EFRAG

European Financial Reporting Advisory Group

DRAFT ENDORSEMENT ADVICE AND EFFECTS STUDY REPORT ON INVESTMENT ENTITIES

(AMENDMENTS TO IFRS 10, IFRS 12 AND IAS 27)

INVITATION TO COMMENT ON EFRAG'S ASSESSMENTS

Comments should be sent to commentletters@efrag.org or uploaded via our website by 28 January 2013

EFRAG has been asked by the European Commission to provide it with advice and supporting material on *Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27)* ('the Amendments'). In order to do that, EFRAG has been carrying out an assessment of the Amendments against the technical criteria for endorsement set out in Regulation (EC) No 1606/2002 and has also been assessing the costs and benefits that would arise from its implementation in the European Union (the EU) and European Economic Area.

A summary of the Amendments is set out in Appendix 1.

Note to constituents

The Amendments include consequential amendments to IFRS 9 *Financial Instruments*, which has not yet been endorsed in the EU. Those consequential amendments are not addressed in this Draft Endorsement Advice and will be considered together with the related requirements in IFRS 9.

Before finalising its two assessments, EFRAG would welcome your views on the issues set out below. Please note that all responses received will be placed on the public record, unless the respondent requests confidentiality. In the interest of transparency EFRAG will wish to discuss the responses it receives in a public meeting, so we would prefer to be able to publish all the responses received.

1 Please provide the following details about yourself:

(a) Your name or, if you are responding on behalf of an organisation or company, its name:

ICAEW

(b) Are you a:

☐ Preparer ☐ User ☐ Other (please specify)

Professional accountancy body

(c) Please provide a short description of your activity:

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(d) Country where you are located:

International organisation head quartered in the UK

(e) Contact details including e-mail address:

eddy.james@icaew.com

2 EFRAG's initial assessment of the Amendments is that they meet the technical criteria for endorsement. In other words, they are not contrary to the principle of true and fair view and they meet the criteria of understandability, relevance, reliability and comparability. EFRAG's reasoning is set out in Appendix 2.

(a) Do you agree with this assessment?

☐ Yes ☐ No

If you do not, please explain why you do not agree and what you believe the implications of this should be for EFRAG's endorsement advice.

(b) Are there any issues that are not mentioned in Appendix 2 that you believe EFRAG should take into account in its technical evaluation of the Amendments? If there are, what are those issues and why do you believe they are relevant to the evaluation?

No

3 EFRAG is also assessing the cost and benefits that are likely to arise for preparers on implementation of the Amendments in the EU, both in year one and in subsequent years. Some initial work has been carried out, and the responses to this Invitation to Comment will be used to complete the assessment.

The results of the initial assessment of costs are set out in paragraphs 7-14 of Appendix 3. To summarise, EFRAG's initial assessment is that: for investment entity preparers, the amendments will result in significant cost savings.

Do you agree with this assessment?

☐ Yes ☐ No

If you do not, please explain why you do not and (if possible) explain broadly what you believe the costs involved will be?

In addition, EFRAG is assessing the cost and benefits that are likely to arise for users from the Amendments. The results of the initial assessment of benefits are set out in paragraphs 15-18 of Appendix 3. To summarise, EFRAG's initial assessment is that the Amendments will also result in significant cost savings for users of the financial statements of investment entities.

Do you agree with this assessment?

☐ Yes ☐ No

If you do not agree with this assessment, please provide your arguments and indicate how this should affect EFRAG's endorsement advice?

4 EFRAG's initial assessment is that the benefits to be derived from implementing the Amendments in the EU as described in paragraph 3 above are likely to outweigh the costs involved as described in paragraph 3 above.

Do you agree with this assessment?

☐ Yes ☐ No

If you do not agree with this assessment, please provide your arguments and indicate how this should affect EFRAG's endorsement advice?

5 EFRAG is not aware of any other factors that should be taken into account in reaching a decision as to what endorsement advice it should give the European Commission on the Amendments.

Do you agree that there are no other factors?

☐ Yes ☐ No

If you do not agree, please provide your arguments and indicate how this should affect EFRAG's endorsement advice?

