October 2012

Project Summary and Feedback Statement

Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27)

IFRS®

At a glance

It has been a longstanding requirement in IFRS that a reporting entity must present financial statements consolidating all of its subsidiaries.

IFRS 10 *Consolidated Financial Statements* is the IASB's most recent pronouncement on consolidated financial statements. During the development of that Standard the IASB was asked to consider introducing an exception to consolidation for entities whose only business purpose is to make investments for capital appreciation, investment income, or both, and who evaluate the performance of those investments on a fair value basis. Such entities are commonly referred to as 'investment entities'.[1]

In February 2010, the IASB, together with the US Financial Accounting Standards Board (FASB), began examining the possibility of creating such an exception. In August 2011, the IASB issued an Exposure Draft, *Investment Entities* ('the ED'), for public comment.

In October 2012, the IASB issued *Investment Entities* (Amendments to IFRS 10, IFRS 12 and IAS 27). These amendments include:

- the creation of a definition of an investment entity;
- the requirement that such entities measure investments in subsidiaries at fair value through profit or loss instead of consolidating them;
- new disclosure requirements for investment entities; and
- requirements for an investment entity's separate financial statements.

The amendments are effective from 1 January 2014 with early adoption permitted.

1 US Generally Accepted Accounting Principles (US GAAP) has a similar type of entity, 'investment company', which is defined in US legislation.

What the amendments do

Exception to consolidation

The *Investment Entities* amendments provide an exception from the requirements of consolidation and instead require investment entities to present their investments in subsidiaries as a net investment that is measured at fair value.

The exception means that investment entities will be able to measure all of their investments at fair value using the requirements in IFRS.

Who is affected?

An investment entity is an entity whose business purpose is to make investments for capital appreciation, investment income, or both. An investment entity also evaluates the performance of those investments on a fair value basis.

The IASB thinks that the most common types of investment entity will be private equity organisations, venture capital organisations, pension funds, sovereign wealth funds and other investment funds.

Why the IASB undertook this project

In 2003, the IASB added a consolidation project to its agenda. The project aimed to address divergence in practice when applying IAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation–Special Purpose Entities*.

As a result of this project, IFRS 10 was issued in 2011 as a replacement for IAS 27 and SIC-12. Both IFRS 10 and IAS 27 required consolidation of all controlled entities.

During the development of IFRS 10, the IASB was asked to consider whether it should provide an exception to consolidation for 'investment entities', for the following reasons:

Relevant information

Preparers and investors in the investment entity industry have, for many years, stated that measuring the subsidiaries of investment entities at fair value provides more relevant information than consolidating those subsidiaries. Similar views were received during the development of IFRS 10.

Investors in investment entities have said that consolidating the subsidiaries of investment entities makes it difficult to assess the value of their investments.

Preparers of financial statements noted that preparing consolidated information for investment entities was time-consuming and costly and provided little benefit, because investors were more interested in the non-consolidated, fair value information.

Comparability

Respondents told the IASB that all investments of investment entities are managed and evaluated on a fair value basis, including investments in subsidiaries. IFRS either requires or permits fair value measurement for most investments. However, before these amendments, investments in subsidiaries were required to be consolidated and could not be measured at fair value. Consequently, an investment entity with no subsidiaries was able to present all of its investments at fair value, whereas an entity with one controlled investee would have had to have consolidated that investee. Introducing an exception to consolidation improves comparability both within an investment entity's financial statements and between investment entities' financial statements.

Why we undertook this project continued...

National GAAP

Historically, several national accounting requirements have had an exception to consolidation for investment entities. In some jurisdictions, investment entities were given the opportunity to retain those national accounting requirements rather than adopt IFRS. In addition, entities that will now qualify as investment entities are already voluntarily providing information about the fair value of all of their investments.

The project was undertaken jointly with the FASB, with the aim of achieving alignment between IFRS and US GAAP. US GAAP already has accounting and reporting guidance for investment companies (Topic 946 *Investment Companies* in the *FASB Accounting Standards Codification®*). The IASB did not need to develop broader financial reporting requirements for investment entities. IFRS already requires or permits fair value measurement for an entity's investments, including investments in associates, joint ventures, financial assets and investment properties.

The IASB and FASB worked together to develop a consistent view of which entities should qualify as investment entities. The IASB finalised its requirements before the FASB had completed its deliberations.

