Regulation Impact Statement

Amendments to Australian Accounting Standards – Investment Entities

**August 2013**



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Background

Under section 227(1) of the *Australian Securities and Investments Commission Act 2001* (ASIC Act), the functions of the Australian Accounting Standards Board (AASB) are to:

• develop a conceptual framework, not having the force of an accounting standard, for the purpose of evaluating proposed accounting standards and international standards;

• make accounting standards under section 334 of the *Corporations Act* for the purposes of the corporations legislation;

• formulate accounting standards for other purposes; and

• participate in and contribute to the development of a single set of accounting standards for world-wide use having regard to the interests of Australian corporations that raise or propose to raise capital in major international financial centres.

In general, the AASB issues Australian Accounting Standards that incorporate International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB).

The AASB issues one series of Standards applicable to both for-profit and not-for-profit entities, including public sector entities.

The AASB includes some disclosure requirements that are in addition to the IFRSs, but aims to keep these to a minimum on the basis that the IFRSs represent best international practice for general purpose financial reporting of publicly accountable for-profit entities.

The AASB has decided to prepare a single stage RIS for AASB 2013‑5 *Amendments to Australian Accounting Standards – Investment Entities* on the grounds that the two consultation documents issued by the AASB in relation to AASB 2013-5 were each accompanied by Bases for Conclusions that included an outline of benefits and costs of the proposals. Exposure Draft ED 220 *Investment Entities* (AASB ED 220) was accompanied by the IASB’s Basis for Conclusions, which focused on why the consolidation exemption for investment entities should be established and also included dissenting views of those IASB members opposed to the exemption. Exposure Draft ED 233 *Australian Additional Disclosures – Investment Entities* was accompanied by the AASB’s Basis for Conclusions, which outlined arguments for and against requiring Australian additional disclosures on adopting the exemption from consolidation for investment entities and also the arguments against adopting the exemption..

The AASB has prepared a single-stage RIS, and as no decision has been previously announced, an options-stage RIS is not required.

1. Problem
   1. There are currently two approaches to reporting controlled investees in the group financial statements of investment entities:
2. The Australian approach where all reporting entities need to consolidate all their controlled investees, regardless of the nature of the reporting entity; and
3. The international approach (as per the recent IASB amendments referred to below) where entities that meet the criteria of investment entities report their investments in controlled investees at fair value.

### Australian approach

* 1. The Australian approach requires investment entities to consolidate the financial statements of the parent entity and its controlled investees. This requires a line-by-line aggregation of all the items in the parent entity and its controlled investees’ financial statements and presenting them in consolidated financial statements after eliminating intra-group transactions.
  2. Most Australian superannuation entities, listed investment companies, pooled investment trusts and Federal, State and Territory fund management authorities that are reporting entities would meet the criteria of investment entities. Some significant number of this population of entities would, from time to time, have controlling interests in one or more of their investees. There are also investment entities that are intermediate entities in a larger group that would have controlling interests in one or more of their investees.

### International approach

* 1. The international approach provides an exception to consolidation to investment entities and requires them to fair value their controlled investees every reporting period and take any gain or loss arising to the income statement for the period.

### Possible issues from having an approach that is inconsistent with the international approach

* 1. An investment entity’s strategy is generally the same for all its investments regardless of the significance of the investments and feedback from constituents suggests that fair value information about the controlled investees is more relevant than consolidated information of the investment entity and its controlled investees in making decisions about the performance and financial position of the investment entity.
  2. Australian investment entities that are currently consolidating their controlled investees incur higher costs of compliance relative to their international counterparts for little or no additional benefits, resulting in a competitive disadvantage for them.
  3. For entities such as superannuation entities where investment holdings change frequently due to changes in members’ preferences, there is the added burden of having to monitor their investments closely throughout the reporting period to determine whether or not it controls any of its investees and, therefore, whether it needs to prepare consolidated financial statements.

### Background to problem

* 1. Accounting Standard AASB 10 *Consolidated Financial Statements* incorporates International Financial Reporting Standard IFRS 10 *Consolidated Financial Statements* (issued in 2011). AASB 10 requires reporting entities to consolidate all controlled entities, regardless of the nature of the reporting entity.
  2. Some respondents to the IASB Exposure Draft (ED 10) that preceded IFRS 10 questioned the usefulness of financial statements of investment entities that consolidate investees that the investment entity controls. They pointed out that some national accounting requirements, including United States Generally Accepted Accounting Principles (US GAAP), have historically provided industry–specific requirements for investment entities to measure all of their investments, including those that they control, at fair value. These respondents argued that an investment entity holds investments for the sole purpose of capital appreciation, investment income (such as dividends or interest), or both. Some users of the financial statements of these investment entities told the IASB that the fair value of the investments and an understanding of how the investment entity measures the fair value of its investments is the most useful information.
  3. In weighing up the feedback, the IASB decided to issue IFRS 10 to require consolidation of all controlled entities and to undertake further due process in relation to investment entities. The IASB published ED/2011/4 *Investment Entities* in August 2011 proposing that investment entities would be required to measure their investments in subsidiaries (except those subsidiaries that provide investment–related services) at fair value through profit or loss in accordance with IFRS 9 *Financial Instruments* (or IAS 39 *Financial Instruments: Recognition and Measurement*, if IFRS 9 has not yet been adopted). ED/2011/4 also set out criteria for identifying investment entities.
  4. An investment entity would be an entity that:

1. obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;
2. commits to its investors(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and
3. measures and evaluates the performance of substantially all of its investments on a fair value basis.

An entity that has the objective of obtaining other benefits from the entity’s investments (other than returns from capital appreciation or investment income) that are not available to other parties that are not related to the investee would generally not be an investment entity. Such benefits would include, for example, the acquisition, use, exchange or exploitation of the processes, assets or technology of an investee.

* 1. Examples of investment entities would include the following.

1. Managed Investment Scheme ABC obtains funds from investors for the purpose of investing in the equity of Australian companies. Most of Scheme ABC’s investments may be holdings of small proportions of the total equity of each company. However, one of Scheme ABC’s holdings (in Company EFG) is such a high proportion of the equity of Company EFG that Scheme ABC has the capacity to control Company EFG . Although Scheme ABC has no intention of exercising that capacity, because it is only interested in receiving dividends and reaping capital gains from its investment, Company EFG would still be a subsidiary of Scheme ABC.
2. One of the investment choices that Superannuation Plan XYZ offers its members is exposure to interest-bearing debt securities. Plan XYZ obtains that exposure by acquiring units in Specialist Debt Fund, which focuses on investing in interest-bearing debt securities. Plan XYZ acquires such a significant proportion of the units in Specialist Debt Fund that Plan XYZ obtains the capacity to control Specialist Debt Fund. Although Plan XYZ has no intention of exercising that capacity, because it is only interested in receiving investment returns on the units for its members (which are based on interest and capital gains earned by Specialist Debt Fund), Specialist Debt Fund would still be a subsidiary of Plan XYZ.
   1. The AASB issued ED 220 in September 2011 (incorporating IASB ED/2011/4).
   2. In the material accompanying ED 220, some AASB members expressed concerns with the ED/2011/4 proposals, including:
3. the exception to consolidation goes against the application of the well-established accounting concept of control, which is designed to result in the presentation of all the assets, liabilities, income and expenses of the group, and the amendments would result in a loss of relevant information for users of financial statements;
4. the basis of the exception to consolidation is the type of entity, rather than the underlying relationship between investors and investees; and
5. there are no clear principles underpinning the classification of entities as investment entities and the criteria for identifying investment entities are rule-based and open to opportunistic behaviour.
   1. As evident from the responses to AASB ED 220, views were divided among Australian constituents. Some expressed concerns similar to those of the AASB members. However, others expressed broad support for requiring some types of entities to account for controlled investees at fair value through profit or loss, rather than having them consolidate such entities.
   2. The AASB expressed its concerns in its submission to the IASB on IASB ED/2011/4.
   3. In October 2012, the IASB amended IFRS 10, IFRS 12 *Disclosures of Interest in Other Entities* and IAS 27 *Separate Financial Statements* (‘IASB amendments’) for investment entities to provide an exception to consolidating particular subsidiaries for investment entities, requiring them instead to measure their investments in unconsolidated subsidiaries at fair value through profit or loss.
   4. The AASB noted that its concerns with the ED/2011/4 proposals were not adequately addressed in the IASB amendments. The AASB also considered the disclosures required by the IASB amendments and noted that they require an investment entity to provide information about the exception to consolidation rather than addressing the loss of consolidation information.
   5. Because of its concerns with the IASB amendments, the AASB decided to undertake further due process. After considering a number of different possible approaches to the recognition and measurement of controlled investees of investment entities, including (i) consolidation and (ii) fair value measurement with compensating disclosures, the AASB issued ED 233 in December 2012. It proposed to introduce the exception to consolidation for investment entities (as per the IASB amendments) and to require Australian additional disclosures for Australian entities that meet the IASB’s investment entity criteria. The Australian additional disclosures proposed in ED 233 were in the form of:

* consolidated financial statements prepared in a manner consistent with the definition of consolidated financial statements in Appendix A of AASB 10; and
* a summary of the significant accounting policies used in preparing those consolidated financial statements that are not otherwise disclosed in accordance with AASB 101 *Presentation of Financial Statements*.
  1. ED 233also specifically asked respondents, whether they have any alternative approaches/disclosure strategies that could be employed to minimise the potentially adverse impact on the decision-making of the loss of consolidation information.
  2. The AASB received 29 submissions on ED 233. The vast majority of respondents did not support the proposed Australian additional disclosures. These respondents expressed support for introducing the IASB amendments without Australian additional disclosures (i.e. Option 1 below). They regarded the fair value information about the controlled investees as more relevant than consolidated information of the investment entity and its controlled investees in making decisions about the performance and financial position of the investment entity.