Appendix 1

A SUMMARY OF THE AMENDMENTS TO IFRS 10, IFRS 12 AND IAS 27

Background

1 IFRS 10 *Consolidated Financial Statements* identifies control as the basis for consolidation by all entities, regardless of the nature of the entity, including an investment entity and its investments in subsidiaries. Furthermore, existing IFRSs refer to venture capital organisations, private equity entities and similar organisations venture capital and similar entities, but do also not define an investment entity.

2 Consolidation of investments in subsidiaries held by an investment entity has been of concern to users of financial statements, who argued that consolidating these subsidiaries did not produce decision useful information.

3 Users noted that fair value was the most relevant information for them in their assessment and analysis of investment entities' subsidiaries, given that the nature of the business of an investment entity generally is to maximise income or capital gains rather than manage the underlying assets and liabilities of their subsidiaries. Users commented that consolidation of interests in subsidiaries will therefore hinder their ability to assess an investment entity's financial position and performance, because it emphasises the operations of the investments of the entity, rather than those of the entity itself.

4 The *Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27)* ('the Amendments') respond to the above concerns.

What has changed?

5 The Amendments to IFRS 10 introduce a requirement for investment entities to measure their investments in particular subsidiaries at fair value through profit or loss, instead of consolidating them.

6 The scope of the IAS Regulation is based on the Seventh Accounting Directive and does not depend on whether IFRSs require consolidation or not. Therefore, an entity would not be able to avoid applying IFRSs because of the investment entities requirements set out in the Amendments.

7 The main changes introduced by the Amendments are:

(a) *Definition of an investment entity* – The Amendments provide a definition of an investment entity and guidance on the typical characteristics displayed by an investment entity, which an entity should consider when determining whether it qualifies as an investment entity.

(b) *Exception to consolidation* – Entities that meet the definition of an investment entity will not consolidate their investments in subsidiaries. However, this exception does not apply in the following cases:

(i) an investment entity is still required to consolidate a subsidiary that provides services that relate to the investment entity's activities; and

(ii) a parent of an investment entity, that is itself not an investment entity, is still required to consolidate all its investments in subsidiaries, meaning that consolidation is still required but at a higher level. This is sometimes referred to as the prohibition of the "roll-up".

(c) *Measurement at fair value* – An investment entity is required to measure its investments in subsidiaries at fair value through profit loss in accordance with IFRS 9 *Financial Instruments*.

(d) *Specific disclosure requirements* – IFRS 12 *Disclosure of Interests in Other Entities* requires specific disclosures about subsidiaries that are not consolidated because they are investments of an investment entity. The same disclosure requirements apply in the separate financial statements of an investment entity.

(e) *Separate financial statements of investment entities* – The Amendments remove the measurement option in IAS 27 *Consolidated and Separate Financial Statements* for investments in particular subsidiaries, and require entities that meet the definition of an investment entity to measure those particular subsidiaries in the same way as in the consolidated accounts (i.e. at fair value through profit or loss).

The option to measure investments in subsidiaries at cost or at fair value under existing IAS 27 would still be available for parent entities that do not meet the definition of an investment entity and for the subsidiaries of investment entities that will be required to be consolidated by an investment entity (e.g. a subsidiary that provides services that relate to the investment entity's investment activities).

(f) *Consequential changes to other IFRSs* – The Amendments align the consolidation exception and the requirement to measure investments in subsidiaries at fair value with existing IFRS requirements. The main consequential changes include the requirement for a first-time adopter of IFRS (that is a parent) to assess whether it is an investment entity – on the basis of the facts and circumstances that exist at the date of transition to IFRSs; and in a separate change to state that the requirements of IFRS 3 *Business Combinations* do not apply to the acquisition by an investment entity.

Definition and typical characteristics displayed by an investment entity

8 The Amendments define an investment entity as an entity that has the following three essential elements:

(a) it obtains funds from one or more investors for the purpose of providing the investor(s) with investment management services;

(b) it commits to its investor(s) that its business purpose is investing funds solely for returns from capital appreciation, investment income, or both; and

(c) it measures and evaluates the performance of substantially all of its investments on a fair value basis.

