

Snapshot: Investment Entities

This snapshot is a brief introduction to the exposure draft *Investment Entities*. The proposals were developed jointly with the US national standard-setter, the Financial Accounting Standards Board (FASB).

The comment period for the IASB and the FASB exposure drafts are aligned to enable joint deliberations. Once completed, this project will also conclude the IASB's consolidation project.

Project objective: To provide investors with the information they need to determine the value of their investments in investment entities and to better reflect the business model of these types of entities. If adopted, entities that would qualify as investment entities would be exempt from consolidating their financial statements with that of a subsidiary. Instead, the investment entity would be required to measure the fair value of all investments through profit or loss.

Status: The IASB published its exposure draft in August 2011. The FASB exposure draft is forthcoming but the comment deadlines of both exposure drafts will end on the same date.

Next steps: During the comment period the IASB will undertake further outreach to seek views on these proposals. Depending on the feedback received, the IASB expects to complete the project in the second half of 2012.

Comment deadline: 5 January 2012

Why are we undertaking the project?

IFRS 10 Consolidated Financial Statements does not distinguish entities that pool investments from a wide range of investors for investment purposes, from other entities, such as capital organisations, mutual funds or unit trusts.

Typically these types of entities measure their investments at fair value because this is the information investors require to be able to make judgements about the performance of their investments.

Currently investment entities would have to follow the consolidation requirements as set out in IFRS 10 *Consolidated Financial Statements* because IFRSs do not differentiate between them and other entities. As a result, they would have to consolidate their financial statements with that of an entity they are investing in if they control that entity.

However, feedback received from investors during the development of IFRS 10 indicated that consolidating of financial statements between an investment entity and an entity it is investing in makes it difficult for investors to judge the value of these investments. These investors are interested in the fair value of their investments.

Convergence

The boards decided to undertake this project jointly with the objective of improving existing US GAAP requirements and achieving convergence in the accounting for these types of entities.

What are we proposing?

Joint definition for investment entities

The IASB and FASB propose six qualifying criteria that an entity must meet in order to be classified as an investment entity.

- 1 The entity's nature is such that its only substantive activities are investing in multiple entities to achieve capital appreciation, earn investment income, or both.
- 2 The entity's business purpose is investing to earn capital appreciation, investment income, or both and it makes an explicit commitment to investors about this.
- 3 Investors own units of investments (e.g. shares or partnership interests) in the entity.
- 4 The entity pools the funds it receives from its investors, so that the investors can benefit from professional investment management.

- 5 The entity manages and evaluates the performance of its investments on a fair value basis.
- 6 The entity provides financial information about its investment activities to its investors.

Those entities that meet the criteria for qualifying as an investment entity would be exempt from consolidating its subsidiaries in accordance with IFRS 10.

Investments measured at fair value through profit or loss

If adopted, the proposals would require investment entities to account for their subsidiaries at fair value through profit or loss. This, together with the proposed consequential amendments, would result in investment entities accounting for all their investments at fair value through profit or loss.

Related disclosures

In order to provide investors with information about the nature and type of investments undertaken by the investment entity, the boards propose introducing appropriate disclosure requirements.

These disclosure requirements would complement the disclosures required by IFRS 7 *Financial Instruments: Disclosures*, IFRS 12 *Disclosures of Interests in Other Entities*, and IFRS 13 *Fair Value Measurement*.

The cost-benefit impact

Benefits:

1 Provide investors with the information that they say they need

Exempting investment entities from consolidating their financial statements in those cases where they control an entity they are investing in, and requiring these entities to measure all their investments in fair value through profit or loss, would ensure that investors are provided with the information they need to judge the value of their investments.

2 Greater transparency

A clear definition of investment entities with the appropriate accounting and disclosure requirements would provide greater transparency.

Current IFRSs talk about capital organisations, mutual funds or unit trusts but do not specify qualification criteria for those types of entities. If adopted, many of these types of entities are likely to meet the criteria of investment entities.

3 Convergence

If adopted, the proposals will broadly align the accounting for investment entities under IFRSs and US GAAP.

The FASB proposal would also include entities that are considered investment entities under US regulatory requirements.

The boards reached different preliminary conclusions regarding the accounting in cases when the investment entity is part of a larger group and the parent entity is not an investment entity itself.