2. Objectives

2.1 The objectives of issuing Amending Standard AASB 2013-5 *Amendments to Australian Accounting Standards – Investment Entities* are to:

(a) reduce the compliance costs of Australian investment entities;

(b) ensure that information that is relevant for decision making is provided; and

(c) contribute to the development of a single set of accounting standards for world-wide use having regard to the interests of Australian investment entities that raise or propose to raise capital in major international financial centres.

3. Options

*Option 1 (Regulatory ‘light handed’ option)*

3.1 Issue AASB 2013-5 to provide an exception to consolidation to Australian investment entities and require them to measure their investments in subsidiaries (except those subsidiaries that provide investment–related services) at fair value through profit or loss. Based on the overwhelming support for this approach from respondents to ED 233, including specific feedback on the relevance of consolidated information, it would appear that there would be no significant adverse impact to decision-making if consolidated information of an investment entity and its controlled investees is not disclosed in the financial statements of an investment entity.

*Option 2 (Status quo)*

3.2 Status quo (do nothing). This option would mean that Australian investment entities would continue to consolidate all their controlled investees as per the current requirements.

In simple terms, consolidation means a line-by-line aggregation of all the items in the parent entity and its controlled investees’ financial statements and presenting them in consolidated financial statements after eliminating intra-group transactions.

*Option 3 (Regulatory option)*

3.3 The AASB considered the option of issuing the IASB amendments with Australian additional disclosures in the form of consolidated financial statements and related notes.

4. Impact Analysis

**4.1 *Affected Parties***

4.1.1 In the process of setting accounting standards, the AASB issues Exposure Drafts and Invitations to Comment to consult with stakeholders. Comments received from constituents are taken into account in developing the standards.

4.1.2 When issuing Exposure Drafts of Australian Accounting Standards that incorporate IASB Standards, the AASB specifically seeks comment from constituents on whether the proposals are in the best interests of the Australian economy and on whether there are regulatory or other issues that may affect the implementation of the proposals.

4.1.3 Parties likely to be most directly affected by the Standard are:

(a) reporting entities required to prepare general purpose financial reports and that meet the ‘investment entity’ criteria in AASB 2013-5;

(b) users of reports identified in (a) such as:

(i) resource providers (including fund managers, investors, creditors and employees);

(ii) participants in the Australian capital markets;

(iii) parties performing a review or oversight function (including analysts, ASIC and ASX); and

(iv) management and governing bodies (including use of these reports in the discharge of accountability).

**4.2 *Costs and Benefits***

4.2.1 The AASB assesses from a public interest perspective whether the costs of providing certain financial information exceed the benefits to be derived from its provision. There is no universally accepted methodology for quantitatively measuring costs and benefits of information presented in financial reports. The costs of providing financial information are incurred, in the main, by reporting entities, but extend in various direct and indirect ways to the users of general purpose financial statements. In this context, the AASB is often guided by the feedback received from constituents as to the costs that may be involved in implementing newly issued accounting requirements. This feedback is both from the AASB’s due process and also from the IASB’s due process. For example, entities are likely to incur one-off costs in the transition to implement any systems changes and their review for external audit purposes. However, there is no guarantee that the costs are borne ultimately by those who derive the benefits.

4.2.2 Under option 1, investment entities would need to report the fair value of their controlled investments, along with any dividends and capital gains instead of reporting consolidated information of the investment entity parent and its controlled entities as per current requirement. Those fair values would, for example, be based on quoted share prices or fair value measurement models already employed for management purposes.

4.2.3 The AASB expects that the introduction of AASB 2013-5 (i.e. option 1) will result in significant compliance cost savings for preparers due to the exception to consolidation, particularly on an ongoing basis. This expectation is based on the feedback the AASB has received from respondents to AASB ED 220 and AASB ED 233 and the feedback the IASB has received from respondents to IASB ED/2011/4.