9 In addition, when assessing whether it meets the above definition, an entity should also consider whether it has the following typical characteristics to qualify as an investment entity (although their absence does not preclude classification as an investment entity):

(a) it has more than one investment;

(b) it has more than one investor;

(c) it has investors that are not related parties of the entity; and/or

(d) it has ownership interests in the form of equity or similar interests.

10 If an entity does not have any of the above typical characteristics it is not necessarily disqualified from being an investment entity. In those situations, an entity would need to apply addition judgement to determine whether it is an investment entity and disclose the reasons for concluding that it still meets the definition of an investment entity.

11 The Amendments require any changes to the investment entity status to be accounted prospectively from the date at which the change in status occurred and apply IFRS 3 to any subsidiary that was previously measured at fair value through profit or loss. Similarly, an investment entity will cease to consolidate its investments in subsidiaries at the date of the change in status.

Amendments to IFRS 12

12 In developing the Amendments, the IASB considered that investment entities would be required to make disclosures already contained in other IFRSs, namely IFRS 7 *Financial Instruments: Disclosures* and IFRS 13 *Fair Value Measurement.*

13 Accordingly, the Amendments do not require additional disclosure requirements relating to fair value measurement. Furthermore, they focus on disclosures in IFRS 12 that are specific for investments entities (including investment entities that are parents of other investment entities).

14 Specifically, the Amendments require the following disclosure under IFRS 12:

(a) significant judgements and assumptions in determining that it meets the definition of an investment entity, including the reasons for concluding that it is an investment entity if it does not have one or more of the typical characteristics of an investment entity;

(b) the change in investment entity status and the reasons for the change including the effect of the change of status on the financial statements for the period presented;

(c) the nature and extent of any significant restrictions on the ability of an unconsolidated subsidiary to transfer funds to the investment entity and any current commitments or intentions to provide financial or other support to the investment entity;

(d) current commitments or intentions to provide financial support or other support to an unconsolidated subsidiary, including commitments or intentions to assist the subsidiary in obtaining financial support;

(e) in case financial support is provided, without a contractual obligation to do so, the type and amount of the support provided to an unconsolidated subsidiary without a contractual obligation to do so, and the reasons for that;

(f) the terms of any contractual arrangements that could require an investment entity or its unconsolidated subsidiaries to provide support to a structured entity including events and circumstances that could expose the entity to a loss.

Transitional provisions

15 Entities are required to apply the Amendments retrospectively, with some transitional relief, consistent with the transition requirements in IFRS 10 as amended in June 2012. Specifically, the Amendments:

(a) clarify that the assessment of whether an entity meets the definition of an investment entity is only required at the date of initial application of these Amendments;

(b) allow an impracticability exception to identify retrospectively fair value for all controlled investees;

(c) allow investment entities to retain the previous accounting instead of applying the investment entity requirements for investments in subsidiaries that were disposed of before the date of initial application of the Amendments;

(d) permit an entity to restate only the annual period immediately preceding the date of initial application of the Amendments; and

(e) allow investment entities that elect to apply the consolidation exception retrospectively for any period prior to the effective date of IFRS 13, to retain the fair value amounts that were previously reported to investors or to management, provided they meet certain conditions.

16 The transition relief described above is also applicable when an investment entity applies the Amendments in its separate financial statements.

Who is affected by the Amendments?

17 The entities mostly likely to be affected by the Amendments are private equity or venture capital funds who may have a business model in which they take a controlling interest in an entity they investment in, or control entities through debt and equity investment.

18 The Amendments will also affect master-feeder and funds-of-funds structures and sovereign wealth funds and other types of investment funds, when they meet the definition of an investment entity and hold controlling investments in other entities.

When do the Amendments become effective?

19 The Amendments will apply retrospectively and become effective for annual periods beginning on or after 1 January 2014, with earlier application permitted. Early adopters would need to disclose that fact and apply all the amendments at the same time.

Appendix 2

EFRAG'S TECHNICAL ASSESSMENT OF INVESTMENT ENTITIES (AMENDMENTS TO IFRS 10, IFRS 12 AND IAS 27)

In its comment letters to the IASB, EFRAG points out that such letters are submitted in EFRAG's capacity of contributing to the IASB's due process. They do not necessarily indicate the conclusions that would be reached by EFRAG in its capacity of advising the European Commission on endorsement of the definitive IFRS in the European Union and European Economic Area.

