CPA Hong Kong Institute of Certified Public Accountants 香港會計師公會

MEMBERS' HANDBOOK

Update No. 123

(Issued 12 December 2012)

This Update contains:

- *Investment Entities* (Amendments to HKFRS 10 *Consolidated Financial Statements,* HKFRS 12 *Disclosure of Interests in Other Entities* and HKAS 27 (2011) *Separate Financial Statements*)

Document Reference and Title	***Instructions***	***Explanations***
VOLUME II		
Contents of Volume II	Discard the existing pages i to ii and replace with the new pages i to ii	Revised contents pages
HONG KONG ACCOUNTING STANDARDS (HKAS)		
HKAS 27 (2011) *Separate Financial Statements*	Replace the cover page, pages 2-3 and 9 with revised cover page, pages 2-3 and 9. Insert pages 9A-9D after page 9 and page 15A after page 15	- Note
HONG KONG FINANCIAL REPORTING STANDARDS (HKFRS)		
HKFRS 10 *Consolidated Financial Statements* (Standard)	Replace the cover page and pages 3-4 with revised cover page and pages 3-4. Insert pages 58-72 after page 57	- Note
HKFRS 10 *Consolidated Financial Statements* (Basis for Conclusions)	Replace the cover page, pages 4 and 54-55 with revised cover page, pages 4 and 54-55. Insert pages 56-80 after page 55 .	- Note
HKFRS 12 *Disclosure of Interests in Other Entities* (Standard)	Replace the cover page, pages 3 and 24-25 with revised cover page, pages 3 and 24-25. Insert pages 26-28 after page 25	- Note

HKFRS 12 *Disclosure of Interests in Other Entities* (Basis for Conclusions)	Replace the cover page and page 4 with revised cover page and page 4. Insert pages 28-29 after page 27	- Note

Note:

The *Investment Entities* amendments apply to a particular class of business that qualify as investment entities. The term 'investment entity' refers to an entity whose business purpose is to invest funds solely for returns from capital appreciation, investment income or both. An investment entity must also evaluate the performance of its investments on a fair value basis. Such entities could include private equity organisations, venture capital organisations, pension funds, sovereign wealth funds and other investment funds.

Under HKFRS 10 *Consolidated Financial Statements*, reporting entities were required to consolidate all investees that they control (i.e. all subsidiaries). Preparers and users of financial statements have suggested that consolidating the subsidiaries of investment entities does not result in useful information for investors. Rather, reporting all investments, including investments in subsidiaries, at fair value, provides the most useful and relevant information.

In response to this, the amendments provide an exception to the consolidation requirements in HKFRS 10 and require investment entities to measure particular subsidiaries at fair value through profit or loss, rather than consolidate them. The amendments also set out disclosure requirements for investment entities.

The amendments are effective from 1 January 2014 with early adoption permitted in order to allow investment entities to apply the amendments at the same time they first apply the rest of HKFRS 10.

Hong Kong Institute of Certified Public Accountants
香港會計師公會

MEMBERS' HANDBOOK
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(Updated to December 2012)

HKAS 27 (2011)
~~Issued June 2011~~Revised December 2012

Effective for annual periods
beginning on or after 1 January 2013

Hong Kong Accounting Standard 27 (2011)

Separate Financial Statements

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Appendix A
Amendments to HKFRS 10, HKFRS 12 and HKAS 27 (2011) – *Investment Entities*

The following sets out amendments required for this Standard resulting from amendments to HKFRS 10, HKFRS 12 and HKAS 27 (2011) that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Standard and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

In the Introduction, paragraph IN3 is added.

IN3 *Investment Entities* (Amendments to HKFRS 10, HKFRS 12 and HKAS 27), issued in December 2012, introduced an exception to the principle in HKFRS 10 *Consolidated Financial Statements* that all subsidiaries shall be consolidated. The amendments define an investment entity and require a parent that is an investment entity to measure its investments in particular subsidiaries at fair value through profit or loss in accordance with HKFRS 9 (or HKAS 39 *Financial Instruments: Recognition and Measurement*, if HKFRS 9 has not yet been adopted) instead of consolidating those subsidiaries in its consolidated and separate financial statements. Consequently, the amendments also introduced new disclosure requirements for investment entities in HKFRS 12 *Disclosure of Interests in Other Entities*, with related disclosures introduced in this HKFRS.

Paragraphs 5–6 are amended. New text is underlined.

5 The following terms are defined in Appendix A of HKFRS 10 *Consolidated Financial Statements*, Appendix A of HKFRS 11 *Joint Arrangements* and paragraph 3 of HKAS 28 *Investments in Associates and Joint Ventures*:

- associate
- control of an investee
- group
- <u>investment entity</u>
- joint control
- ...

6 Separate financial statements are those presented in addition to consolidated financial statements or in addition to financial statements in which investments in associates or joint ventures are accounted for using the equity method, other than in the circumstances set out in paragraphs 8<u>–8A</u>. Separate financial statements need not be appended to, or accompany, those statements.

After paragraph 8, paragraph 8A is added.

8A An investment entity that is required, throughout the current period and all comparative periods presented, to apply the exception to consolidation for all of its subsidiaries in accordance with paragraph 31 of HKFRS 10 presents separate financial statements as its only financial statements.

After paragraph 11, paragraphs 11A–11B are added.

11A If a parent is required, in accordance with paragraph 31 of HKFRS 10, to measure its investment in a subsidiary at fair value through profit or loss in accordance with HKFRS 9, it shall also account for its investment in a subsidiary in the same way in its separate financial statements.

11B When a parent ceases to be an investment entity, or becomes an investment entity, it shall account for the change from the date when the change in status occurred, as follows:

(a) when an entity ceases to be an investment entity, the entity shall, in accordance with paragraph 10, either:

(i) account for an investment in a subsidiary at cost. The fair value of the subsidiary at the date of the change of status shall be used as the deemed cost at that date; or

(ii) continue to account for an investment in a subsidiary in accordance with HKFRS 9.

(b) when an entity becomes an investment entity, it shall account for an investment in a subsidiary at fair value through profit or loss in accordance with HKFRS 9. The difference between the previous carrying amount of the subsidiary and its fair value at the date of the change of status of the investor shall be recognised as a gain or loss in profit or loss. The cumulative amount of any fair value adjustment previously recognised in other comprehensive income in respect of those subsidiaries shall be treated as if the investment entity had disposed of those subsidiaries at the date of change in status.

After paragraph 16, paragraph 16A is added.

16A When an investment entity that is a parent (other than a parent covered by paragraph 16) prepares, in accordance with paragraph 8A, separate financial statements as its only financial statements, it shall disclose that fact. The investment entity shall also present the disclosures relating to investment entities required by HKFRS 12 *Disclosure of Interests in Other Entities*.

Paragraph 17 is amended. New text is underlined.

17 When a parent (other than a parent covered by paragraph<u>s</u> 16<u>–16A</u>) or an investor with joint control of, or significant influence over, an investee prepares separate financial statements, the parent or investor shall identify the financial statements prepared in accordance with HKFRS 10, HKFRS 11 or HKAS 28 (as amended in 2011) to which they relate. The parent or investor shall also disclose in its separate financial statements:

(a) ...

Paragraph 18 is amended. Deleted text is struck through.

18 … If an entity applies this Standard earlier, it shall disclose that fact and apply HKFRS 10, HKFRS 11, HKFRS 12 ~~*Disclosure of Interests in Other Entities*~~ and HKAS 28 (as amended in 2011) at the same time.

After paragraph 18, paragraphs 18A–18I are added.

18A *Investment Entities* (Amendments to HKFRS 10, HKFRS 12 and HKAS 27 (2011)), issued in December 2012, amended paragraphs 5, 6, 17 and 18, and added paragraphs 8A, 11A–11B, 16A and 18B–18I. An entity shall apply those amendments for annual periods beginning on or after 1 January 2014. Early adoption is permitted. If an entity applies those amendments earlier, it shall disclose that fact and apply all amendments included in *Investment Entities* at the same time.

18B If, at the date of initial application of the *Investment Entities* amendments (which, for the purposes of this HKFRS, is the beginning of the annual reporting period for which those amendments are applied for the first time), a parent concludes that it is an investment entity, it shall apply paragraphs 18C–18I to its investment in a subsidiary.

18C At the date of initial application, an investment entity that previously measured its investment in a subsidiary at cost shall instead measure that investment at fair value through profit or loss as if the requirements of this HKFRS had always been effective. The investment entity shall adjust retrospectively the annual period immediately preceding the date of initial application and shall adjust retained earnings at the beginning of the immediately preceding period for any difference between:

(a) the previous carrying amount of the investment; and

(b) the fair value of the investor's investment in the subsidiary.

18D At the date of initial application, an investment entity that previously measured its investment in a subsidiary at fair value through other comprehensive income shall continue to measure that investment at fair value. The cumulative amount of any fair value adjustment previously recognised in other comprehensive income shall be transferred to retained earnings at the beginning of the annual period immediately preceding the date of initial application.

18E At the date of initial application, an investment entity shall not make adjustments to the previous accounting for an interest in a subsidiary that it had previously elected to measure at fair value through profit or loss in accordance with HKFRS 9, as permitted in paragraph 10.

18F Before the date that HKFRS 13 *Fair Value Measurement* is adopted, an investment entity shall use the fair value amounts previously reported to investors or to management, if those amounts represent the amount for which the investment could have been exchanged between knowledgeable, willing parties in an arm's length transaction at the date of the valuation.