4.2.4The AASB also expects that some users of investment entity financial statements would benefit from the provision of more fair value information, based on the outreach conducted by the IASB (refer to paragraphs BC304-BC308 of IFRS 10). The AASB also notes that constituents responding to the proposals for an exception to consolidation viewed fair value information as most relevant for investors of investment entities in many circumstances. They also argued that providing the exception to consolidation to Australian investment entities without Australian additional disclosures would reduce their compliance costs and enable them to maintain consistency relative to their international peers.

4.2.5 On initial application, there may be some costs involved in identifying and documenting some of the additional disclosures introduced. In particular, investment entities will need to collect information to comply with the general disclosure requirements of AASB 7 *Financial Instruments: Disclosures*, AASB 13 *Fair Value Measurement* and the amended requirements of AASB 12 *Disclosures of Interest in Other Entities* and IAS 27 *Separate Financial Statements*.

4.2.6 However, as the IASB has indicated, the majority of investment entities will already have much of the fair value information that they need in order to comply with the new disclosure requirements, because they already measure substantially all of their investments on a fair value basis and many already elect to provide this information to their investors. The IASB expects this to mitigate the initial and ongoing costs of applying the exception to consolidation (refer to paragraph BC310 of IFRS 10).

4.2.7 The AASB also notes that by providing Option 1, Australia would remain an IFRS compliant jurisdiction, which has significant reputational benefits for Australian financial reporting in general.

4.2.8 Thus, in arriving at its decisions, the AASB has considered the costs of complying with AASB 2013-5 and believes that the benefits of the information produced and the benefits of maintaining IFRS compliance would outweigh the costs of providing that information. In addition, the initial application costs will be more than offset by the cost savings resulting from the removal of the need to gather information from subsidiaries in order to consolidate their assets, liabilities, revenues and expenses on a line by line basis.

4.2.9 Option 2 (i.e. the approach of not adopting the IASB amendments in Australia) would result in Australian investment entities not being able to assert IFRS compliance, an outcome that would be contrary to the AASB’s policy of having “…Tier 1 for-profit entities being IFRS compliant”[[1]](#footnote-1).

4.2.10 The overwhelming response to ED 233 received from constituents was not supportive of Option 3. The AASB also considered other types of less onerous Australian additional disclosures that could be required, but noted that the responses to ED 233 did not support having any types of additional disclosure, largely on the basis that the cost of providing the additional disclosure would outweigh the benefits and would be a burden that investment entities adopting IFRSs in other jurisdictions would not have to bear.

5. Consultation

5.1 The AASB issued ED 220 in September 2011 and ED 233 in December 2012 for public comment. The majority of those who responded to these Exposure Drafts expressed support for providing the exception to consolidation for investment entities and requiring them to measure their subsidiaries at fair value. In total, over the two Exposure Drafts, there were 44 respondents.

5.2 The AASB also conducted targeted user consultation to try and identify alternative Australian additional disclosures might be useful to make decisions about investment entities.

6. Conclusion and Recommendation

6.1 On balance, the AASB concluded, based on the feedback from respondents to ED 233, that:

* Option 1 offers a greater level of benefits to preparers and users of financial statements of investment entities more generally than Option 2 (the status quo);
* Option 1 achieves the identified objectives in paragraph 2; and
* users would be better off under Option 1 than they are under Option 2 in terms of the availability of relevant information, and in the context of IFRS compliance.

6.2 Option 2, which would keep the status quo, is seen as inappropriate as reflected in constituents’ comments on ED 220 and ED 233.

Although some AASB members remain sceptical that their concerns regarding loss of consolidation information may not be fully addressed by Option 1, overall the AASB as a whole concluded that those concerns are significantly mitigated by the plan to monitor the implementation of Option 1 (which may include a post implementation review, as explained in section 7 below). The AASB noted it would evaluate the findings of its review of the implementation of Option 1 and if additional disclosures (either in the form of consolidated information or less other disclosures) are warranted, they can be introduced at that later stage.

7. Implementation and Review

7.1 The AASB will monitor the implementation of AASB 2013-5, which will include monitoring the disclosures made in accordance with AASB 12 and AASB 101 *Presentation of Financial Statements* paragraph 17(c). Such monitoring, which may be via a post-implementation review, will be undertaken with a view to potentially adding Australian additional disclosure requirements at a later stage, if it were to become evident that additional disclosures are warranted, noting that such disclosures might be different from those proposed in ED 233. Monitoring might also lead to the AASB deciding to write to the IASB, informing it of the findings and concerns arising from the Australian experience.

7.2 Any post-implementation review would probably need to be conducted with at least two years of application experience. The exception to consolidation for investment entities takes effect for periods beginning on or after 1 January 2014 and, accordingly, any post-implementation review is unlikely to commence until 2016.

1. AASB Policy Statement Policies and Processes March 2011, paragraph 7 [↑](#footnote-ref-1)