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8 September 2014

Submitted electronically through the IFRS Foundation website (www.ifrs.org)

ED/2014/2 Investment Entities: Applying the Consolidation Exception (Proposed amendments to IFRS 10 and IAS 28)

Grant Thornton International Ltd is pleased to comment on the International Accounting Standards Board's (the Board) Exposure Draft ED/2014/2 *Investment Entities: Applying the Consolidation Exception (Proposed amendments to IFRS 10 and IAS 28)* (the "Exposure Draft" or "ED"). We have considered the ED, as well as the accompanying draft Basis for Conclusions.

Overall, we concur with the proposed amendments, subject to a number of observations we would like to bring to your attention. These observations and our responses to the questions in the ED's Invitation to Comment are set out in the Appendix to this letter.

If you have any questions on our response, or wish us to amplify our comments, please contact our Global Head of IFRS, Andrew Watchman (andrew.watchman@gti.gt.com or telephone + 44 207 391 9510).

Yours sincerely,

Kenneth C. Sharp

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Responses to Invitation to Comment questions

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 proposed amendment.

We concur with the Board's reasoning in paragraph BC4 of the ED that: "*Removing the exemption so that any subsidiary of an investment entity that prepares IFRS financial statements would have to present consolidated financial statements in such circumstances could result in significant additional costs, without commensurate benefit.*" We also agree that removing the exemption would be contrary to the Board's intention to allow investment entities to provide relevant information and reduce costs as described in paragraphs BC309 and BC314 of IFRS 10.

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.

Paragraph BC12 of the ED states that it was the original objective of the Board, when drafting paragraph 32 of IFRS 10, to require consolidation of a subsidiary providing services related to its investment entity parent's investment activities as an extension of the operations of that parent. We support that objective. We also support the Board's proposed amendment to paragraph 32 to require that subsidiaries of investment entity parents would only be subject to consolidation under paragraph 32 if they do not qualify as investment entities in their own right. We agree with the reasoning in paragraphs BC10-12 of the ED which distinguishes between a subsidiary that earns fees by providing investment-related services and a subsidiary that is itself an investment entity and earns fees from its core investment activities.

Notwithstanding our general support, we wish to point out that accounting for 'dual-purpose' subsidiaries at fair value could impair comparability in particular situations and may present structuring opportunities. An investment entity could avoid reporting certain management and administration costs by choosing to locate these activities in an intermediate parent entity that itself meets the definition of 'investment entity'. The investment entity parent will be required to account for the intermediate parent at fair value even if the intermediate parent's investment service activities are in substance an extension of the parent's service activities. Accordingly, while we support the proposed amendment on the basis of providing clarity and avoiding significant new complexity, we encourage the Board to consider whether the investment entity accounting model should be refined in due course. An enhanced accounting model may involve differentiating between subsidiaries that are purely investments, those that are purely or predominantly service entities and those that act predominantly as an extension of the investment entity parent. We note that a key difference between investments and dual-purpose subsidiaries may be the existence (or lack) of exit strategies, as acknowledged in IFRS 10.B85H. An investment entity has exit strategies for its investments by definition, but would not ordinarily have an exit strategy for a subsidiary that acts as an extension of itself.

In addition, we note the inclusion of the words "main purpose" in the proposed amendment introduces a specific threshold where none existed previously. The Basis for Conclusions does not explain the Board's reasons for including this threshold. The inclusion of the words "main purpose" in the amendment may increase the possibility that investment entity parents will be able to engineer different accounting outcomes by delegating loss making activities or cost centres into non-investment entity subsidiaries and continuing to measure them at fair value as long as they do not fall on the wrong side of the "main purpose" threshold. We encourage the Board to expand the commentary in the Basis for Conclusions to explain whether the addition of this specific threshold represents a clarification of the Board's original intention, or a change in practice. If a change in practice, it may be helpful to include the additional explanation in the Standard itself.

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?

We agree with the proposed addition of paragraph 36A to IAS 28.

We believe that requiring 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 is reasonable and pragmatic in view of the significant costs and practical challenges that would be faced by these entities if required to 'unwind' the fair value accounting applied by their investment entity associates. A non-investment entity investor may not be able to obtain required information from an investee that it does not control, or may face significant costs in so doing.

Moreover, the Board's reasoning in BC14-19 implies that unwinding the equity-accounted investee's fair value accounting would be preferable in principle. We are not convinced this is the case. We note the Board's reasoning for requiring a non-investment entity parent to consolidate all subsidiaries (including those held through an investment entity subsidiary) was based more on reducing structuring opportunities than the usefulness of the resulting information. The structuring argument seems largely irrelevant in the context of a non-investment entity investor in an associate as the equity method is required to be applied. The ED's Basis for Conclusions does not address whether unwinding or retaining the investee's specialised fair value accounting for the purpose of applying the equity method would result in better information.

In relation to paragraph 36B, we understand the Board's reasons for proposing that a joint venturer should be treated differently to an investor in an associate (and would be prohibited from retaining the specialised fair value measurement applied by its investment entity joint venture). We agree with the point made in BC21 of the ED that an entity is more able to choose to hold particular investments via a joint venture than via an associate. However, a decision to hold a subsidiary via a joint venture would result in losing control which would presumably be a significant disincentive. Also, the issue at hand concerns how (not whether) equity accounting is applied. This has far less effect on the non-investment entity's financial statements than whether the investment entity subsidiary's fair value accounting is unwound or retained by its parent. Accordingly the incentives for structuring are far less in the context of this issue.

Finally, as noted in BC22, this proposal would create a difference in how the equity method is applied to associates and joint ventures.

Notwithstanding these concerns, we do not necessarily disagree with this particular amendment but suggest that the Board should re-evaluate:

- whether unwinding fair value measurement results in more useful information
- the significance of structuring opportunities and incentives in the context of equity method accounting.