18G If measuring the investment in the subsidiary in accordance with paragraphs 18C–18F is impracticable (as defined in HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*), an investment entity shall apply the requirements of this HKFRS at the beginning of the earliest period for which application of paragraphs 18C–18F is practicable, which may be the current period. The investor shall adjust retrospectively the annual period immediately preceding the date of initial application, unless the beginning of the earliest period for which application of this paragraph is practicable is the current period. When the date that it is practicable for the investment entity to measure the fair value of the subsidiary is earlier than the beginning of the immediately preceding period, the investor shall adjust equity at the beginning of the immediately preceding period for any difference between:

(a) the previous carrying amount of the investment; and

(b) the fair value of the investor's investment in the subsidiary.

If the earliest period for which application of this paragraph is practicable is the current period, the adjustment to equity shall be recognised at the beginning of the current period.

18H If an investment entity has disposed of, or lost control of, an investment in a subsidiary before the date of initial application of the *Investment Entities* amendments, the investment entity is not required to make adjustments to the previous accounting for that investment.

18I Notwithstanding the references to the annual period immediately preceding the date of initial application (the 'immediately preceding period') in paragraphs 18C–18G, an entity may also present adjusted comparative information for any earlier periods presented, but is not required to do so. If an entity does present adjusted comparative information for any earlier periods, all references to the 'immediately preceding period' in paragraphs 18C–18G shall be read as the 'earliest adjusted comparative period presented'. If an entity presents unadjusted comparative information for any earlier periods, it shall clearly identify the information that has not been adjusted, state that it has been prepared on a different basis, and explain that basis.

Appendix B

Comparison with International Financial Reporting Standards

This comparison appendix, which was prepared in June 2011 and deals only with significant differences in the standards extant, is produced for information only and does not form part of the standards in HKAS 27.

The International Accounting Standard comparable with HKAS 27 is IAS 27 *Separate Financial Statements*.

There are no major textual differences between HKAS 27 and IAS 27.

Appendix

Amendments to Basis for Conclusions on IFRS 10, IFRS 12 and IAS 27 – *Investment Entities*

This appendix contains amendments to the Basis for Conclusions on IAS 27 that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Conclusions and this appendix will be deleted.

After paragraph BC8, a heading and paragraph BC8A are added.

Investment entities

BC8A *Investment Entities* (Amendments to IFRS 10, IFRS 12 and IAS 27), issued in October 2012, introduced an exception to the principle in IFRS 10 that all subsidiaries shall be consolidated. The amendments define an investment entity and require a parent that is an investment entity to measure its investments in particular subsidiaries at fair value through profit or loss in accordance with IFRS 9 *Financial Instruments* (or IAS 39 *Financial Instruments: Recognition and Measurement*, if IFRS 9 has not yet been adopted) instead of consolidating those subsidiaries. Consequently, the Board decided to amend IAS 27 to require an investment entity to also measure its investments in subsidiaries at fair value through profit or loss in its separate financial statements. The Board also made corresponding amendments to the disclosure requirements for an investment entity's separate financial statements, noting that if an investment entity prepares separate financial statements as its only financial statements, it is still appropriate for the investment entity to make the disclosures otherwise required in IFRS 12 about its interests in subsidiaries.

HKFRS 10
Revised ~~July~~ December 2012

Effective for annual periods beginning on or after 1 January 2013

Hong Kong Financial Reporting Standard 10

Consolidated Financial Statements

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

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Appendix F
Amendments to HKFRS 10, HKFRS 12 and HKAS 27 (2011) – *Investment Entities*

The following sets out amendments required for this Standard resulting from amendments to HKFRS 10, HKFRS 12 and HKAS 27 (2011) that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Standard and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

In the Introduction, paragraph IN7A is added and paragraph IN12 is amended. New text is underlined and deleted text is struck through. Paragraph IN7 is not amended but is reproduced here for clarity.

IN7 The HKFRS defines the principle of control and establishes control as the basis for determining which entities are consolidated in the consolidated financial statements. The HKFRS also sets out the accounting requirements for the preparation of consolidated financial statements.

IN7A *Investment Entities* (Amendments to HKFRS 10, HKFRS 12 and HKAS 27 (2011)), issued in December 2012, introduced an exception to the principle that all subsidiaries shall be consolidated. The amendments define an investment entity and require a parent that is an investment entity to measure its investments in particular subsidiaries at fair value through profit or loss in accordance with HKFRS 9 *Financial Instruments*[1] instead of consolidating those subsidiaries in its consolidated and separate financial statements. In addition, the amendments introduce new disclosure requirements related to investment entities in HKFRS 12 *Disclosure of Interests in Other Entities* and HKAS 27 (2011) *Separate Financial Statements*.

IN12 The disclosure requirements for interests in subsidiaries are specified in HKFRS 12 ~~*Disclosure of Interests in Other Entities*~~.

Paragraphs 2 and 4 are amended. New text is underlined and deleted text is struck through.

2 To meet the objective in paragraph 1, this HKFRS:

(a) …

(c) sets out how to apply the principle of control to identify whether an investor controls an investee and therefore must consolidate the investee; ~~and~~

(d) sets out the accounting requirements for the preparation of consolidated financial statements~~.~~; and

(e) defines an investment entity and sets out an exception to consolidating particular subsidiaries of an investment entity.

3 …

[1] Paragraph C7 of HKFRS 10 *Consolidated Financial Statements* states "If an entity applies this HKFRS but does not yet apply HKFRS 9, any reference in this HKFRS to HKFRS 9 shall be read as a reference to HKAS 39 *Financial Instruments: Recognition and Measurement*."

4 An entity that is a parent shall present consolidated financial statements. This HKFRS applies to all entities, except as follows:

(a) …

(c) an investment entity need not present consolidated financial statements if it is required, in accordance with paragraph 31 of this HKFRS, to measure all of its subsidiaries at fair value through profit or loss.

After paragraph 26, headings and paragraphs 27–33 are added.

Determining whether an entity is an investment entity

27 A parent shall determine whether it is an investment entity. 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.

Paragraphs B85A–B85M provide related application guidance.

28 In assessing whether it meets the definition described in paragraph 27, an entity shall consider whether it has the following typical characteristics of an investment entity:

(a) it has more than one investment (see paragraphs B85O–B85P);

(b) it has more than one investor (see paragraphs B85Q–B85S);

(c) it has investors that are not related parties of the entity (see paragraphs B85T–B85U); and

(d) it has ownership interests in the form of equity or similar interests (see paragraphs B85V–B85W).

The absence of any of these typical characteristics does not necessarily disqualify an entity from being classified as an investment entity. An investment entity that does not have all of these typical characteristics provides additional disclosure required by paragraph 9A of HKFRS 12 *Disclosure of Interests in Other Entities*.

29 If facts and circumstances indicate that there are changes to one or more of the three elements that make up the definition of an investment entity, as described in paragraph 27, or the typical characteristics of an investment entity, as described in paragraph 28, a parent shall reassess whether it is an investment entity.

30 A parent that either ceases to be an investment entity or becomes an investment entity shall account for the change in its status prospectively from the date at which the change in status occurred (see paragraphs B100–B101).

Investment entities: exception to consolidation

31 **Except as described in paragraph 32, an investment entity shall not consolidate its subsidiaries or apply HKFRS 3 when it obtains control of another entity. Instead, an investment entity shall measure an investment in a subsidiary at fair value through profit or loss in accordance with HKFRS 9.**[2]

32 Notwithstanding the requirement in paragraph 31, if an investment entity has a subsidiary that provides services that relate to the investment entity's investment activities (see paragraphs B85C–B85E), it shall consolidate that subsidiary in accordance with paragraphs 19–26 of this HKFRS and apply the requirements of HKFRS 3 to the acquisition of any such subsidiary.

33 A parent of an investment entity shall consolidate all entities that it controls, including those controlled through an investment entity subsidiary, unless the parent itself is an investment entity.

In Appendix A, a new definition is added. New text is underlined.

group **<u>investment entity</u>** …

<u>An entity that:</u>

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

<u>(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</u>

<u>(c) measures and evaluates the performance of substantially all of its investments on a fair value basis.</u>

In Appendix B, headings and paragraphs B85A–B85W are added.

Determining whether an entity is an investment entity

B85A An entity shall consider all facts and circumstances when assessing whether it is an investment entity, including its purpose and design. An entity that possesses the three elements of the definition of an investment entity set out in paragraph 27 is an investment entity. Paragraphs B85B–B85M describe the elements of the definition in more detail.

Business purpose

B85B The definition of an investment entity requires that the purpose of the entity is to invest solely for capital appreciation, investment income (such as dividends, interest or rental income), or both. Documents that indicate what the entity's investment objectives are, such as the entity's offering memorandum, publications distributed by the entity and other corporate or partnership documents, will typically provide evidence of an investment entity's business purpose. Further evidence may include

[2] Paragraph C7 of HKFRS 10 *Consolidated Financial Statements* states "If an entity applies this HKFRS but does not yet apply HKFRS 9, any reference in this HKFRS to HKFRS 9 shall be read as a reference to HKAS 39 *Financial Instruments: Recognition and Measurement*."

the manner in which the entity presents itself to other parties (such as potential investors or potential investees); for example, an entity may present its business as providing medium-term investment for capital appreciation. In contrast, an entity that presents itself as an investor whose objective is to jointly develop, produce or market products with its investees has a business purpose that is inconsistent with the business purpose of an investment entity, because the entity will earn returns from the development, production or marketing activity as well as from its investments (see paragraph B85I).

B85C An investment entity may provide investment-related services (eg investment advisory services, investment management, investment support and administrative services), either directly or through a subsidiary, to third parties as well as to its investors, even if those activities are substantial to the entity.

