



Guidance Notes

TECH 01/14

Interaction between the amendments to IFRS 10, IFRS 12 and IAS 27 regarding investment entities and the Seventh Directive

Contents	Reference
Introduction	1 – 3
Scope	4 – 5
The new requirements introduced by the amendments	6 – 10
Legislation	11 – 12
The issue	13 – 16
Conclusion	17 – 18

These guidance notes are only intended to provide practical guidance to Members and are not, and should not be interpreted as, a substitute to any legislation, IFRS, IAS, IFRIC Interpretation or parts thereof. These guidance notes should be read in conjunction with the relevant legislation and standards. The Malta Institute of Accountants shall not be responsible for any loss sustained by any person who relies on this publication.

Introduction

1. In October 2012, the IASB published the amendments to IFRS 10, Consolidated Financial Statements, IFRS 12, Disclosure of Interests in Other Entities and IAS 27, Separate Financial Statements regarding investment entities. The European Union has published Commission Regulation (EC) No 1174/2013 of 20 November 2013 amending Regulation (EC) No 1126/2008 adopting certain International Accounting Standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council in the Official Journal on 21 November 2013. This regulation adopts the amendments made by the IASB in October 2012. The amendments have been given an effective date of 1 January 2014 for the preparation of financial statements in accordance with the requirements of International Financial Reporting Standards as adopted by the European Union (unless an entity elects to early adopt these amendments).
2. The amendments introduce an exception to the consolidation principles of IFRS 10 by requiring entities which meet the definition of an 'investment entity' to measure their investments in subsidiaries that do not provide services related to the investment entity's investment activities, at fair value through profit and loss in accordance with the requirements of IFRS 9 (currently applied though the requirements of IAS 39). An investment entity shall not consolidate these subsidiaries. As a consequence, parent investment entities would be solely required to present separate financial statements in the circumstances highlighted above (IAS 27 paragraph 8A).
3. The Malta Institute of Accountants (MIA) has received a number of queries about whether such an exception is inconsistent with the requirements of the Seventh Directive to prepare consolidated accounts under similar circumstances. Similar concerns may potentially also arise with the new Accounting Directive (DIR 2013/34/EU) published on 26 June 2013.

Scope

4. These Guidance Notes are being issued by the MIA on 15 July 2014 to assist Members in complying with the relevant requirements in European Directives and Generally Accepted Accounting Principles and Practice (GAAP) as defined in the Accountancy Profession (Accounting and Auditing Standards) Regulations issued in terms of the Accountancy Profession Act (Chapter 281 of the Laws of Malta), namely the requirements to be found in IFRS 10, IFRS 12, and IAS 27.
5. These Guidance notes:
 - (a) Take into consideration the European Commission services' views on the interaction between the amendments to IFRS 10, IFRS 12 and IAS 27 regarding investment entities and the Seventh Directive - Groups comprised of only investment entities.
 - (b) Are applicable to financial statements for which the amendments to IFRS 10, IFRS 12 and IAS 27 regarding investment entities have become applicable taking cognisance of the effective date and early adoption, if relevant to the specific reporting entity.

The new requirements introduced by the amendments

6. In October 2012, the IASB published amendments to IFRS 10, IFRS 12 and IAS 27. The amendments to IFRS 10:
 - (a) introduce a requirement for investment entities to measure their investments in subsidiaries, that do not provide services related to the investment entity's investment activities, at fair value through profit or loss, instead of consolidating them (paragraph 31 of the amendment to IFRS 10); and
 - (b) state that an investment entity that is required, throughout the current period and the comparative period presented, to apply the exception to consolidation for all of its subsidiaries in accordance with paragraph 31 of IFRS 10, solely presents separate financial statements (paragraph 8A of the amendments to IAS 27).
7. To fall within the scope of this exception, an entity has to meet the definition of "investment entity" provided by the amendments, which is based on the three following elements:
 - (a) it obtains funds from one or more investors for the purpose of providing those 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.

In assessing whether an entity meets this definition, it shall consider four typical characteristics of an investment entity as set out in paragraph 28 of IFRS 10.
8. Parent entities that meet the definition of an investment entity will not consolidate any of their investments in subsidiaries that do not provide services related to the investment entity's investment activities, and will only prepare separate financial statements according to the requirements of IAS 27.
9. The exception has limitations and does not apply in the following cases:
 - (a) an investment entity is still required to consolidate a subsidiary that provides services that relate to the investment entity's investment activities as highlighted above; and
 - (b) a parent of an investment entity, that is itself not an investment entity, is still required to consolidate all its investments in subsidiaries unless it avails itself of any other exemption that is available and is unrelated to the amendments.
10. Investment entities that fall within the scope of the exception have to make specific disclosures on the non-consolidated subsidiaries.

