

Applying the investment entities amendments

Proposals seek to address
application issues

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IN THE HEADLINES

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“Should an investment entity consolidate intermediate holdings between itself and its underlying investment portfolio? That’s the real question.”

– Mike Metcalf, KPMG’s global IFRS business combinations and consolidation leader

Proposals seek to address application issues

New requirements allowing investment entities to use fair value accounting came into effect in early 2014¹, but early adoption had already highlighted a series of application issues.

In response, on 11 June 2014 the IASB issued Exposure Draft *Investment Entities: Applying the Consolidation Exception* (the ED), which seeks to clarify the following questions.

1 How should an investment entity parent account for an investment entity subsidiary that provides investment-related services on its behalf?

Proposal: At fair value through profit or loss (FVTPL).

2 Can an intermediate parent (holding) in an investment entity group be exempt from preparing consolidated financial statements?

Proposal: Yes.

3 How should a non-investment entity investor apply the equity method to investments in associates and joint ventures that are investment entities?

Proposal: Unwind the fair value accounting applied by a joint venture, but retain the fair value accounting applied by an associate.

¹ *Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27).*

1 Fair value accounting for all investment entity subsidiaries

It is unclear how to account for investment entity subsidiaries that provide investment-related services: at FVTPL or consolidate? The ED proposes that all subsidiaries of investment entities be accounted for at FVTPL, regardless of whether they provide investment-related services.

The requirement to consolidate subsidiaries that provide investment-related services would be limited to subsidiaries that are not themselves investment entities and whose main purpose is to provide support services for the investment entity parent’s activities.

The proposal will reopen the discussion of whether accounting for intermediate subsidiaries at fair value is the most useful approach for users of the financial statements. Some want to see the fair values of the investments making up the underlying investment portfolio that is held by the subsidiary, rather than a single fair value for the subsidiary holding the investments. As a result, some entities are already using parallel non-GAAP measures to present more granular fair value information.

2 Consolidation exemption still available for subsidiaries of an investment entity

Some intermediate holdings (that are not themselves investment entities) currently take advantage of the exemption from preparing consolidated financial statements when the relevant criteria are met. One of the criteria is that “its ultimate or any intermediate parent produces consolidated financial statements that are available for public use and comply with IFRSs”. Therefore, an issue arises as to whether such holdings can continue to use this exemption if the parent is an investment entity that does not prepare consolidated financial statements.

The ED proposes to make the exemption available to an intermediate holding in an investment entity group. This would avoid the intermediate holding incurring the cost of preparing consolidated financial statements unnecessarily.

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3 Application of the equity method to depend on the type of investee

A parent of an investment entity that is not an investment entity itself consolidates all investees that it controls – i.e. the fair value accounting by an investment entity subsidiary does not flow up to a non-investment entity parent. However, it is unclear whether this is also the case for a non-investment entity investor in accounting for investment entity associates or joint ventures.

Under the proposals, when a non-investment entity investor applies the equity method, it would be required to:

- unwind the fair value accounting applied by an investment entity joint venture; but
- retain the fair value accounting applied by an investment entity associate.

The different approach for associates is based on practicability, because the IASB believes that it could be burdensome or even impractical to require an associate (but not a joint venture) to prepare a second set of financial information on a consolidated basis solely for the purpose of equity accounting. However, it is likely that there will be increased compliance costs for investment entity joint ventures.

Next steps

Comments are due to the IASB by 15 September 2014. Although not stated explicitly, the key question for those providing feedback is whether an investment entity should consolidate intermediate holdings between itself and its underlying investment portfolio.

Find out more

For more information on the ED, please go to the [IASB press release](#) or speak to your usual KPMG contact.

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