B85D An investment entity may also participate in the following investment-related activities, either directly or through a subsidiary, if these activities are undertaken to maximise the investment return (capital appreciation or investment income) from its investees and do not represent a separate substantial business activity or a separate substantial source of income to the investment entity:

(a) providing management services and strategic advice to an investee; and

(b) providing financial support to an investee, such as a loan, capital commitment or guarantee.

B85E If an investment entity has a subsidiary that provides investment-related services or activities, such as those described in paragraphs B85C–B85D, to the entity or other parties, it shall consolidate that subsidiary in accordance with paragraph 32.

Exit strategies

B85F An entity's investment plans also provide evidence of its business purpose. One feature that differentiates an investment entity from other entities is that an investment entity does not plan to hold its investments indefinitely; it holds them for a limited period. Because equity investments and non-financial asset investments have the potential to be held indefinitely, an investment entity shall have an exit strategy documenting how the entity plans to realise capital appreciation from substantially all of its equity investments and non-financial asset investments. An investment entity shall also have an exit strategy for any debt instruments that have the potential to be held indefinitely, for example perpetual debt investments. The entity need not document specific exit strategies for each individual investment but shall identify different potential strategies for different types or portfolios of investments, including a substantive time frame for exiting the investments. Exit mechanisms that are only put in place for default events, such as a breach of contract or non-performance, are not considered exit strategies for the purpose of this assessment.

B85G Exit strategies can vary by type of investment. For investments in private equity securities, examples of exit strategies include an initial public offering, a private placement, a trade sale of a business, distributions (to investors) of ownership interests in investees and sales of assets (including the sale of an investee's assets followed by a liquidation of the investee). For equity investments that are traded in a public market, examples of exit strategies include selling the investment in a private placement or in a public market. For real estate investments, an example of an exit strategy includes the sale of the real estate through specialised property dealers or the open market.

B85H An investment entity may have an investment in another investment entity that is formed in connection with the entity for legal, regulatory, tax or similar business reasons. In this case, the investment entity investor need not have an exit strategy for that investment, provided that the investment entity investee has appropriate exit strategies for its investments.

Earnings from investments

B85I An entity is not investing solely for capital appreciation, investment income, or both, if the entity or another member of the group containing the entity (ie the group that is controlled by the investment entity's ultimate parent) obtains, or has the objective of obtaining, other benefits from the entity's investments that are not available to other parties that are not related to the investee. Such benefits include:

(a) the acquisition, use, exchange or exploitation of the processes, assets or technology of an investee. This would include the entity or another group member having disproportionate, or exclusive, rights to acquire assets, technology, products or services of any investee; for example, by holding an option to purchase an asset from an investee if the asset's development is deemed successful;

(b) joint arrangements (as defined in HKFRS 11) or other agreements between the entity or another group member and an investee to develop, produce, market or provide products or services;

(c) financial guarantees or assets provided by an investee to serve as collateral for borrowing arrangements of the entity or another group member (however, an investment entity would still be able to use an investment in an investee as collateral for any of its borrowings);

(d) an option held by a related party of the entity to purchase, from that entity or another group member, an ownership interest in an investee of the entity;

(e) except as described in paragraph B85J, transactions between the entity or another group member and an investee that:

   (i) are on terms that are unavailable to entities that are not related parties of either the entity, another group member or the investee;

   (ii) are not at fair value; or

   (iii) represent a substantial portion of the investee's or the entity's business activity, including business activities of other group entities.

B85J An investment entity may have a strategy to invest in more than one investee in the same industry, market or geographical area in order to benefit from synergies that increase the capital appreciation and investment income from those investees. Notwithstanding paragraph B85I(e), an entity is not disqualified from being classified as an investment entity merely because such investees trade with each other.

Fair value measurement

B85K An essential element of the definition of an investment entity is that it measures and evaluates the performance of substantially all of its investments on a fair value basis, because using fair value results in more relevant information than, for example, consolidating its subsidiaries or using the equity method for its interests in associates or joint ventures. In order to demonstrate that it meets this element of the definition, an investment entity:

(a) provides investors with fair value information and measures substantially all of its investments at fair value in its financial statements whenever fair value is required or permitted in accordance with HKFRSs; and

(b) reports fair value information internally to the entity's key management personnel (as defined in HKAS 24), who use fair value as the primary measurement attribute to evaluate the performance of substantially all of its investments and to make investment decisions.

B85L In order to meet the requirement in B85K(a), an investment entity would:

(a) elect to account for any investment property using the fair value model in HKAS 40 *Investment Property*;

(b) elect the exemption from applying the equity method in HKAS 28 for its investments in associates and joint ventures; and

(c) measure its financial assets at fair value using the requirements in HKFRS 9.

B85M An investment entity may have some non-investment assets, such as a head office property and related equipment, and may also have financial liabilities. The fair value measurement element of the definition of an investment entity in paragraph 27(c) applies to an investment entity's investments. Accordingly, an investment entity need not measure its non-investment assets or its liabilities at fair value.

Typical characteristics of an investment entity

B85N In determining whether it meets the definition of an investment entity, an entity shall consider whether it displays the typical characteristics of one (see paragraph 28). The absence of one or more of these typical characteristics does not necessarily disqualify an entity from being classified as an investment entity but indicates that additional judgement is required in determining whether the entity is an investment entity.

More than one investment

B85O An investment entity typically holds several investments to diversify its risk and maximise its returns. An entity may hold a portfolio of investments directly or indirectly, for example by holding a single investment in another investment entity that itself holds several investments.

B85P There may be times when the entity holds a single investment. However, holding a single investment does not necessarily prevent an entity from meeting the definition of an investment entity. For example, an investment entity may hold only a single investment when the entity:

(a) is in its start-up period and has not yet identified suitable investments and, therefore, has not yet executed its investment plan to acquire several investments;

(b) has not yet made other investments to replace those it has disposed of;

(c) is established to pool investors' funds to invest in a single investment when that investment is unobtainable by individual investors (eg when the required minimum investment is too high for an individual investor); or

(d) is in the process of liquidation.

More than one investor

B85Q Typically, an investment entity would have several investors who pool their funds to gain access to investment management services and investment opportunities that they might not have had access to individually. Having several investors would make it less likely that the entity, or other members of the group containing the entity, would obtain benefits other than capital appreciation or investment income (see paragraph B85I).

B85R Alternatively, an investment entity may be formed by, or for, a single investor that represents or supports the interests of a wider group of investors (eg a pension fund, government investment fund or family trust).

B85S There may also be times when the entity temporarily has a single investor. For example, an investment entity may have only a single investor when the entity:

(a) is within its initial offering period, which has not expired and the entity is actively identifying suitable investors;

(b) has not yet identified suitable investors to replace ownership interests that have been redeemed; or

(c) is in the process of liquidation.

Unrelated investors

B85T Typically, an investment entity has several investors that are not related parties (as defined in HKAS 24) of the entity or other members of the group containing the entity. Having unrelated investors would make it less likely that the entity, or other members of the group containing the entity, would obtain benefits other than capital appreciation or investment income (see paragraph B85I).

B85U However, an entity may still qualify as an investment entity even though its investors are related to the entity. For example, an investment entity may set up a separate 'parallel' fund for a group of its employees (such as key management personnel) or other related party investor(s), which mirrors the investments of the entity's main investment fund. This 'parallel' fund may qualify as an investment entity even though all of its investors are related parties.

Ownership interests

B85V An investment entity is typically, but is not required to be, a separate legal entity. Ownership interests in an investment entity are typically in the form of equity or similar interests (eg partnership interests), to which proportionate shares of the net assets of the investment entity are attributed. However, having different classes of investors, some of which have rights only to a specific investment or groups of investments or which have different proportionate shares of the net assets, does not preclude an entity from being an investment entity.

B85W In addition, an entity that has significant ownership interests in the form of debt that, in accordance with other applicable HKFRSs, does not meet the definition of equity, may still qualify as an investment entity, provided that the debt holders are exposed to variable returns from changes in the fair value of the entity's net assets.

In Appendix B, a heading and paragraphs B100–B101 are added.

Accounting for a change in investment entity status

B100 When an entity ceases to be an investment entity, it shall apply HKFRS 3 to any subsidiary that was previously measured at fair value through profit or loss in accordance with paragraph 31. The date of the change of status shall be the deemed acquisition date. The fair value of the subsidiary at the deemed acquisition date shall represent the transferred deemed consideration when measuring any goodwill or gain from a bargain purchase that arises from the deemed acquisition. All subsidiaries shall be consolidated in accordance with paragraphs 19–24 of this HKFRS from the date of change of status.

B101 When an entity becomes an investment entity, it shall cease to consolidate its subsidiaries at the date of the change in status, except for any subsidiary that shall continue to be consolidated in accordance with paragraph 32. The investment entity shall apply the requirements of paragraphs 25 and 26 to those subsidiaries that it ceases to consolidate as though the investment entity had lost control of those subsidiaries at that date.

In Appendix C, new paragraph C1B is added.

C1B *Investment Entities* (Amendments to HKFRS 10, HKFRS 12 and HKAS 27 (2011)), issued in December 2012, amended paragraphs 2, 4, C2A, C6A and Appendix A and added paragraphs 27–33, B85A–B85W, B100–B101 and C3A–C3F. An entity shall apply those amendments for annual periods beginning on or after 1 January 2014. Early application is permitted. If an entity applies those amendments earlier, it shall disclose that fact and apply all amendments included in *Investment Entities* at the same time.

In Appendix C, paragraph C2A is amended. New text is underlined.