Legislation

11. The Seventh Company Law Directive (83/349/EEC) lays down when consolidated financial statements should be prepared as well as the required scope of consolidation. These requirements have been transposed in Chapter X of Part V of the Maltese Companies Act, 1995.

Although similar provisions are included in the new Accounting Directive that will repeal and replace the Fourth and Seventh Directives, both the current Seventh Company Law Directive and the new Accounting Directive do not (and will not) permit a treatment similar to that required by the amended IFRS 10 in respect of parent investment entities.

12. The IAS Regulation (EC No 1606/2002) sets out the legal context and provides the legal basis for the application of IFRS in the EU. The EU IAS Regulation requires the application of IFRSs as adopted by the EU ('adopted IFRSs') for the consolidated financial statements of European companies whose securities trade in a regulated securities markets as defined in Article 4 of that Regulation. In addition, Article 5 allows Member States to permit or require (i) the companies referred to in Article 4 to prepare their annual accounts, and (ii) companies other than those referred to in Article 4 to prepare their annual and/or consolidated accounts, in conformity with IFRS adopted under the IAS Regulation. In fact Regulation 3(1) of SL 281.02 Accountancy Profession (Accounting and Auditing Standards) Regulations makes direct reference to IFRS as adopted by the EU as the national GAAP, except for entities that are permitted to, and apply, the General Accounting Principles for Smaller Entities (GAPSE).

The issue

13. The issue arises when an investment entity is required, throughout the current period and the comparative period presented, to apply the exception to consolidation for all of its subsidiaries in accordance with paragraph 31 of IFRS 10, and is required to present only separate financial statements in accordance with paragraph 8A of the amendments to IAS 27.
14. The amendments would require such parent investment entities not to prepare consolidated financial statements while the Seventh Directive would appear to require that entity to prepare consolidated financial statements, provided that the entity is not exempted from preparing consolidated financial statements by virtue of a provision within the Seventh Directive itself. In the circumstances, the application of IFRS as adopted by the EU would lead investment entities which satisfy the specified criteria to prepare separate financial statements that follow accounting rules which are distinct from those applying to consolidated financial statements in the Seventh Directive and/or the new Accounting Directive.
15. Recital 3 of the IAS Regulation clarifies that the aim of the IAS Regulation is "to supplement the legal framework applicable to publicly traded companies". To do so, the IAS Regulation introduces derogations to the common regime set by the Accounting Directives, in that it provides rules regarding individual or consolidated accounts which are more specific than the Accounting Directives and thus represent *lex specialis* in comparison with the Accounting Directives, which constitute *lex posteriori*.
16. The new Accounting Directive further clarifies in a Recital that its provisions should only apply to the extent that they are not inconsistent with, or contradicted by, provisions specified elsewhere for the financial reporting of certain types of undertakings. The new Accounting Directive would therefore not restrict or hinder a company's compliance with (or choice under) adopted IFRSs further to the IAS Regulation.

Conclusion

17. Unless an entity adopts GAPSE as its financial reporting framework, provided it is eligible to do so, all incorporated entities are required under Maltese law to prepare their financial statements in accordance with adopted IFRS and therefore an entity complying with the Seventh Directive is also captured within the scope of the IAS Regulation. Any contradictions between the Directive and the Regulation are resolved using the concepts of *lex specialis* and *lex posteriori*. According to the concept of *lex specialis*, legislation that is deemed to be more specific than the Accounting Directive, the IAS Regulation would apply.
18. Based on this analysis, a parent company that meets the criteria to be classified as an investment entity and would accordingly prepare separate financial statements as a result of the requirements described within these notes, in accordance with the amendments to IFRS 10, 12 and IAS 27, shall be deemed to be compliant with the requirements of both the Seventh Directive and the IAS Regulation. Since the application of the IAS Regulation cannot subsequently change the conditions which gave rise to such application, an investment entity shall not be required to prepare consolidated accounts in addition to those separate financial statements. This would still apply with the new Accounting Directive.