The FASB proposal would extend the exemption to these cases.

The consultation will direct the boards in their future discussions.

Costs:

The IASB expects that the proposals, if adopted, will not result in significant costs for preparers.

To qualify, entities will already be accounting for their investments using fair value. In those cases where IFRS 10 would currently require them to consolidate their financial statements with that of the subsidiary they are investing in, entities are likely to provide investors with the fair value of these investments already.

What do we want to know?

The exposure draft contains the IASB's conclusions of its deliberations to date. The IASB is interested in hearing the views of all interested parties about all aspects of the proposal.

1 Accounting exemption – yes or no?

The IASB is particularly interested in understanding whether stakeholders think that the introduction of this accounting exemption would be beneficial or not. The IASB's opinion was divided and three Board members dissented from the proposals.

2 Parent entity accounting

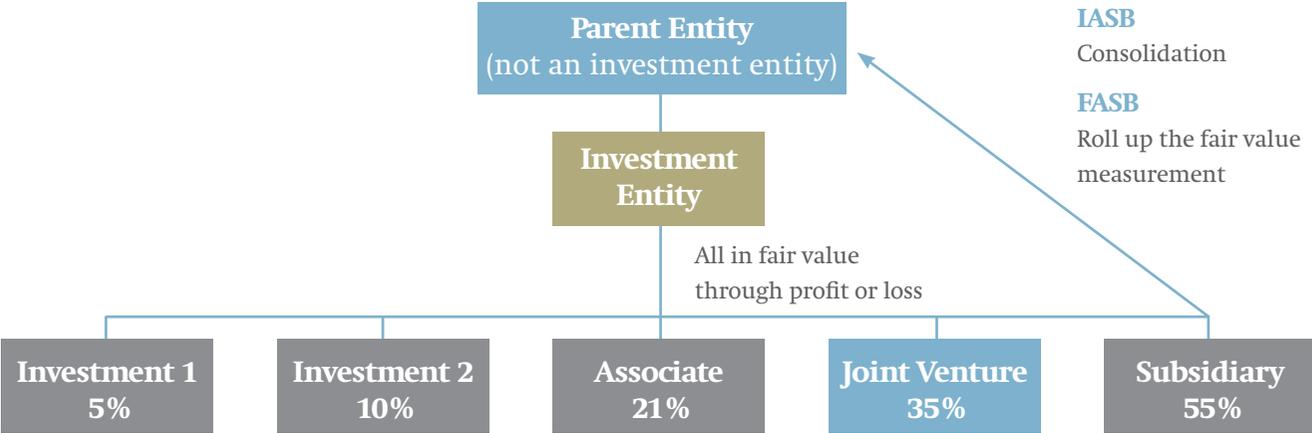
The IASB and the FASB came to different tentative decisions regarding the accounting treatment in cases where the investment entity is controlled by another entity that is not itself an investment entity (parent entity).

The IASB is proposing that in these cases the parent entity would have to consolidate its financial statements with that of the subsidiary (owned by) the investment entity.

The FASB is considering proposing a 'roll-up' approach; such an approach would mean that the exemption from the consolidation requirements would extend to the parent entity. As a result, the parent entity would 'roll-up' the fair value of the subsidiary to be included in its own financial statements.

The two boards reached different conclusions as to whether allowing the roll-up of fair value would provide structuring possibilities.

The IASB is interested in understanding the views of its stakeholders on this issue.



Due process

The exposure draft is a continuation of the Board's project on consolidation. This is the first time the Board is proposing such an exception. The Board decided to develop this exception to IFRS 10 in the light of comments and requests received when consulting about IFRS 10 Consolidated Financial Statements.

Because the investment entity proposals are a continuation of the consolidations project, and reflect the discussions and comments received during the development of IFRS 10, the Board decided to proceed directly to the publication of an exposure draft.

Next steps

The IASB greatly encourages the submission of comment letters electronically via its website:
<http://go.iasb.org/open+to+comment>

The Board and staff are also happy to discuss the proposals in meetings or events. For further information please contact: info@ifrs.org

Resulting requirements will be included in IFRS 10 *Consolidated Financial Statements*.

Notes

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