C2A Notwithstanding the requirements of paragraph 28 of HKAS 8, when this HKFRS is first applied, <u>and, if later, when the *Investment Entities* amendments to this HKFRS are first applied,</u> an entity need only present the quantitative information required by paragraph 28(f) of HKAS 8 for the annual period immediately preceding the date of initial application of this HKFRS (the 'immediately preceding period'). An entity may also present this information for the current period or for earlier comparative periods, but is not required to do so.

In Appendix C, new paragraphs C3A–C3F are added.

C3A At the date of initial application, an entity shall assess whether it is an investment entity on the basis of the facts and circumstances that exist at that date. If, at the date of initial application, an entity concludes that it is an investment entity, it shall apply the requirements of paragraphs C3B–C3F instead of paragraphs C5–C5A.

C3B Except for any subsidiary that is consolidated in accordance with paragraph 32 (to which paragraphs C3 and C6 or paragraphs C4–C4C, whichever is relevant, apply), an investment entity shall measure its investment in each subsidiary at fair value through profit or loss as if the requirements of this HKFRS had always been effective. The investment entity shall retrospectively adjust both the annual period that immediately precedes the date of initial application and equity at the beginning of the immediately preceding period for any difference between:

(a) the previous carrying amount of the subsidiary; and

(b) the fair value of the investment entity's investment in the subsidiary.

The cumulative amount of any fair value adjustments previously recognised in other comprehensive income shall be transferred to retained earnings at the beginning of the annual period immediately preceding the date of initial application.

C3C Before the date that HKFRS 13 *Fair Value Measurement* is adopted, an investment entity shall use the fair value amounts that were previously reported to investors or to management, if those amounts represent the amount for which the investment could have been exchanged between knowledgeable, willing parties in an arm's length transaction at the date of the valuation.

C3D If measuring an investment in a subsidiary in accordance with paragraphs C3B–C3C is impracticable (as defined in HKAS 8), an investment entity shall apply the requirements of this HKFRS at the beginning of the earliest period for which application of paragraphs C3B–C3C is practicable, which may be the current period. The investor shall retrospectively adjust the annual period that immediately precedes the date of initial application, unless the beginning of the earliest period for which application of this paragraph is practicable is the current period. If this is the case, the adjustment to equity shall be recognised at the beginning of the current period.

C3E If an investment entity has disposed of, or has lost control of, an investment in a subsidiary before the date of initial application of this HKFRS, the investment entity is not required to make adjustments to the previous accounting for that subsidiary.

C3F If an entity applies the *Investment Entities* amendments for a period later than when it applies HKFRS 10 for the first time, references to 'the date of initial application' in paragraphs C3A–C3E shall be read as 'the beginning of the annual reporting period for which the amendments in *Investment Entities* (Amendments to HKFRS 10, HKFRS 12 and HKAS 27), issued in December 2012, are applied for the first time.'

In Appendix C, paragraph C6A is amended. New text is underlined and deleted text is struck through.

C6A Notwithstanding the references to the annual period immediately preceding the date of initial application (the 'immediately preceding period') in paragraphs <u>C3B</u>~~C4~~–C5A, an entity may also present adjusted comparative information for any earlier periods presented, but is not required to do so. If an entity does present adjusted comparative information for any earlier periods, all references to the 'immediately preceding period' in paragraphs C3B~~C4~~–C5A shall be read as the 'earliest adjusted comparative period presented'.

Consequential amendments to other Standards

HKFRS 3 *Business Combinations*

In the Introduction, paragraph IN6 is amended. New text is underlined.

IN6 A business combination must be accounted for by applying the acquisition method, unless it is a combination involving entities or businesses under common control or the acquiree is a subsidiary of an investment entity, as defined in HKFRS 10 *Consolidated Financial Statements*, which is required to be measured at fair value through profit or loss. …

HKAS 7 *Statement of Cash Flows*

In the rubric 'paragraphs 1–57' is amended to 'paragraphs 1–58'.

HKAS 34 *Interim Financial Reporting*

In the rubric 'paragraphs 1–53' is amended to 'paragraphs 1–54'.

HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards*

Paragraph 39T is added.

39T *Investment Entities* (Amendments to HKFRS 10, HKFRS 12 and HKAS 27 (2011)), issued in December 2012, amended paragraphs D16, D17 and Appendix C and added a heading and paragraphs E6–E7. An entity shall apply those amendments for annual periods beginning on or after 1 January 2014. Earlier application of *Investment Entities* is permitted. If an entity applies those amendments earlier it shall also apply all amendments included in *Investment Entities* at the same time.

Appendix C is amended. New text is underlined.

This appendix is an integral part of the HKFRS. An entity shall apply the following requirements to business combinations that the entity recognised before the date of transition to HKFRSs. This Appendix should only be applied to business combinations within the scope of HKFRS 3 Business Combinations.

In Appendix D, paragraphs D16–D17 are amended. New text is underlined.

D16 If a subsidiary becomes a first-time adopter later than its parent, the subsidiary shall, in its financial statements, measure its assets and liabilities at either:

(a) the carrying amounts that would be included in the parent's consolidated financial statements, based on the parent's date of transition to HKFRSs, if no adjustments were made for consolidation procedures and for the effects of the business combination in which the parent acquired the subsidiary (this election is not available to a subsidiary of an investment entity, as defined in HKFRS 10, that is required to be measured at fair value through profit or loss); or

(b) …

D17 However, if an entity becomes a first-time adopter later than its subsidiary (or associate or joint venture) the entity shall, in its consolidated financial statements, measure the assets and liabilities of the subsidiary (or associate or joint venture) at the same carrying amounts as in the financial statements of the subsidiary (or associate or joint venture), after adjusting for consolidation and equity accounting adjustments and for the effects of the business combination in which the entity acquired the subsidiary. Notwithstanding this requirement, a non-investment entity parent shall not apply the exception to consolidation that is used by any investment entity subsidiaries.

In Appendix E, after paragraph E5, a heading and paragraphs E6–E7 are added.

Investment entities

E6 A first-time adopter that is a parent shall assess whether it is an investment entity, as defined in HKFRS 10, on the basis of the facts and circumstances that exist at the date of transition to HKFRSs.

E7 A first-time adopter that is an investment entity, as defined in HKFRS 10, may apply the transition provisions in paragraphs C3C–C3D of HKFRS 10 and paragraphs 18C–18G of HKAS 27 (2011) if its first HKFRS financial statements are for an annual period ending on or before 31 December 2014. The references in those paragraphs to the annual period that immediately precedes the date of initial application shall be read as the earliest annual period presented. Consequently, the references in those paragraphs shall be read as the date of transition to HKFRSs.

HKFRS 3 *Business Combinations*

Paragraph 7 is amended and paragraphs 2A and 64G are added. New text is underlined and deleted text is struck through.

2A The requirements of this Standard do not apply to the acquisition by an investment entity, as defined in HKFRS 10 *Consolidated Financial Statements*, of an investment in a subsidiary that is required to be measured at fair value through profit or loss.

7 The guidance in HKFRS 10 ~~*Consolidated Financial Statements*~~ shall be used to identify the acquirer …

64G *Investment Entities* (Amendments to HKFRS 10, HKFRS 12 and HKAS 27 (2011)), issued in December 2012, amended paragraph 7 and added paragraph 2A. An entity shall apply those amendments for annual periods beginning on or after 1 January 2014. Earlier application of *Investment Entities* is permitted. If an entity applies these amendments earlier it shall also apply all amendments included in *Investment Entities* at the same time.

HKFRS 7 *Financial Instruments: Disclosures*

Paragraph 3 is amended and paragraph 44X is added. New text is underlined and deleted text is struck through.

3 This HKFRS shall be applied by all entities to all types of financial instruments, except:

(a) those interests in subsidiaries, associates or joint ventures that are accounted for in accordance with HKFRS 10 *Consolidated Financial Statements*, HKAS 27 (2011) *Separate Financial Statements* or HKAS 28 (2011) *Investments in Associates and Joint Ventures*. However, in some cases, HKFRS 10, HKAS 27 (2011) or HKAS 28 (2011) require or permit~~s~~ an entity to account for an interest in a subsidiary, associate or joint venture using HKFRS 9; in those cases, entities shall apply the requirements of this HKFRS and, for those measured at fair value, the requirements of HKFRS 13 *Fair Value Measurement*. Entities shall also apply this HKFRS to all derivatives linked to interests in subsidiaries, associates or joint ventures unless the derivative meets the definition of an equity instrument in HKAS 32.

44X *Investment Entities* (Amendments to HKFRS 10, HKFRS 12 and HKAS 27 (2011)), issued in December 2012, amended paragraph 3. An entity shall apply that amendment for annual periods beginning on or after 1 January 2014. Earlier application of *Investment Entities* is permitted. If an entity applies that amendment earlier it shall also apply all amendments included in *Investment Entities* at the same time.

HKAS 7 *Statement of Cash Flows*

Paragraphs 42A and 42B are amended and paragraphs 40A and 58 are added. New text is underlined and deleted text is struck through.

40A An investment entity, as defined in HKFRS 10 *Consolidated Financial Statements*, need not apply paragraphs 40(c) or 40(d) to an investment in a subsidiary that is required to be measured at fair value through profit or loss.

42A Cash flows arising from changes in ownership interests in a subsidiary that do not result in a loss of control shall be classified as cash flows from financing activities, unless the subsidiary is held by an investment entity, as defined in HKFRS 10, and is required to be measured at fair value through profit or loss.