In the latter capacity, EFRAG's role is to make a recommendation about endorsement based on its assessment of the final IFRS or Interpretation against the technical criteria for the European endorsement, as currently defined. These are explicit criteria which have been designed specifically for application in the endorsement process, and therefore the conclusions reached on endorsement may be different from those arrived at by EFRAG in developing its comments on proposed IFRSs or Interpretations. Another reason for a difference is that EFRAG's thinking may evolve.

Does the accounting that results from the application of *Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27)* meet the technical criteria for EU endorsement?

1 EFRAG has considered whether *Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27)* ('the Amendments') meet the technical requirements of the European Parliament and of the Council on the application of international accounting standards, as set out in Regulation (EC) No 1606/2002, in other words that the Amendments:

(a) are not contrary to the principle of 'true and fair view' set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and

(b) meet the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

EFRAG also considered whether it had any evidence that it would not be conducive to the European public good to adopt the Amendments.

Approach adopted for the technical assessment of the Amendments

2 In performing its initial assessment, EFRAG focused on the impact of the new elements introduced by the Amendments.

(a) Definition an investment entity and guidance on the typical characteristics displayed by an investment entity.

(b) Exception to consolidation.

(c) Measurement at fair value.

(d) Accounting for subsidiaries of investment entities in the separate financial statements.

3 Elements (a), (b) and (c) have been assessed together as a single amendment in this Appendix, while element (d) has been assessed separately.

4 As explained in Appendix 1, the Amendments also introduce consequential amendments to other IFRSs. In EFRAG's view, the consequential amendments are straightforward and do not raise any new concerns. For this reason, these are not discussed specifically in this appendix. However, EFRAG notes that the consequential amendments to IFRS 9 have not been assessed and will be considered together with the related requirements in IFRS 9.

5 Furthermore, EFRAG observes that the transitional provisions included in the Amendments are consistent with the transition requirements in IFRS 10 as amended in June 2012, and do not introduce any new concerns. Therefore they are not discussed specifically in the appendix.

Qualification and measurement of an investment entity: exception from consolidation

Relevance

6 Information is relevant when it influences the economic decisions of users by helping them evaluate past, present or future events or by confirming or correcting their past evaluations.

7 EFRAG considered whether these Amendments would result in the provision of relevant information – in other words, information that has predictive value, confirmatory value or both – or whether it would result in the omission of relevant information.

<u>Definition and typical characteristics of an investment entity</u>

8 The definition of an investment entity comprises three essential elements that focus on the business purpose of an entity – that is whether it (a) obtains funds from investors and (b) commits to its investor(s) its business purpose is to provide investment management services and invest funds *solely* for returns from capital appreciation, investment income, or both, and (c) measures and evaluates the performance of substantially all of its investments on a fair value basis.

9 Given its business purpose in the definition, an investment entity should not hold its investments indefinitely, and we therefore agree that such an entity would need an exit strategy for its investments to reflect this objective. Furthermore, the Amendments provide a series of characteristics that are regarded to be typical of an investment entity, and should be considered (although not mandatory) when determining whether an entity qualifies as an investment entity. EFRAG agrees with this approach as it encourages an entity to consider all facts and circumstances about how it operates, its ownership structure and how manages it investments, when assessing whether it qualifies as an investment entity.

10 EFRAG believes that the typical characteristics of an investment entity set out in the Amendments are intended to support the definition of an investment, and at the same time allow an entity to exercise a degree of judgement in order to consider relevant facts and circumstances in making the assessment. We support this principles-based approach, and the focus on the business model of an entity and its core activities, without the rigidness of having to meet a set of predefined qualification criteria.

11 The provision of investment-related services or activities to third parties or investors by a subsidiary of an entity, does not disqualify that entity from being an investment entity even if the investment-related services are substantial. Instead, the Amendments require the investment entity to consolidate that subsidiary. EFRAG agrees with this requirement as it will ensure that relevant information is not omitted as a result of an investment entity having one or more subsidiaries that provide investment-related services.

Exception to consolidation

12 Under the Amendments, entities that meet the definition of an investment entity will not consolidate their investments in subsidiaries. However, this exception is not extended to a parent of an investment entity that is not itself an investment entity.

