda paper on this topic could be explored in order to improve the rationale and the justification for this distinction.

10. On a different point, ESMA also notes that the proposed amendments should also have clarified at the same time the equity method treatment of lower-level associates and joint ventures of either middle-level investment entities associates or joint ventures of higher-level non-investment company.

11. Paragraph 36 and the proposed paragraphs 36A and 36B of IAS 28 give additional guidance as to how a parent entity should apply the equity method. ESMA believes that it should be clearly stated in IAS 28 that these paragraphs only relate to situations in which the parent entity does not elect to use the equity method exemptions contained in paragraphs 18 and 19 of IAS 28.

12. In addition, ESMA recommends the IASB to take the opportunity of amending the two standards in order to clarify differences in terminology[1] that may cause uncertainties whether an entity needs to use the consolidation method as per IFRS 10 or the equity method as per IAS 28 and how the two categories of entity interact with each other.

13. Finally, ESMA notes that this is the third ED in approximately one year which is 'clarifying' aspects of the equity method despite the on-going discussions as to what the equity method represents (i.e. measurement or one line consolidation). Therefore, we are of the opinion that there is a need for a broader project on the equity method as a whole and support the current research project on equity method accounting currently discussed by the Board.

[1] 'investment entities' and 'venture capital organisations, or a mutual fund, unit trust and similar entities including investment-linked insurance funds'.