Straight away

IFRS bulletin from PwC

01 November 2012

IASB amends IFRS 10 to provide an exception from consolidation for 'investment entities'

What's new?

Many funds and similar entities will be exempted from consolidating controlled investees under amendments to IFRS 10, 'Consolidated financial statements'. This is a result of the IASB issuing amendments to IFRS 10, IFRS 12, 'Disclosure of interests in other entities' and IAS 27, 'Separate financial statements', on 31 October 2012. This will particularly benefit private equity funds, as those that qualify will fair-value all of their investments, including those that are controlled.

The guidance applies to an 'investment entity'. The amendment to IFRS 10 defines an investment entity and introduces an exception from consolidation. The amendments to IFRS 12 also introduce disclosures that an investment entity needs to make.

The amendments apply for annual periods beginning on or after 1 January 2014; earlier application is permitted.

The key features of the guidance are set out below.

Definition of an investment entity

You will need to make an assessment of whether your business meets the investment entity definition.

An investment entity is an entity that:

"(a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;

(b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income or both; and

(c) measures and evaluates the performance of substantially all of its investments on a fair value basis."

You will also need to consider a set of typical characteristics. These, combined with the definition, are intended to allow for an appropriate balance between creating a clear scope and allowing judgement in assessing whether you are an investment entity. The characteristics are: holding more than one investment, having more than one investor, having investors that are not related parties of the entity, and having ownership interests in the form of equity or similar interests. The absence of one or more of these characteristics does not prevent the entity from qualifying as an investment entity.

You will not be disqualified from being an investment entity where you carry out any of the following activities:

- provision of investment-related services to third parties and to your investors, even when substantial; and
- providing management services and financial support to your investees, but only when these do not represent separate substantial business activity and are carried out with the objective of maximising the

investment return from your investees.

Exception from consolidation and measurement of investees

You are required to account for your subsidiaries at fair value through profit or loss in accordance with IFRS 9, 'Financial instruments' (or IAS 39, 'Financial instruments: recognition and measurement', where applicable), where you qualify as an investment entity. The only exception is for subsidiaries that provide services to you that are related to your investment activities, which are consolidated.

Accounting by a non-investment entity parent for the controlled investments of an investment entity subsidiary

You may be an investment entity but your parent is not. For example, your investment entity fund is controlled by an insurance company. Your non-investment entity parent is required to consolidate all entities it controls including those controlled through an investment entity. The insurance group will have to consolidate the subsidiaries of your fund in the insurance group's financial statements, even though in your fund's own financial statements you will fair value your subsidiaries. Therefore, what is known as the fair value 'roll-up' is not permitted to a non-investment parent entity.

Disclosure

Required disclosures, where you qualify as an investment entity, include the following:

- significant judgements and assumptions made in determining that you have met the definition of an investment entity;
- reasons for concluding that you are an investment entity even though you don't have one or more of the typical characteristics;
- information on each unconsolidated subsidiary (name, country of incorporation, proportion of ownership interest held);
- restrictions on unconsolidated subsidiaries transferring funds to the investment entity;
- financial or other support provided to unconsolidated subsidiaries during the year, where there wasn't any contractual obligation to do so; and
- information about any 'structured entities' you control (for example, any contractual arrangements to provide any financial or other support).

Am I affected?

You will be affected if you are a fund or a similar entity. Some may qualify as investment entities, and some may not.

What do I need to do?

You should look closely at the guidance to determine whether or not you are an investment entity. If you are, for example, a property fund that actively develops properties, you are unlikely to qualify, as your objective is not solely capital appreciation or investment income. On the other hand, if you are a limited life fund set up to buy and sell or list a range of infrastructure subsidiaries, you might qualify as an investment entity.

You should start collating comparative information where you qualify as an investment entity, as the change in accounting has to be applied retrospectively in most cases.