13 EFRAG generally believes that a reporting entity should not differentiate between types of entities when applying the control model of consolidation in IFRS 10 *Consolidated Financial Statements*. However, EFRAG notes that the Amendments respond to the concerns of users of financial statements, who expressed support for a consolidation exception for subsidiaries of investment entities, and argued that their interests are best served by having a single line measurement basis based on fair value, instead of consolidation of subsidiaries of investment entities.

14 However, some constituents are concerned that the Amendments should have permitted further entities to benefit from the exception and therefore omit relevant information being provided to users. These constituents disagree with an "entity-based" approach to the exception to consolidation, and believe that the exception should be provided at the asset (investment) level, based on certain characteristics of an investment held by an entity, rather than the other way round. In their view, limiting the use of the exemption to consolidation by investment entities is a missed opportunity as it does not allow a non-investment parent entity to provide relevant information in its consolidated accounts.

15 Although these constituents acknowledge the IASB's concerns about potential abuses that could arise from extending the exception to non-investment entity parents – for example by holding subsidiaries directly or indirectly through an investment entity an entity could obscure leverage or loss-making activities – they believe the IASB could have tried to resolve potential anti-abuse issues by requiring the exception to be provided at a lower asset level, as explained in the paragraph above.

16 Although EFRAG acknowledges the above concerns, we believe that limiting the use of the exception to investment entities as defined under the Amendments, does not affect the relevance of information produced by those entities, and therefore should not preclude the information provided under the Amendments from meeting the relevance criterion.

Fair value measurement

17 EFRAG believes that when an entity invests only for capital appreciation or investment income, rather than to manage the underlying assets and liabilities of its investees (i.e. the investee is the unit-of-account), fair value provides relevant information as it reflects the underlying substance of the activities of the entity and how it is managed, rather than of the operations of the investee. The relevant cash flows relating to these activities are those of the investment entity itself.

Consolidating the cash flows of a subsidiary of an investment entity may hinder users' ability to predict the cash flows that are relevant information to users.

18 EFRAG considered whether the loss of consolidation under IFRS 10, would have a negative impact on relevance because certain key information would not be provided to users. EFRAG notes that IFRS 12 *Disclosure of Interests in Other Entities* requires investment entities to provide qualitative and quantitative information about the nature and risks of its interest in the investees that it does not consolidate.

19 We agree that for entities that meet the definition of an investment entity fair value provides relevant information for these entities.

Conclusion

20 For the above reasons, EFRAG's initial assessment is that the Amendments satisfy the relevance criterion..

Reliability

21 EFRAG also considered the reliability of the information that will be provided by applying these Amendments. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully what it either purports to represent or could reasonably be expected to represent, and is complete within the bounds of materiality and cost.

22 There are a number of aspects to the notion of reliability: freedom from material error and bias, faithful representation, and completeness.

Definition and typical characteristics of an investment entity

23 EFRAG acknowledges that consideration of the facts and circumstances in which the business model of an entity operates will involve a degree of judgement which might, if applied incorrectly, have a negative impact on the reliability of information provided.

24 However, in our view, the definition and the guidance on the typical characteristics of an investment entity should be helpful to address concerns on consistent application of the definition, which may affect reliability of information. Furthermore, we believe that the disclosures required by IFRS 12 will assist users in understanding the assumptions made by management and help mitigate the reliability concerns that might arise from the degree of judgement exercised.

Fair value measurement

25 To meet the definition of an investment entity, an entity must also demonstrate that fair value is the primary measurement attribute used to evaluate the performance of its investments, both internally and externally. Consequently, we believe that fair value information would already be available for most investments entities, because they already measure substantially all of their investments at fair value.

26 Furthermore, we believe that IFRS 13 *Fair Value Measurement* provides appropriate guidance to ensure that fair values will be reliable. In developing its endorsement advice on IFRS 13, EFRAG concluded that IFRS 13 does not cause any significant issues in relation to reliability of information about assets or liabilities subject to fair value measurement or disclosure requirements, and satisfies the reliability criterion.