Project timeline

2010	2011	2012	2013	2014
Investment Entities project started during IFRS 10 deliberations	**May:** IFRS 10 publication **August:** *Investment Entities* Exposure Draft publication	**February and March:** Round-table meetings held in London, Toronto, Norwalk and Kuala Lumpur. **April – September:** *Investment Entities* Redeliberations **October:** *Investment Entities* amendments published	**1 January:** IFRS 10 effective date.	**1 January:** *Investment Entities* amendments effective date.

Summary of the main changes from the ED

ED proposals	Requirement
Qualifying as an investment entity The ED proposed that, in order to qualify as an investment entity, an entity would need to meet six criteria that are related to: (a) nature of the investment activity; (b) business purpose; (c) unit ownership; (d) pooling of funds; (e) fair value management; and (f) legal entity.	The definition of an investment entity was changed to include some of the six criteria. The remaining criteria are now described as typical characteristics of an investment entity. An entity must assess whether it meets the definition of an investment entity and whether it displays the typical characteristics of an investment entity. An entity is not required to display all of the typical characteristics of an investment entity in order to qualify as one but the absence of one or more of those characteristics may indicate that additional judgement is needed in determining whether it meets the definition.
The fair value option in IAS 28 The ED proposed to remove the fair value option from IAS 28 *Investment in Associates and Joint Ventures*, which is available to venture capital organisations, mutual funds, unit trusts and similar entities, including investment-linked insurance funds, which allows those entities to elect to measure their investment in associates or joint ventures at fair value through profit or loss in accordance with IFRS 9 *Financial Instruments*. Instead, the ED proposed to introduce a requirement for investment entities to measure their interests in joint ventures and associates at fair value through profit or loss.	The fair value option for venture capital organisations, mutual funds, unit trusts and similar entities, including investment-linked insurance funds, has been retained. In retaining this option the IASB noted that, to meet the definition of an investment entity, an entity must elect the fair value option in IAS 28 for any investments in associates or joint ventures.

Summary of the main changes from the ED continued...

ED proposals	Requirement
Scope of the disclosure requirements The ED proposed a disclosure objective that required an investment entity to disclose information about *all* of its investment activities.	The disclosure requirements have been narrowed to focus on an investment entity's interests in *subsidiaries* measured at fair value.
Retrospective versus prospective application The ED proposed that the amendments should be applied prospectively.	Entities are required to retrospectively apply the *Investment Entities* amendments, with some transition relief.

Due process and outreach activities

The IASB received 170 comment letters in response to the ED that it published in August 2011.

The Investment Entities project was limited in scope, and was expected to affect a relatively small number of entities. The issues involved were well understood by the IASB and its respondents. Consequently, the IASB performed targeted outreach on this project.

IASB members and staff discussed the proposals at one-to-one meetings with preparers, users, regulators, standard-setters and other interested parties, and at public round-table meetings in London, Norwalk, Toronto and Kuala Lumpur.

The final amendments to IFRS 10, IFRS 12 and IAS 27 were issued in October 2012. All IASB members approved the issue of the amendments.

Feedback statement

The project aimed to:

- define an investment entity; and
- require such an entity to measure its subsidiaries at fair value through profit or loss rather than consolidating them.

Respondents' comments

Most respondents supported the proposal and argued that, for investment entities, measuring subsidiaries at fair value rather than consolidating them would result in more relevant information and provide better comparability with the fair value measurements used for non-controlled investments held for the same business purpose.

However, some respondents disagreed with the proposal and thought that creating an exception to consolidation undermines the principle of control, creates the potential for accounting abuse and reduces the usefulness of the financial statements.

Our response

The IASB has been reluctant to create an exception to the principle that when one entity controls another, the parent consolidates its subsidiary.

The IASB was persuaded by the consistent message from investors that, for this narrowly defined type of entity, measuring all of its investments at fair value provided investors with the best information. The IASB ensured that this exception is available only to entities that evaluate the performance of their investments on a fair value basis.

Feedback statement continued...

The proposals required an entity to meet the six criteria in order to qualify as an investment entity.

Respondents' comments

Some respondents agreed with the criteria and thought that they appropriately defined the population of investment entities.

Other respondents thought that the six criteria were too strict and that entities that they believed should qualify as investment entities were not captured.