42B Changes in ownership interests in a subsidiary that do not result in a loss of control, such as the subsequent purchase or sale by a parent of a subsidiary's equity instruments, are accounted for as equity transactions (see HKFRS 10 ~~*Consolidated Financial Statements*~~), unless the subsidiary is held by an investment entity and is required to be measured at fair value through profit or loss. Accordingly, the resulting cash flows are classified in the same way as other transactions with owners described in paragraph 17.

58 *Investment Entities* (Amendments to HKFRS 10, HKFRS 12 and HKAS 27(2011)), issued in December 2012, amended paragraphs 42A and 42B and added paragraph 40A. An entity shall apply those amendments for annual periods beginning on or after 1 January 2014. Earlier application of *Investment Entities* is permitted. If an entity applies those amendments earlier it shall also apply all amendments included in *Investment Entities* at the same time.

HKAS 12 *Income Taxes*

Paragraphs 58 and 68C are amended and paragraph 98C is added. New text is underlined

58 Current and deferred tax shall be recognised as income or an expense and included in profit or loss for the period, except to the extent that the tax arises from:

(a) …

(b) a business combination (other than the acquisition by an investment entity, as defined in HKFRS 10 *Consolidated Financial Statements*, of a subsidiary that is required to be measured at fair value through profit or loss) (see paragraphs 66 to 68).

68C As noted in paragraph 68A, the amount of the tax deduction (or estimated future tax deduction, measured in accordance with paragraph 68B) may differ from the related cumulative remuneration expense. Paragraph 58 of the Standard requires that current and deferred tax should be recognised as income or an expense and included in profit or loss for the period, except to the extent that the tax arises from (a) a transaction or event that is recognised, in the same or a different period, outside profit or loss, or (b) a business combination (other than the acquisition by an investment entity of a subsidiary that is required to be measured at fair value through profit or loss). If the amount of the tax deduction (or estimated future tax deduction) exceeds the amount of the related cumulative remuneration expense, this indicates that the tax deduction relates not only to remuneration expense but also to an equity item. In this situation, the excess of the associated current or deferred tax should be recognised directly in equity.

98C *Investment Entities* (Amendments to HKFRS 10, HKFRS 12 and HKAS 27 (2011)), issued in December 2012, amended paragraphs 58 and 68C. An entity shall apply those amendments for annual periods beginning on or after 1 January 2014. Earlier application of *Investment Entities* is permitted. If an entity applies those amendments earlier it shall also apply all amendments included in *Investment Entities* at the same time.

HKAS 24 *Related Party Disclosures*

Paragraphs 4 and 9 are amended and paragraph 28B is added. New text is underlined.

4 Related party transactions and outstanding balances with other entities in a group are disclosed in an entity's financial statements. Intragroup related party transactions and outstanding balances are eliminated, except for those between an investment entity and its subsidiaries measured at fair value through profit or loss, in the preparation of consolidated financial statements of the group.

9 The terms 'control' and 'investment entity', 'joint control', and 'significant influence' are defined in HKFRS 10, HKFRS 11 *Joint Arrangements* and HKAS 28 (2011) *Investments in Associates and Joint Ventures* respectively and are used in this Standard with the meanings specified in those HKFRSs.

28B *Investment Entities* (Amendments to HKFRS 10, HKFRS 12 and HKAS 27 (2011)), issued in December 2012, amended paragraphs 4 and 9. An entity shall apply those amendments for annual periods beginning on or after 1 January 2014. Earlier application of *Investment Entities* is permitted. If an entity applies those amendments earlier it shall also apply all amendments included in *Investment Entities* at the same time.

HKAS 32 *Financial Instruments: Presentation*

Paragraph 4 is amended and paragraph 97N is added. New text is underlined and deleted text is struck through.

4 This Standard shall be applied by all entities to all types of financial instruments except:

(a) those interests in subsidiaries, associates or joint ventures that are accounted for in accordance with HKFRS 10 *Consolidated Financial Statements*, HKAS 27 (2011) *Separate Financial Statements* or HKAS 28 (2011) *Investments in Associates and Joint Ventures*. However, in some cases, HKFRS 10, HKAS 27 (2011) or HKAS 28 (2011) require or permit an entity to account for an interest in a subsidiary, associate or joint venture using HKFRS 9; in those cases, entities shall apply the requirements of this Standard. Entities shall also apply this Standard to all derivatives linked to interests in subsidiaries, associates or joint ventures.

97N *Investment Entities* (Amendments to HKFRS 10, HKFRS 12 and HKAS 27 (2011)), issued in December 2012, amended paragraph 4. An entity shall apply that amendment for annual periods beginning on or after 1 January 2014. Earlier application of *Investment Entities* is permitted. If an entity applies that amendment earlier it shall also apply all amendments included in *Investment Entities* at the same time.

HKAS 34 *Interim Financial Reporting*

Paragraph 16A is amended and paragraph 54 is added. New text is underlined.

16A In addition to disclosing significant events and transactions in accordance with paragraphs 15–15C, an entity shall include the following information, in the notes to its interim financial statements, if not disclosed elsewhere in the interim financial report. The information shall normally be reported on a financial year-to-date basis.

(a) …

(k) for entities becoming, or ceasing to be, investment entities, as defined in HKFRS 10 *Consolidated Financial Statements*, the disclosures in HKFRS 12 *Disclosure of Interests in Other Entities* paragraph 9B.

54 *Investment Entities* (Amendments to HKFRS 10, HKFRS 12 and HKAS 27 (2011)), issued in December 2012, added paragraph 16A. An entity shall apply that amendment for annual periods beginning 1 January 2014. Earlier application of *Investment Entities* is permitted. If an entity applies that amendment earlier it shall also apply all amendments included in *Investment Entities* at the same time.

HKAS 39 *Financial Instruments: Recognition and Measurement*

Paragraphs 2 and 80 are amended and paragraph 103R is added. New text is underlined and deleted text is struck through.

2 This Standard shall be applied by all entities to all types of financial instruments except:

(a) those interests in subsidiaries, associates and joint ventures that are accounted for in accordance with HKFRS 10 *Consolidated Financial Statements*, HKAS 27 (2011) *Separate Financial Statements* or HKAS 28 (2011) *Investments in Associates and Joint Ventures*. However, in some cases, HKFRS 10, HKAS 27 (2011) or HKAS 28 (2011) require or permit an entity to account for ~~entities shall apply this Standard to~~ an interest in a subsidiary, associate or joint venture ~~that according to HKAS 27 or HKAS 28 is accounted for under~~ in accordance with some or all of the requirements of this Standard. Entities shall also apply this Standard to derivatives on an interest in a subsidiary, associate or joint venture unless the derivative meets the definition of an equity instrument of the entity in HKAS 32 *Financial Instruments: Presentation*.

(b) …

(g) any forward contract between an acquirer and a selling shareholder to buy or sell an acquiree that will result in a business combination within the scope of HKFRS 3 *Business Combinations* at a future acquisition date. The term of the forward contract should not exceed a reasonable period normally necessary to obtain any required approvals and to complete the transaction.

80 … It follows that hedge accounting can be applied to transactions between entities in the same group only in the individual or separate financial statements of those entities and not in the consolidated financial statements of the group, except for the consolidated financial statements of an investment entity, as defined in HKFRS 10, where transactions between an investment entity and its subsidiaries measured at fair value through profit or loss will not be eliminated in the consolidated financial statements. …

103R *Investment Entities* (Amendments to HKFRS 10, HKFRS 12 and HKAS 27 (2011)), issued in December 2012, amended paragraphs 2 and 80. An entity shall apply those amendments for annual periods beginning on or after 1 January 2014. Earlier application of *Investment Entities* is permitted. If an entity applies those amendments earlier it shall also apply all amendments included in *Investment Entities* at the same time.

HKFRS 10 BC
Revised ~~July~~ December 2012

Basis for Conclusions on
Hong Kong Financial Reporting Standard 10

Consolidated Financial Statements

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

Appendix

Amendments to Basis for Conclusions on IFRS 10, IFRS 12 and IAS 27 – *Investment Entities*

This appendix contains amendments to the Basis for Conclusions on IFRS 10 that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Conclusions and this appendix will be deleted.

Paragraphs BC8 and BC206 are footnoted with the following text and the heading above paragraph BCZ22 and paragraphs BCZ22–BCZ28 are deleted.

Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27), issued in October 2012, introduced an exception to the principle that all subsidiaries shall be consolidated. The amendments define an investment entity and require a parent that is an investment entity to measure its investments in particular subsidiaries at fair value through profit or loss instead of consolidating those subsidiaries. These amendments are discussed in paragraphs BC215–BC317.

After paragraph BC214, headings and paragraphs BC215–BC317 are added.

Exception to consolidation for investment entities (2012 amendments)

Background

BC215 In October 2012, the Board issued *Investment Entities* (Amendments to IFRS 10, IFRS 12 and IAS 27), which provides an exception to consolidation for a class of entities that are defined as 'investment entities'. The Board added the Investment Entities project to its agenda in the course of its deliberations on IFRS 10 as a response to the comments received on ED 10.

BC216 The Board had considered this issue previously. In 2002, the respondents to the Exposure Draft of IAS 27 asked the Board to provide an exception to consolidation for the subsidiaries of venture capital organisations, private equity entities and similar organisations. At that time, the Board decided not to introduce such an exception because it did not think that it should differentiate between the types of entity, or the types of investment, when applying a control model of consolidation. It also did not agree that management's reasons for holding an investment should determine whether or not that investment is consolidated. The Board concluded that for investments under the control of venture capital organisations, private equity entities and similar organisations, users' information needs are best served by financial statements in which those investments are consolidated, thus revealing the extent of the operations of the entities they control.