Conclusion

27 For the above reasons, EFRAG's initial assessment is that the Amendments satisfy the reliability criterion.

Comparability

28 The notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently.

29 EFRAG has considered whether the Amendments result in transactions that are:

(a) economically similar being accounted for differently; or

(b) transactions that are economically different being accounted for as if they are similar.

Definition and typical characteristics of an investment entity

30 In EFRAG's view, the reference to the business purpose in the definition of an investment entity ensures that entities with the same business models are accounted in the same way, and therefore producing information that is comparable between entities.

Exception to consolidation

31 An investment entity's control of an investment in a subsidiary may change from one reporting period to the next, as an investment entity is likely to buy and sell investments or parts of investments on a frequent basis. Without the exception to consolidation, an investment entity would be required to consolidate an investment in one period and deconsolidate it in another period. EFRAG believes that requiring a consistent measurement basis to report its investments in subsidiaries will ensure that investment entities produce comparable information.

32 Under the fair value measurement option in existing IAS 28, an entity (that is considered to be a venture capital organisation or a similar entity) may elect to measure its investments in associates and joint ventures at fair value under IFRS 9 *Financial Instruments*. The Amendments will result in subsidiaries held by investment entities being measured at fair value, and therefore creating a consistent measurement attribute for all investments held by entities that are considered to be investment entities or similar.

33 Some believe that the Amendments will result in information that is not comparable in the following cases:

(a) when similar transactions might be presented differently between entities across different industries when the definition of an investment entity is not met.

(b) when different measurement bases are being applied for the same investment in a subsidiary, depending on whether that investment is reported at a non-investment entity parent level or investment entity subsidiary level.

34 These constituents argue that the above concerns arise because (a) the exception to consolidation focuses on the business model and core activities of an *entity*, rather than the individual investments (assets) it holds and (b) because the Amendments

prohibit a parent entity, that is not an investment entity itself, from retaining the measurement basis of its investment entity subsidiary's investments in its consolidated accounts.

35 The Amendments focus on financial reporting of "investment entities" and achieving comparability of information for those entities. EFRAG acknowledges that limiting the use of the exception to investment entities will result in a loss of comparability of information for the situations explained in paragraph 33 (a) and (b), because some entities that have economically identical "investment entity activities" will be required to report those activities in a different way, depending on whether the reporting entity meets the definition of an investment entity. In EFRAG's view, there is a trade-off to be considered between achieving relevance and meaningful information for financial reporting of investment entities, and achieving comparability of information between reporting entities that are not considered to be investment entities under the Amendments. EFRAG accepts this trade-off on the basis that information reported by investment entities will be comparable between these entities.

<u>Conclusion</u>

36 Therefore, EFRAG's initial assessment is that the Amendments satisfy the comparability criterion.

Understandability

37 The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting and the willingness to study the information with reasonable diligence.

38 Although there are a number of aspects to the notion of 'understandability', EFRAG notes that most of the aspects are covered by the discussion above about relevance, reliability and comparability.

39 As a result, EFRAG is of the view that the main additional issue it needs to consider, in assessing whether the information resulting from the application of the Amendments is understandable, is whether that information will be unduly complex.

40 EFRAG notes that the exception to consolidation has been introduced to address the concerns of the users who argued that fair value information about the investment entity's investments is the most understandable information for their analysis.

41 The Amendments will result in different measurement bases being used for the same investment depending on whether the investment is reported at a non-investment entity parent level or investment entity subsidiary level. Some disagree with this approach, and believe that having a different measurement bases for the same investments could create complexities for users.

42 In EFRAG's view, having a different measurement basis for subsidiaries of investment entities should not increase complexity in understanding the information, as both consolidation and fair value accounting are well understood by users of financial statements.

43 For the above reason, EFRAG believes that the exception to consolidation will not introduce any new complexities that may impair understandability. Furthermore, the requirement of IFRS 12 to disclose significant judgements and assumptions made in

determining whether an entity qualifies as an investment entity will ensure that the information produced under the Amendments is understandable to users, as it will enable them to better understand the financial information provided

44 Therefore, EFRAG's overall initial assessment is that the Amendments satisfy the understandability criterion.

Accounting for investments in subsidiaries in the separate financial statements of an investment entity

45 Under existing IFRSs, interests in subsidiaries are accounted for at cost or at fair value in accordance with IFRS 9 regardless of the nature of the parent entity.

