15 September 2014

International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH
United Kingdom
Email: CommentLetters@ifrs.org

Dear Sir/Madam

**SAICA SUBMISSION ON ED 2014/2 – *INVESTMENT ENTITIES: APPLYING THE CONSOLIDATION EXCEPTION*: PROPOSED AMENDMENTS TO IFRS 10 – *CONSOLIDATED FINANCIAL STATEMENTS* AND IAS 28 – *INVESTMENTS IN ASSOCIATES AND JOINT VENTURES***

In response to your request for comments on ED 2014/2 – *Investment Entities: Applying the Consolidation Exception:* Proposed Amendments to IFRS 10 – *Consolidated Financial Statements* and IAS 28 – *Investments in Associates and Joint Ventures,* attached is the comment letter prepared by the Accounting Practices Committee (APC) of The South African Institute of Chartered Accountants (SAICA). This comment letter results from deliberations of the APC which comprises members from reporting organisations, regulators, auditors, IFRS specialists and academics.

We thank you for the opportunity to provide comments on this document.

Please do not hesitate to contact us should you wish to discuss any of our comments.

Yours faithfully,

**Sue Ludolph**
**Project Director – Financial Reporting**

cc: Prof Danie Coetsee (Chairman of the Accounting Practices Committee)

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## GENERAL COMMENTS

Whilst we welcome the proposed amendments to IFRS 10, we generally believe that the introduction of the exemptions or 'rules' in IFRS 10, which commenced with the publication of the *Investment Entity* – Amendments to IFRS 10, IFRS 12 and IAS 27 in 2012, is likely to perpetuate the practical challenges of applying the IFRS 10 requirements for investment entities as well as encourage structuring opportunities. Accordingly, we would encourage the International Accounting Standards Board (IASB) to consider the challenges that could arise as a consequence of the 'rules' being introduced in IFRS 10 by the various amendments and how the IASB will address these. We have provided a list of the areas of difficulty when applying the amendments issued in 2012 below:

- There are practical difficulties in applying the definition of an investment entity, especially the requirements of paragraphs 27(a) and (b) of IFRS 10.

- In cases where the investment entity subsidiary has issued debt, measuring it at fair value may not result in fair presentation of information as these debt instruments would not be separately presented in the group financial statements.

In addition we believe that the investment entity exception should not be mandatory but rather be a policy choice as this would allow entities which prefer to consolidate the opportunity to do so.

## SPECIFIC COMMENTS

### 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?*

We agree with the proposal to amend paragraph 4(a)(iv) of IFRS 10 to extend the exemption from preparing consolidated financial statements to a parent entity that is a subsidiary of an investment entity that measures its subsidiaries at fair value because we believe that without this amendment the standard results in an unintended outcome.

However, we request the IASB to reconsider the relevance of and the need for the criterion in paragraph 4(a)(iv) of the current standard more generally. It is not apparent to us why there should be a requirement that a parent entity of the intermediate parent seeking to apply the exemption should be applying IFRS. We believe that it restricts, unnecessarily, the application of the exemption. For example, an intermediate parent may be a subsidiary of a parent company that does not apply IFRS, such as US Generally Accepted Accounting Practice, Australian Accounting Standards or IFRS as endorsed by the European Union. The financial position and financial performance of this intermediate group may not even be significant in the consolidated financial statements of the parent company. Therefore, even if the parent company applies IFRS, it would not be possible to glean relevant information about the intermediary group from the consolidated financial statements of the parent company. Accordingly, we question the purpose of the criterion in paragraph 4(a)(iv).

In this regard we also draw attention to BC4 of the exposure draft in which it is stated that the *"Board observed that, when an investment entity measures its interest in a subsidiary at fair value, the disclosures required by IFRS 12 – Disclosure of Interests in Other Entities are supplemented by those required in IFRS 7 – Financial Instruments: Disclosures and IFRS 13 – Fair Value Measurement. Accordingly, the IASB decided that this combination of information provides sufficient grounds to retain the existing exemption from presenting consolidated financial statements for subsidiaries of investment entities that are themselves parent entities."* Given that the intermediate group may not be significant enough to warrant the IFRS 12, IFRS 7 or IFRS 13 disclosures in the parent's consolidated financial statements, we do not believe that the rationale given in BC4 is necessarily valid, whether for investment entities or non-investment entities. Accordingly, we propose that the criterion in paragraph 4(a)(iv) be deleted. We have the same views on the criterion in IAS 28 paragraph 17(d) for the exemption from applying the equity method.

**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?*

We agree with the proposed amendment.

**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.*

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*Do you agree with the proposed amendments? Why or why not?*

Currently there is a lack of clarity around whether equity accounting is a type of consolidation or a measurement basis. We are aware that the IASB is planning to start research in this area. We believe that prior to the IASB providing much needed clarity in this area, there should be limited amendments to the equity method of accounting. Without limiting our views on this project, the current tentative view of our commentators is that equity accounting should be a measurement basis, rather than a type of consolidation technique. With this background we would therefore support the proposed amendments for equity accounting an investment entity associate. If equity accounting is a measurement basis, then we would see no basis for a different treatment for investment entity joint ventures.

Under the current requirements of IAS 28 to align accounting policies, we would support the proposed amendments for equity accounting an investment entity associate due to practical difficulties in obtaining the information, which we understand to be the IASB's rationale. Given that in some instances the information may be available, we believe that there should be a free choice to either retain the fair value measurements or not. Some of our commentators are of the view that if the motivation for the relief is based on the practical difficulty of obtaining the required information, this should be the basis on which IAS 28 requires an investor to apply the equity method. In other words, the standard should contain an exemption from aligning the consolidation accounting policies if doing so would be impractical due to the inability of obtaining the information.

We believe that, until the IASB addresses equity accounting more fundamentally, equity accounting should be the same for an investment entity associate as for an investment entity joint venture. Accordingly, we do not support there being a different basis for investment entity joint ventures.

In addition, we note that the proposed new paragraph 36B refers to joint venturers without distinguishing between those joint venturers that are investment entities themselves and those that are not. The proposal would result in all joint venturers (even if they are investment entities themselves) with an interest in an investment entity joint venture not being able to retain the fair value measurements applied by the joint venture. We are doubtful that this was the IASB's intention. Although it could be argued that, by aligning the accounting policies with those of the investment entity joint venturer, the fair value measurements would be retained by investment entity joint venturers because of the explicit statement that the fair value measurements may not be retained by joint venturers. We believe that there is likely to be diversity in the application of paragraph 36B. Accordingly, we request the IASB to clarify whether investment entity joint venturers would retain the fair value measurements (which we believe would be appropriate) and if not to explain why not.

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