BC217 The scope of the proposals in ED 10 was the same as the scope of the proposals in IAS 27. IAS 27 required reporting entities to consolidate all controlled entities, regardless of the nature of the reporting entity. Respondents to ED 10 questioned the usefulness of financial statements of investment entities that consolidate investees that the investment entity controls. They pointed out that some national accounting requirements, including United States Generally Accepted Accounting Principles (US GAAP), have historically provided industry–specific guidance that requires investment entities to measure all of their investments, including those that they control, at fair value. The respondents argued that an investment entity holds investments for the sole purpose of capital appreciation, investment income (such as dividends or interest), or both. Users of the financial statements of these investment entities told the Board that the fair value of the investments and an understanding of how the investment entity measures the fair value of its investments is the most useful information.

BC218 Furthermore, respondents to ED 10 argued that consolidated financial statements of an investment entity may hinder users' ability to assess an investment entity's financial position and results, because it emphasizes the financial position, operations and cash flows of the investee, rather than those of the investment entity. Often, an investment entity holds non-controlling interests in some entities that are reported at fair value, as well as controlling interests in other entities that are consolidated in accordance with current principles in IFRSs. Reporting investments on more than one basis hinders comparability within the financial statements, because all investments are held by an investment entity for a similar purpose—returns from capital appreciation, investment income, or both. In addition, some of the items consolidated may be measured at historical cost, which distorts the performance assessment of the investment entity and does not reflect the way in which the business of the entity is managed.

BC219 Respondents to ED 10 also argued that when an investment entity consolidates entities that it controls, it is not required to provide the disclosures related to fair value measurements that would be required if the subsidiaries were measured at fair value. For example, IFRS 7 *Financial Instruments: Disclosures* relates only to recognised financial assets and liabilities. There is no requirement to provide disclosures related to fair value for investments in consolidated subsidiaries. Information about fair value and the methodology and inputs used for determining fair value is vital for users to make investment decisions about investment entities. Investors in an investment entity are interested in the fair value of their interest in that entity and often transact with it on a fair value basis (ie their investment in the investment entity is based on a share of the net assets of that entity). Reporting the fair value of substantially all of the net assets of an investment entity allows the investors in that entity to more easily identify the value of their share of those net assets.

BC220 In response to this feedback, the Board published an Exposure Draft *Investment Entities* (*Investment Entities* ED) in August 2011. The *Investment Entities* ED proposed that investment entities would be required to measure their investments in subsidiaries (except those subsidiaries that provide investment–related services) at fair value through profit or loss in accordance with IFRS 9 *Financial Instruments* (or IAS 39, if IFRS 9 has not yet been adopted). The majority of respondents to the *Investment Entities* ED broadly supported the proposed exception to consolidation for the reasons outlined in paragraphs BC217–BC219.

BC221 The Board conducted its deliberations leading to the publication of the *Investment Entities* ED and the final investment entities requirements jointly with the FASB. The similarities and differences between the investment entities guidance in IFRS and US GAAP are discussed further in paragraphs BC289–BC291.

Scope of the project

BC222 The *Investment Entities* ED proposed a limited-scope exception to consolidation for investment entities. A number of respondents to the *Investment Entities* ED asked the Board to expand the scope of its proposals.

BC223 Some respondents asked the Board to expand the scope of the project to require an investment entity to measure all of its investments at fair value. However, the Board noted that, in most cases, existing IFRSs require or permit investments held by an investment entity to be measured at fair value. For example an entity:

(a) may elect the fair value option in IAS 40 *Investment Property*; and

(b) would be required to measure its financial assets at fair value through profit or loss in accordance with IFRS 9 (or IAS 39) when those assets are managed on a fair value basis.

Consequently, the Board decided to limit the scope of the project to only providing an exception to consolidation for investment entities.

BC224 Other respondents requested an extension of the proposed exception to consolidation. In particular, respondents from the insurance industry requested an exception to consolidating their interests in insurance investment funds. They argued that presenting the fair value of their interests in insurance investment funds as a single line item, along with a single line item for the current value of their liability to policyholders who receive the returns from those investment funds, would provide more useful information to users than consolidation. The Board noted that providing an exception to consolidation for insurers' interests in insurance investment funds is outside the scope of the Investment Entities project, which was meant to provide an exception to consolidation for investment entities. In addition, any additional exceptions to consolidation would require the Board to do further work to define the entities that could apply those exceptions. The Board noted that this additional exception to consolidation was not contemplated in the scope of the project nor was it exposed for comment. Consequently, the Board decided not to extend the proposed exception to consolidation.

BC225 Other respondents asked the Board to provide guidance permitting an investor in an investment entity to use the reported net asset value (NAV) per share of that investment entity as a practical expedient for measuring the fair value of its investment in that investment entity. Similar guidance exists in US GAAP. The Board considered providing such a practical expedient in their deliberations on IFRS 13 *Fair Value Measurement* but decided against it because, at the time, there was no specific accounting guidance for investment entities in IFRS and because there are different practices for calculating NAVs in jurisdictions around the world. The Board decided that it is outside the scope of the Investment Entities project to provide fair value measurement guidance for investments in investment entities. The Board developed the definition of an investment entity to identify which entities should qualify for an exception to consolidation. The definition was not designed to decide which entities should qualify for a fair value measurement practical expedient. Moreover, the Board still has concerns that NAV could be calculated differently in different jurisdictions. Consequently, the Board decided not to provide an NAV practical expedient for fair value measurement as part of the Investment Entities project.

BC226 The Board has decided to adopt an entity-based approach to the exception to consolidation. That is, the exception to consolidation is based on the type of entity that owns the subsidiary. The Board considered providing an asset-based approach to the exception to consolidation. Under an asset-based approach, an entity would consider its relationship with, and the characteristics of, each of its subsidiaries (that is, each individual asset) to decide whether fair value measurement is more appropriate than consolidation. However, the Board decided to retain the entity-based exception to consolidation that was proposed in the *Investment Entities* ED. The Board was concerned that an asset-based approach would significantly broaden the exception to consolidation by making the exception available to any entity holding relevant assets. This would represent a significant conceptual change to the consolidation model that the Board has developed in this IFRS. In addition, the Board believes that investment entities have a unique business model that makes reporting subsidiaries at fair value more appropriate than consolidation. An entity-based approach captures the unique business model of investment entities.

BC227 The Board also considered providing an option to allow investment entities to either consolidate subsidiaries or measure them at fair value through profit or loss. However, the Board believes that providing this option would be inconsistent with their view that fair value information is the most relevant information for all investment entities. Moreover, providing an option would reduce comparability between different investment entities. Consequently, the Board decided that an investment entity should be required to measure its subsidiaries at fair value through profit or loss.

Approach to assessing investment entity status

BC228 In the *Investment Entities* ED, the Board proposed six criteria that must be met in order for an entity to qualify as an investment entity. These criteria were based on guidance in US GAAP (Topic 946 *Financial Services— Investment Companies* in the *FASB Accounting Standards Codification*®).

BC229 Many respondents expressed concern that requiring an entity to meet all six criteria proposed in the *Investment Entities* ED would be too prescriptive. They thought that the proposed criteria inappropriately focused on the structure of an investment entity rather than on its business model and did not allow for the use of judgement in determining whether an entity is an investment entity. These respondents stated that a less prescriptive approach to assessing the criteria would result in more consistent reporting by entities with similar business models.

BC230 In addition, many respondents argued that the six proposed criteria in the *Investment Entities* ED did not provide a general description of an investment entity and an explanation of why fair value measurement is more relevant for the subsidiaries of an investment entity. Because the concept of an investment entity is new to IFRS, those respondents argued that the guidance should include a more general definition of an investment entity (rather than merely criteria to be an investment entity) and a justification for the exception to consolidation.

BC231 In response to the comments from respondents, the Board decided to provide a definition of an investment entity based on some of the criteria originally proposed in the *Investment Entities* ED. An entity that meets the definition of an investment entity would not consolidate its controlled subsidiaries (other than those subsidiaries that provide investment-related services or activities).

BC232 The Board agreed with respondents who stated that some of the proposed criteria were too strict and would inappropriately exclude some structures from qualifying as investment entities. The Board believes that there are structures in practice in which an entity does not meet one or more of the criteria that were described in the *Investment Entities* ED, but should still qualify as an investment entity. For example, the *Investment Entities* ED required an investment entity to have more than one investor; the Board thinks that some pension funds, sovereign wealth funds, and other investment funds with a single investor should qualify as investment entities. Moreover, respondents commented that the application guidance in the *Investment Entities* ED provided too many exceptions to the strict criteria.

BC233 Consequently, the Board decided that an entity would not be required to satisfy the remaining criteria to meet the definition of an investment entity and qualify for the exception to consolidation. However, the Board noted that the remaining criteria represent typical characteristics of an investment entity and decided to include these typical characteristics in the investment entities guidance to help entities determine whether they qualify as an investment entity. If an entity does not display one or more of the typical characteristics, it indicates that additional judgement is required in determining whether the entity meets the definition of an investment entity. Consequently, the Board also decided that an investment entity that does not have one or more of the typical characteristics would be required to disclose how it still meets the definition of an investment entity.

BC234 The Board thinks that it is very unlikely that an entity that displays none of the typical characteristics of an investment entity would meet the definition of one. However, it may be possible in rare circumstances. For example, a pension fund that has a single investor and does not issue equity ownership interests could qualify as an investment entity even if it only holds a single investment temporarily (eg at commencement or wind-down of the entity).