46 In addition, currently IAS 27 *Consolidated and Separate Financial Statements* does not require a parent entity to disclose the information required in IFRS 12 relating to investment entities in its separate accounts.

47 The Amendments require the investments of the investment entity to be accounted for in the separate financial statements in the same manner as they are accounted for in the consolidated financial statements – at fair value through profit and loss under IFRS 9.

Relevance

48 Information is relevant when it influences the economic decisions of users by helping them evaluate past, present or future events or by confirming or correcting their past evaluations.

49 EFRAG considered whether these Amendments would result in the provision of relevant information – in other words, information that has predictive value, confirmatory value or both – or whether it would result in the omission of relevant information.

50 As described above, in its initial assessment on the accounting in the consolidated financial statements of investment entities, EFRAG concluded that a fair value measurement basis for investments in subsidiaries held by investment entities will provide relevant information for investment entities. In EFRAG's view, it is equally relevant information if an investment entity measures those same subsidiaries also at fair value through profit or loss in its separate financial statements.

51 For the above reasons, EFRAG believes that the Amendments satisfy the relevance criterion in the separate financial statements of an investment entity.

Reliability

52 EFRAG also considered the reliability of the information that will be provided by applying these Amendments. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully what it either purports to represent or could reasonably be expected to represent, and is complete within the bounds of materiality and cost.

53 There are a number of aspects to the notion of reliability: freedom from material error and bias, faithful representation, and completeness.

54 The Amendments remove the cost measurement option in existing IAS 27 and require an investment entity to measure its investments in subsidiaries in its separate financial statements in the same way as in its consolidated accounts – at fair value. Therefore, in our view, the Amendments do not raise significant concerns about reliability.

Comparability

55 The notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently.

56 EFRAG has considered whether the Amendments result in transactions that are:

(a) economically similar being accounted for differently; or

(b) transactions that are economically different being accounted for as if they are similar.

57 In EFRAG's view, the Amendments will result in economically similar entities being accounted for in the same way, regardless of whether they are presented in the separate or the consolidated financial statements. This ensures comparability of information for the same entities reporting their activities in the separate financial statements.

58 Some constituents believe that there is no difference between investment entities and other entities when preparing separate financial statements, and therefore there is no reason to require different accounting.

59 However, EFRAG believes that to the extent that an entity is an investment entity as defined by the Amendments that fact should be taken into account, including when preparing its separate financial statements, so that users can benefit from comparable information.

60 For the above reasons, EFRAG believes the Amendments satisfy the comparability criterion.

Understandability

61 The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting and the willingness to study the information with reasonable diligence.

62 Although there are a number of aspects to the notion of 'understandability', EFRAG notes that most of the aspects are covered by the discussion above about relevance, reliability and comparability.

63 As a result, EFRAG is of the view that the main additional issue it needs to consider, in assessing whether the information resulting from the application of the Amendments is understandable, is whether that information will be unduly complex.

64 In EFRAG's view, the requirements in the Amendments do not introduce any new complexities in the separate financial statements that may impair understandability and the Amendments satisfy the understandability criterion.

True and Fair

65 EFRAG's overall initial assessment is that the information resulting from the application of the Amendments would not be contrary to the true and fair view principle.

European public good

66 EFRAG is not aware of any reason to believe that it is not conducive to the European public good to adopt the Amendments.

Conclusion

67 For the reasons set out above, EFRAG's initial assessment is that the Amendments satisfy the technical criteria for EU endorsement.

Appendix 3

EFRAG'S EVALUATION OF THE COSTS AND BENEFITS OF THE AMENDMENTS

1 EFRAG has also considered whether, and if so to what extent, implementing *Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27)* ('the Amendments') in the EU might result in incremental costs for preparers and/or users, and whether those costs are likely to be exceeded by the benefits to be derived from its adoption.

Approach adopted for EFRAG's cost and benefit assessments of the Amendments

2 The approach adopted to conduct EFRAG's initial assessments on the costs and benefits of the Amendments is, similar to the approach EFRAG undertook in its technical assessments of the Amendments, to focus on the amendments that are likely to result in additional costs and additional benefits to preparers and users.

