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Asset Management Spotlight

IASB Issues Guidance on Investment Entities

The Bottom Line

- The IASB recently added the concept of an investment entity to IFRSs. Entities that meet the definition of an investment entity are generally prohibited from consolidating their subsidiaries. Instead, they would measure these investments at fair value.
- An investment entity would continue to account for its other investments in accordance with current requirements, under which the entity may have the option of measuring these investments at fair value.
- A noninvestment entity parent is not permitted to retain the exemption from consolidation applied by its investment entity subsidiaries in its consolidated financial statements. Rather, the investees of the investment entity's subsidiaries would be consolidated in the noninvestment entity parent's consolidated financial statements.
- The new requirements are effective for annual periods beginning on or after January 1, 2014; early application is permitted.

The IASB recently added the concept of an investment entity to IFRSs.

Beyond the Bottom Line

On October 31, 2012, the IASB published amendments[1] to its consolidation requirements. Under the amendments, entities that meet the definition of an "investment entity" are exempt from consolidating certain subsidiaries under IFRS 10.[2] Instead, such entities would measure their investments in these subsidiaries at fair value through profit or loss in accordance with IFRS 9[3] or IAS 39.[4]

The IASB's amendments define an investment entity as an entity that:

- "[O]btains funds from one or more investors for the purpose of providing those investor(s) with investment management services."
- "[C]ommits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both."
- "[M]easures and evaluates the performance of substantially all of its investments on a fair value basis."

When a noninvestment entity parent has a controlling financial interest in an investment entity, the parent is not permitted to retain the exemption from consolidation applied by its investment entity subsidiary in its consolidated financial statements.

An entity must "consider all facts and circumstances when assessing whether it is an investment entity, including its purpose and design." The amendments indicate that an investment entity typically should have the following characteristics:

- More than one investment.
- More than one investor.
- Investors that are not related to the entity or other members of the group containing the entity.
- Ownership interests, typically in the form of equity or similar interests (e.g., partnership interests), to which proportionate shares of the net assets of the investment entity are attributed.

An entity that does not have one or more of these characteristics must justify and disclose how its activities are consistent with those of an investment entity. The amendments also provide implementation guidance on evaluating whether an entity is an investment entity.

If an entity meets the definition of an investment entity, it is not permitted to consolidate its subsidiaries and is required to measure its investments in those subsidiaries, including investments in other investment entities, at fair value through profit or loss. However, an investment entity is required to consolidate a subsidiary that provides services related to the investment entity's investment activities.

The amendments provide guidance on how a noninvestment entity parent should account for the investments of its investment entity subsidiaries in its consolidated financial statements. When a noninvestment entity parent has a controlling financial interest in an investment entity, the parent is not permitted to retain the exemption from consolidation applied by its investment entity subsidiary in its consolidated financial statements. Rather, investees of the investment entity subsidiary would be consolidated in the noninvestment entity parent's consolidated financial statements.

The amendments also:

- Introduce new disclosure requirements for investment entities in IFRS 12[5] and IAS 27.[6]
- Provide a scope exemption for investment entities from IFRS 3[7] (i.e., such entities do not need to apply business combination accounting to acquired subsidiaries).
- Make various consequential changes to numerous other standards.

[1] IASB Amendments, *Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27).*
[2] IFRS 10, *Consolidated Financial Statements.*
[3] IFRS 9, *Financial Instruments.*
[4] IAS 39, *Financial Instruments: Recognition and Measurement.*
[5] IFRS 12, *Disclosure of Interests in Other Entities.*
[6] IAS 27, *Separate Financial Statements.*
[7] IFRS 3, *Business Combinations.*

The amendments do not introduce any new accounting requirements for investments in associates or joint ventures. IAS 28[8] already permits venture capital organizations; mutual funds; unit trusts; and similar entities, including investment-linked insurance funds, to elect to measure investments in associates and joint ventures at fair value through profit or loss in accordance with IFRS 9 or IAS 39 rather than apply the equity method of accounting. The IASB expects investment entities to apply these fair value measurement requirements.

The new requirements are effective, on a modified retrospective basis, for annual periods beginning on or after January 1, 2014, a year later than IFRS 10, which is effective for annual periods beginning on or after January 1, 2013. Early application is permitted; thus, investment entities can elect to apply the amendments when they first apply IFRS 10 and do not need to consolidate subsidiaries only in the first year in which they apply IFRS 10.

Thinking Ahead

The FASB is currently finalizing its amendments to the U.S. GAAP definition of an investment entity and is expected to issue a final standard in the first half of 2013. The investment entity definition that the FASB has tentatively agreed on is generally consistent with the IASB's requirements, except that under the FASB's proposed approach, (1) entities that are regulated under the Investment Company Act of 1940 would be investment entities for accounting purposes and would not be required to assess whether they meet the criteria for, and have the typical characteristics of, an investment entity and (2) all real estate investment trusts would not qualify as investment entities. The FASB also tentatively decided that in a manner consistent with ASC 810,[9] a noninvestment entity parent would retain the specialized accounting applied by its investment entity subsidiaries in its consolidated financial statements. Further, the FASB tentatively decided not to provide any specific guidance on how an investment entity should account for its controlling interests in other investment entities.

The FASB is currently finalizing its amendments to the U.S. GAAP definition of an investment entity and is expected to issue a final standard in the first half of 2013.

[8] IAS 28, *Investments in Associates and Joint Ventures.*

[9] FASB Accounting Standards Codification Topic 810, *Consolidation.*

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