BC235 The Board believes that defining an investment entity and describing its typical characteristics achieves a balance between clearly defining those entities that qualify for the exception to consolidation and avoiding the use of bright lines. In addition, this approach allows the definition to stand on its own, with application guidance providing clarification rather than exceptions.

Definition of an investment entity

BC236 The definition of an investment entity has three essential elements that differentiate investment entities from other types of entities.

Investment management services

BC237 The Board noted that one of the essential activities of an investment entity is that it obtains funds from investors in order to provide those investors with investment management services. The Board believes that this provision of investment management services differentiates investment entities from other entities. Consequently, the Board decided that the definition of an investment entity should state that an investment entity obtains funds from an investor or investors and provides the investor(s) with investment management services.

Business purpose

BC238 The Board believes that an entity's activities and business purpose are critical to determining whether it is an investment entity. An investment entity collects funds from investors and invests those funds to obtain returns solely from capital appreciation, investment income, or both. Consequently, the Board decided that the definition of an investment entity should state that an investment entity commits to its investor(s) that its business purpose is to provide investment management services and invest funds solely for returns from capital appreciation, investment income, or both.

BC239 The *Investment Entities* ED did not allow an entity to qualify as an investment entity if it provided substantive investment-related services to third parties. While some respondents agreed with this, others argued that an investment entity should be allowed to provide such services to third parties. They argued that the provision of these investment-related services to third parties is simply an extension of the investment entity's investing activities and should not prohibit an entity from qualifying as an investment entity. The Board agreed with these arguments, concluding that the provision of such services is within the business model of an investment entity. Although such an entity may earn fee income from the provision of investment-related services, its sole business purpose is still investing for capital appreciation, investment income, or both (whether that is for itself, for its investors or for external parties).

BC240 The Board noted that an investment entity may sometimes hold an interest in a subsidiary that provides investment-related services for its investment activities. The Board did not think that the existence of such a subsidiary should prohibit an entity from qualifying as an investment entity, even if those services were substantial or were provided to third parties in addition to the entity. The Board views such services as an extension of the operations of the investment entity and therefore concluded that subsidiaries that provide those services should be consolidated.

BC241 The Board considered prohibiting investment entities from engaging in some activities, such as providing financial support to its investees or actively managing its investees. However, the Board understands that an investment entity may engage in these activities in order to maximise the overall value of the investee (ie to maximise capital appreciation), rather than to obtain other benefits. Consequently, the Board believes that these activities can be consistent with the overall activities of an investment entity and should not be prohibited as long as they do not represent a separate substantial business activity or source of income other than capital appreciation.

BC242 The Board was concerned that an entity that meets the definition of an investment entity could be inserted into a larger corporate structure to achieve a particular accounting outcome. For example, a parent entity could use an 'internal' investment entity subsidiary to invest in subsidiaries that may be making losses (eg research and development activities on behalf of the overall group) and would record its investments at fair value, rather than reflecting the underlying activities of the investee. To address these concerns and to emphasise the business purpose of an investment entity, the Board decided to include a requirement that an investment entity, or other members of the group containing the entity, should not obtain benefits from its investees that would be unavailable to other parties that are not related to the investee. In the Board's view, this is one of the factors that differentiate an investment entity from a non-investment entity holding company. If an entity or another member of the group containing the entity obtains benefits from its investees that are unavailable to other investors, then the investment will benefit that entity or the group in some operating or strategic capacity and the entity will therefore not qualify as an investment entity.

BC243 However, the Board also clarified that an investment entity may have more than one investment in the same industry, market or geographical area in order to benefit from synergies that increase the capital appreciation of those investments. It noted that such a fact pattern may be common in the private equity industry. Some Board members expressed concern that allowing transactions or synergies between investments may artificially increase the fair value of each investment and, consequently, inappropriately increase the assets reported by the investment entity. However, the Board decided that trading transactions or synergies that arise between the investments of an investment entity should not be prohibited because their existence does not necessarily mean that the investment entity is receiving any returns beyond solely capital appreciation, investment income, or both.

Exit strategy

BC244 The Board believes that a parent with operating subsidiaries often plans to own and operate its subsidiaries indefinitely to realise returns from those operations. However, the Board does not think that an entity that holds its investments indefinitely, especially its subsidiaries, should qualify as an investment entity. Accordingly, the Board considered requiring an exit strategy for substantially all investments held by an investment entity, including debt investments.

BC245 However, respondents to the *Investment Entities* ED noted that some investment funds that would otherwise qualify as investment entities may hold a significant amount of debt investments to maturity and therefore would not have an exit strategy for those debt investments. For example, the Board understands that, in some cases, private equity funds may make both debt and equity investments in their investees. The debt investments may have shorter maturities than the anticipated term of the fund's equity investment and may be held to maturity. Moreover, an investment entity may hold debt instruments to maturity to manage liquidity risk or to mitigate the risk from holding other types of more volatile investments. Although the entity does not have an exit strategy for these debt investments, it does not plan to hold them indefinitely— even if the entity does not plan to sell these investments before maturity, the vast majority of debt investments have a limited life.

BC246 The Board decided that such an entity should not be prohibited from qualifying as an investment entity, provided that substantially all of its investments (including debt investments) are measured at fair value. The Board noted that debt investments may be measured at fair value in accordance with IFRS 9 or IAS 39 even in the absence of an exit strategy.

BC247 However, the Board decided that an investment entity must have an exit strategy for substantially all of its investments that can be held indefinitely (typically equity investments and non-financial assets). The Board does not think it is appropriate for an entity to qualify for an exception to consolidation if that entity is holding equity investments indefinitely and is not planning to realise capital appreciation from those investments. Although the exit strategy may vary depending on circumstances, potential exit strategies that include a substantive time frame for exiting from the investment should still be identified and documented for equity and non-financial investments in order to meet the definition of an investment entity.

BC248 The Board noted that an entity may fail to meet this component of the definition of an investment entity if it is formed in connection with an investment entity investee for legal, regulatory, tax or similar business reasons (eg a 'blocker' entity or a 'master-feeder' structure), and that that investee holds investments on behalf of the entity. The Board decided that the entity should not be prohibited from qualifying as an investment entity merely because it does not have an exit strategy for the investee, if that investee qualifies as an investment entity and has appropriate exit strategies for its own investments.

Fair value measurement

BC249 In the development of IFRS 10 and the *Investment Entities* ED, the Board heard that fair value information is the primary driver of the decisionmaking processes both of the management of, and the investors in, investment entities. Many respondents stated that both management and investors evaluate the performance of an investment entity by reference to the fair value of its investments. The Board heard that some investors in investment entities disregard the consolidated financial statements of investment entities and instead rely on non-GAAP fair value reports.

BC250 The basis for the exception to consolidation that is provided to investment entities is that fair value information is the most relevant for an investment entity's investments, including its investments in subsidiaries. The Board therefore decided that an essential feature of the definition of an investment entity is that the entity would use existing IFRS requirements or accounting policy options to measure substantially all of its investments at fair value. The Board does not think that an entity that fails to elect the fair value measurement options available in IAS 28 *Investments in Associates and Joint Ventures* or IAS 40, or that accounts for more than an insignificant amount of its financial assets at amortised cost under IFRS 9 or IAS 39, should qualify as an investment entity.

BC251 The Board noted that some investments may be measured at fair value in the statement of financial position, with fair value changes recognised in other comprehensive income rather than through profit or loss, and agreed that this would satisfy the fair value measurement element of the definition of an investment entity.

BC252 The Board considers that a significant distinguishing characteristic of an investment entity is that investors in an investment entity are primarily interested in fair value and make their investing decisions based on the fair value of the investment entity's underlying investments. The Board notes that this is partly because, in many cases, investors in an investment entity transact with it on a fair value basis (for example, on the basis of a net asset value per share, which is calculated using the fair value of the entity's underlying investments). Similarly, the Board believes that fair value should also be used by an investment entity's key management personnel to assess the entity's performance and to make investing decisions. Consequently, the Board decided that, in order to meet the definition of an investment entity, an entity should demonstrate that fair value is the primary measurement attribute used to evaluate the performance of its investments, both internally and externally.

Regulatory requirements

BC253 The Board considered whether to include a reference to regulatory requirements in the definition of an investment entity. The Board noted that the FASB proposed, in their own Exposure Draft, that any entity that was regulated as an investment company under the US Securities and Exchange Commission's Investment Company Act of 1940 would automatically be considered to be an investment company for US GAAP financial reporting purposes. Some respondents to the Board's *Investment Entities* ED also asked the Board to include a reference to regulatory requirements in the definition of an investment entity, which would allow any entity regulated as an investment entity to fall within the scope of the investment entity requirements.

BC254 However, the Board was concerned that:

(a) the regulatory requirements in different jurisdictions may result in similar entities qualifying as an investment entity in one jurisdiction but not in another;

(b) regulatory requirements may change over time, resulting in an ever-changing population of entities that would be eligible for an exception to consolidation; and

(c) it would have no control over which entities would qualify for the exception to consolidation.

Consequently, the Board decided not to reference regulatory requirements in the definition of an investment entity.

Typical characteristics of investment entities

BC255 The Board identified several 'typical characteristics' of an investment entity. The Board decided that these typical characteristics could be used to help an entity decide if it meets the definition of an investment entity. The absence of any of these typical characteristics may indicate that an entity does not meet the definition of an investment entity. However, an entity that does not display all of these typical characteristics could, nevertheless, meet the definition of an investment entity.

BC256 The Board identified the following typical characteristics of an investment entity:

(a) more than one investment (paragraphs BC257–BC258);

(b) more than one investor (paragraphs BC259–BC260);

(c) unrelated investors (paragraphs BC261–BC262); and

(d) ownership interests (paragraphs BC263–BC267).