Respondents also raised concerns, for example:

- Some respondents argued that entities with only one investment should qualify as investment entities in some situations, for example, when an investment entity only has one investment because it has not yet identified other investment opportunities.
- Some respondents argued that entities with only one investor should qualify as investment entities in some situations, for example, start-up or wind-down funds, sovereign wealth funds and pension funds.
- Some respondents argued that the unit ownership criterion was too focused on the legal form of an entity's structure and was too rule-based.

Our response

The approach to identifying an investment entity was changed. The requirements include a definition with associated 'typical characteristics'.

The definition captures the business model and core activities of an investment entity.

The typical characteristics are more focused on an investment entity's form. An investment entity is expected, but not required, to possess all of the typical characteristics. Changing these factors from required criteria to typical characteristics addresses respondents' concerns about some investment entities being inappropriately excluded from the scope of the guidance.

Feedback statement continued...

The proposals did not make the exception to consolidation available to the non-investment entity parent of an investment entity. Accordingly, a non-investment entity parent would still be required to consolidate the subsidiaries of its investment entity subsidiary.

Respondents' comments

Respondents who disagreed with this proposal argued that:

- the fair value accounting used by an investment entity subsidiary is still relevant at the non-investment entity parent level; and
- the cost savings and benefits of more relevant reporting would be lost in all cases where an investment entity subsidiary is controlled by a non-investment entity parent.

Our response

The IASB confirmed that a non-investment entity parent would not qualify for the exception to consolidation for subsidiaries of its investment entity subsidiary.

The exception to consolidation was proposed for investment entities because of their unique business model. The IASB concluded that, because non-investment entity parents do not have this unique business model, they should consolidate their subsidiaries.

The IASB also had concerns with allowing a non-investment entity parent to retain the fair value accounting used by its investment entity subsidiaries as this would allow the non-investment entity parent to conceal leverage in a non-consolidated subsidiary.

Feedback statement continued...

IAS 28 has a measurement option that is available for venture capital organisations, mutual funds, unit trusts and similar entities, including investment-linked insurance funds. These entities can measure investments in joint ventures or associates at fair value through profit or loss, rather than using the equity method. The ED proposed removing the existing fair value option in IAS 28 and instead introducing a requirement for investment entities to measure their investments in associates or joint ventures at fair value through profit or loss.

Respondents' comments

Some respondents agreed with this proposal, stating that narrowing the range of entities for which the fair value option would be available would increase comparability. Those respondents also observed that it would be appropriate given the nature of investment entities.

However, many respondents disagreed with this proposal and noted that entities currently electing the fair value option in IAS 28 may not qualify as investment entities even though they manage those investments on a fair value basis.

Our response

The IASB decided not to amend the fair value option in IAS 28.

The IASB also decided that it is not necessary to include a requirement in IAS 28 for investment entities to measure their investments in associates and joint ventures at fair value because, to be an investment entity, an entity must evaluate the performance of those investments on a fair value basis—ie using the fair value option in IAS 28.

Feedback statement continued...

The exception to consolidation was at an entity level as opposed to an asset level.

Respondents' comments

Some respondents believed that this exception should be given at an asset level, and be available to any entity on an investment-by-investment basis, as opposed to an entity level where the exception to consolidation is based on the type of entity that owns the subsidiary.

They argued that an asset-level approach would:

- be more principled and consistent with the rest of asset- or transaction-based guidance in IFRS;
- address the needs of entities that would not qualify for investment entity status but hold some of their investments for capital appreciation or investment income; and
- avoid some of the problems associated with an entity-level approach.

Our response

The IASB decided to take an entity-level approach to the exception to consolidation. It considered that an asset-level approach would inappropriately broaden the exception to consolidation that was proposed in the ED and introduce a broad exception to the consolidation model in IFRS 10. The IASB believes that the unique business model of investment entities justifies the exception to consolidation.

Feedback statement continued...

The ED only proposed requirements related to an investment entity's interests in subsidiaries, joint ventures and associates, instead of providing a broader set of financial reporting requirements for all of its activities.

Respondents' comments

Some respondents requested that a separate and comprehensive set of requirements should be developed for investment entities.

Our response

The IASB did not consider it necessary to develop a separate Standard for investment entities. Existing Standards already provide entities with the ability to measure and present their investments at fair value (including joint ventures and associates) if they are evaluating the performance of those investments on a fair value basis.

Notes

Important information

International Accounting Standards Board® (IASB®)
The IASB is the independent standard-setting body of the IFRS Foundation®

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