

Infrastructure Accounting Alert

Accounting developments affecting funds which invest in PPP/PFI projects



IASB issues *Investment Entities* – Amendments to IFRS 10

In a nutshell

In October 2012 the IASB issued an amendment to IFRS 10 *Consolidated Financial Statements*. An entity that qualifies as an *investment entity* will no longer consolidate its subsidiaries. Instead, it will measure these investments at fair value through profit or loss in accordance with IFRS 9.

This amendment may affect some funds which hold controlling interests in PPP/PFI projects. If the purpose of the fund is solely to maximise returns for investors and it has no significant involvement in managing the construction, operational or maintenance activities of the underlying infrastructure projects, it will need to consider whether it meets the definition of an investment entity.

Background

The IASB issued this narrow-scope amendment in response to feedback that the fair value of investments is the most useful information for users of the financial statements of investment entities.

As a result, an entity that meets the definition of an *investment entity* will not consolidate its subsidiaries or apply IFRS 3 *Business Combinations* when it obtains control of another entity. Instead, the investment entity is required to measure its investments in subsidiaries at fair value through profit or loss in accordance with IFRS 9 *Financial Instruments*.

The key areas impacting PPP/PFI funds are highlighted below along with links to more detailed information and contacts should you wish to discuss these changes further.

Point of focus for the PPP/PFI funds

'Investment-related activities'

An investment entity may only provide financial support to, or actively manage, its investments to maximise investment return. These activities must not represent a separate substantial business activity or source of income.

In the context of a PPP/PFI fund, it is important to understand how the underlying projects are managed. For example, who is responsible for managing the construction, operational, maintenance and lifecycle activities? If the fund is substantially involved in the day to day management of the PPP/PFI projects in which it has invested, its business purpose is not to invest solely for capital appreciation and/or investment income. Therefore, it will not meet the definition of an investment entity.

A fund may have appointed directors to the boards of its PPP/PFI subsidiaries. Where this is the case, an understanding of the roles and responsibilities of those directors, and the extent of their involvement in the day to day management and operation of the PPP/PFI projects, is relevant to this analysis.

Exit strategies

An investment entity is required to have an exit strategy for all investments (equity and debt) that have the potential to be held indefinitely. An exit strategy is therefore not required for debt instruments held to maturity, such as subordinated debt with a fixed term. However, while the underlying infrastructure projects may have limited lives, a PPP/PFI fund needs to have an exit strategy for its equity investments in such projects.

Investor group structures

The exception to consolidation is assessed on the type of entity holding the investment in the PPP/PFI project, not on the nature of investment itself. Parent entities, which do not themselves meet the definition of an investment entity, are required to consolidate all subsidiaries, even those within their group which qualify as investment entities.

In contrast, a parent entity which qualifies as an investment entity is required to measure all of its subsidiaries at fair value, with one exception: a subsidiary that provides investment-related services or limited investment-related activities, as described above, must be consolidated.

A group must therefore assess whether the definition and characteristics of an investment entity are met for each reporting entity in the investment structure.

IAS 28 measurement exemption for associates and joint ventures

Some PPP/PFI funds have historically taken advantage of the exemption from equity accounting in IAS 28 *Investments in Associates* and IAS 31 *Interests in Joint Ventures* and measured investments in associates and joint ventures at fair value.

The investment entity amendment to IFRS 10 does not change the accounting requirements for investments in associates or joint ventures. PPP/PFI funds will not need to meet the definition of an investment entity to continue to use this measurement exemption.

Timing

The investment entity requirements are to be applied retrospectively with specific transitional reliefs available where it is impracticable to identify the fair value of disposed investments. These requirements are effective from periods beginning on or after 1 January 2014 (still subject to EU endorsement), although early application is permitted (also subject to EU endorsement).

In accordance with IAS 8, entities which do not apply this amendment in advance of its effective date will need to disclose the possible impact it will have on the entity's financial statements when it is first applied.

Resources

A comprehensive summary of the amendments can be found in the iGAAP Alert publication on Investment Entities at http://www.deloitte.com/view/en_GB/uk/services/audit/49cdae59be0fb110VgnVCM100000ba42f00aRCRD.htm#news.



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