3 In performing its initial assessment, EFRAG focused on the impact of the new following elements introduced by the Amendments:

(a) Definition an investment entity and additional guidance on the typical characteristics displayed by an investment entity.

(b) Exception to consolidation.

(c) Measurement at fair value with specific disclosure requirements in IFRS 12.

(d) Accounting for subsidiaries of investment entities in the separate financial statements.

4 The above elements are assessed in this Appendix, with element (d) being assessed separately from the other elements.

5 As explained in Appendix 1, the Amendments introduce consequential amendments to other IFRSs. In EFRAG's view, the consequential amendments are straightforward and do not raise any new concerns. For this reason, these are not discussed specifically in this Appendix. However, EFRAG notes that the consequential amendments to IFRS 9 have not been assessed and will be considered together with the related requirements in IFRS 9.

6 Furthermore, EFRAG observes that the transitional provisions included in the Amendments are consistent with the transition requirements in IFRS 10 as amended in June 2012, and do not introduce any new concerns. Therefore they are not discussed specifically in the Appendix.

Qualification and measurement of an investment entity: exception from consolidation

Cost and benefits for preparers

7 EFRAG has carried out an initial assessment of the cost implications for preparers resulting from the Amendments on investment entities.

8 EFRAG understands that investment entities (preparers) might incur some initial costs in order to identify and document some of the new disclosures introduced in IFRS 12, IFRS 7 and IFRS 13. However, we believe that investment entities will already have most of the fair value information that they need in order to comply with the requirements, because they already measure substantially all of their investments at fair value and many will most likely already provide this information to users. Therefore, we do not expect the initial and ongoing costs in relation to the additional disclosure requirements to be significant.

9 On an ongoing basis, EFRAG believes that the Amendments will result in significant cost savings for investment entities (preparers), because they will no longer need to perform the consolidation procedures and account for the underlying net assets of their subsidiaries on a line-by-line basis.

10 The Amendments will facilitate preparers in communication with users in better understanding the fair values of the investments of investment entities, and therefore benefit preparers.

11 Entities are required to apply the Amendments retrospectively, with some transitional relief, consistent with the transition requirements in IFRS 10 as amended in June 2012. EFRAG notes that the Amendments would allow an impracticability exception to identify retrospectively fair value for all controlled investees, and therefore should reduce the burden for affected preparers on initial application.

12 EFRAG acknowledges that a non-investment entity parent will not be permitted to retain the fair value accounting applied by its investment entity subsidiaries. Therefore these entities might incur some ongoing costs by having two different measurement bases of accounting within the group. However, we understand that the Amendments do not change the consolidation requirements for these entities; therefore we do not expect these costs to be significant.

<u>Separate financial statements</u>

13 In addition, the Amendments will require the investments of an investment entity to be accounted for in the separate financial statements in the same manner as they are accounted for in the consolidated financial statements – at fair value through profit and loss under IFRS 9.

14 As explained above, we believe that most investment entities will already have most of the fair value information that they need in order to comply with the requirements, because they already measure substantially all of their investments at fair value to qualify as an investment entity. Therefore, we do not expect the initial and ongoing costs in relation to the additional disclosure requirements to be significant.

Cost and benefits for users

15 EFRAG has carried out an initial assessment of the cost and benefit implications for users resulting from the Amendments.

16 EFRAG notes that the Amendments have been developed at the request from users, and will provide them with information about the fair value of an investment entity's investments in subsidiaries and the way in which the fair value is measured. This information should reduce the cost of analysis for users, and improve the comparability and relevance of information provided to them.

17 We understand that the transition relief on the retrospective application of the exception to consolidation might result in less information for users on initial adoption. In particular, we note that the relief to provide comparative information only for one period might result in increased one off costs for users.

Separate financial statements

18 EFRAG believes that users will also benefit from having a consistent measurement basis at fair value for investments in subsidiaries of investment entities, in their separate financial statements.

Conclusion on costs for preparers and users

19 On balance, EFRAG's initial assessment is that overall the cost savings from implementing the Amendments are expected to be significant for investment entity preparers and the users of their financial statements.