More than one investment

BC257 The *Investment Entities* ED proposed that an investment entity should hold more than one investment. However, respondents provided examples of entities that they believed should qualify as investment entities, but that only hold a single investment. These included single investment funds set up because the required minimum investment is too high for individual investors, or investment funds that hold a single investment temporarily.

BC258 The Board agreed with these arguments and therefore decided that an investment entity would not be required to hold more than one investment. However, the Board understands that investment entities typically invest in more than one investment as a means of diversifying their portfolio and maximising their returns. Consequently, investing in more than one investment is described as a typical characteristic of an investment entity in this IFRS.

More than one investor

BC259 The presence of more than one investor was originally proposed as a requirement in the *Investment Entities* ED. However, respondents provided many examples of investment funds with a single investor. These included funds that temporarily have a single investor, government-owned investment funds, funds wholly-owned by pension plans and endowments, and funds set up by an investment manager for an unrelated single investor with a unique investment strategy.

BC260 The Board does not think that there is a conceptual reason why an investment fund with a single investor should be disqualified from being an investment entity. However, the Board thinks that having more than one investor would make it less likely that the entity, or other members of the group that contains the entity, would obtain benefits other than capital appreciation or investment income from its investment. Consequently, the Board decided to include the presence of more than one investor as a typical characteristic of an investment entity rather than as part of the definition of an investment entity.

Unrelated investors

BC261 The *Investment Entities* ED proposed that an investment entity be required to have investors that are unrelated to the entity or its parent (if any), partly to prevent entities from structuring around the requirement to have more than one investor. However, respondents provided examples of entities with related investors that they believed should qualify as investment entities. For example, a separate 'parallel' entity may be formed to allow the employees of an investment entity to invest in a fund that mirrors the investments in the main fund. The Board agreed with the respondents' arguments and decided that an investment entity would not be required to have investors that are unrelated to the investment entity or to other members of the group that contains the investment entity.

BC262 However, the Board understands that investment entities typically have unrelated investors. Again, having unrelated investors is one way to help ensure that the entity, or another member of the group that contains the entity, does not receive returns from investments that are other than capital appreciation or investment income. Having investors that are unrelated to the entity or its parent (if any), is therefore described as a typical characteristic of an investment entity in this IFRS.

Ownership interests

BC263 An investment entity would typically have ownership interests in the form of equity or similar (eg partnership) interests that entitle investors to a proportionate share of the net assets of the investment entity. This characteristic explains in part why fair value is more relevant to investment entity investors: each unit of ownership in the investment entity entitles an investor to a proportionate share of the net assets of that investment entity. The value of each ownership interest is linked directly to the fair value of the investment entity's investments.

BC264 However, the Board believes that this form of ownership interests in an entity should not be the deciding factor as to whether it is an investment entity. Respondents provided examples of entities that do not have units of ownership in the form of equity or similar interests but provide investors with a proportionate share of their net assets. For example, a pension fund or sovereign wealth fund with a single direct investor may have beneficiaries that are entitled to the net assets of the investment fund, but do not have ownership units. In addition, respondents noted that funds with different share classes or funds in which investors have discretion to invest in individual assets would be disqualified from investment entity status because they did not provide each investor with a proportionate share of net assets.

BC265 The Board does not believe that an entity that provides its investors only a return of their investment plus interest should qualify as an investment entity. Fair value information is more relevant to investors that are entitled to a specifically identifiable portion of the investment entity's net assets and are, therefore, exposed to the upside and downside of the investment entity's performance.

BC266 However, the Board agreed that the requirement proposed in the *Investment Entities* ED (that an investment entity's ownership interests entitle investors to a proportionate share of its net assets) would have inappropriately excluded certain structures from investment entity status. As an alternative, the Board considered requiring that an investment entity's ownership interests be in the form of equity or similar interests. However, the Board was concerned that this would put too much emphasis on the debt/equity classification in IAS 32 *Financial Instruments: Presentation* and would inappropriately exclude some structures whose ownership interests were classified as debt. Moreover, the Board was also concerned that including the 'ownership interest' concept as part of the definition of an investment entity would put too much emphasis on the form of the entity, rather than emphasising its business model.

BC267 Consequently, the Board decided not to include ownership interests as part of the definition of an investment entity but that it should instead be regarded as a typical characteristic of an investment entity.

Reassessment and change of status

BC268 The Board included guidance in the *Investment Entities* ED on reassessing investment entity status. A few respondents asked the Board to clarify this guidance.

BC269 In the *Investment Entities* ED, the Board proposed that an entity would reassess its investment entity status whenever facts or circumstances changed. The Board decided to retain this requirement unchanged because it is consistent with the requirements for reassessment elsewhere in IFRS, including the general reassessment requirements in IFRS 10. The Board noted that they do not believe that the reassessment of facts and circumstances in other situations is considered unduly onerous for preparers or their auditors.

BC270 The Board decided that, when an entity loses investment entity status, it should account for that change as a 'deemed acquisition'. That is, the investment entity would use the fair value of the investment at the date of the change of status as the 'deemed' consideration transferred to obtain control of the investee. This recognises the change in status in the same way as a business combination achieved in stages, as described in IFRS 3. This would result in the recognition of goodwill or a gain on a bargain purchase.

BC271 The Board also decided that, when an entity becomes an investment entity, the entity should account for the change in status as a 'deemed disposal' or 'loss of control' of its subsidiaries. The fair value of the investment at the date of the change of status should be used as the consideration received when applying the guidance in IFRS 10. The Board considered how to account for the gain or loss on the 'deemed disposal' and decided to recognise it as a gain or loss in profit or loss. This treats the change in the business purpose of the investor as a significant economic event and is consistent with the rationale for gains and losses being recognised in profit or loss in IFRS 10 when control is lost.

Parent of an investment entity

Investment entity parent of an investment entity subsidiary

BC272 The *Investment Entities* ED proposed that an investment entity would measure all of its subsidiaries at fair value (except for those subsidiaries providing investment-related services), even those investees who were themselves investment entities. Some respondents questioned this proposal and suggested that at least some investment entity subsidiaries should be consolidated (for example, wholly-owned investment entity subsidiaries that are created for legal, tax or regulatory purposes). However, the Board thinks that fair value measurement of all an investment entity's subsidiaries (except for those subsidiaries providing investment-related services or activities) would provide the most useful information and therefore decided to retain this proposal. The Board considered requiring an investment entity to consolidate only those investment entity subsidiaries that are formed for legal, tax or regulatory purposes, but decided against this because there is no conceptual basis for distinguishing between different investment entity subsidiaries. Moreover, the Board thinks that it would be very difficult to distinguish between an investment entity subsidiary formed for a specific legal, tax or regulatory purpose and those that are set up only for other business reasons.

BC273 The Board considered whether it should require certain investment entity parents to attach the financial statements of their investment entity subsidiaries to the parent's financial statements. Some respondents argued that it would be essential for users of the financial statements of an investment entity parent to have information about the underlying investments of its investment entity subsidiary, particularly when the investment entity parent has only one investment entity subsidiary (eg 'master-feeder funds').

BC274 However, the Board decided against requiring financial statements of an investment entity subsidiary to be attached to the financial statements of an investment entity parent. The Board believed that it would be difficult to define which types of structures should be covered by such a requirement. Moreover, the Board thought that such a requirement would be inconsistent with the proposal that fair value information is always the most relevant information for investment entities.

Non-investment entity parent of an investment entity subsidiary

BC275 The Board also considered whether to retain investment entity accounting in the financial statements of a non-investment entity parent. In the *Investment Entities* ED, the Board proposed that a non-investment entity parent of an investment entity subsidiary would be required to consolidate all of its subsidiaries; that is, the exception to consolidation available to an investment entity would not be available to its non-investment entity parent.

BC276 The Board noted that the majority of respondents disagreed with the proposal, arguing that if fair value information is more relevant than consolidation at an investment entity subsidiary level, it is also more relevant information at the non-investment entity parent level.

BC277 The Board acknowledged the comments received but decided to retain the proposal to require all non-investment entity parents to consolidate all of their subsidiaries.

BC278 The Board has decided to provide an exception to consolidation because of the unique business model of investment entities. Non-investment entities do not have this unique business model; they have other substantial activities besides investing, or do not manage substantially all of their assets on a fair value basis. Consequently, the argument for a fair value measurement requirement is weakened at a non-investment entity level.

BC279 The Board also noted that the decision to define an investment entity and describe its typical characteristics rather than requiring an investment entity to meet a number of criteria has increased the population of entities that could qualify as investment entities, and has also increased the amount of judgement needed to determine whether an entity is an investment entity. For example, an entity with a single investor, or an entity that provides day-to-day management services or strategic advice to its subsidiary, can qualify as an investment entity under this IFRS, when such entities would have been excluded under the *Investment Entities* ED.

BC280 The Board was concerned that some of these changes would increase the likelihood that a non-investment entity parent could achieve different accounting outcomes by holding subsidiaries directly or indirectly through an investment entity. The Board noted that, for example, a noninvestment entity parent may elect to hold subsidiaries through an investment entity subsidiary in order to hide leverage or loss-making activities.

BC281 In addition, the Board considered the practical difficulties in retaining the exception to consolidation when a non-investment entity parent and an investment entity subsidiary invest in the same investment or when an investment entity subsidiary holds a subsidiary that invests in the equity of a non-investment entity parent.

BC282 The Board noted that the retention of the specialised accounting used by an investment company subsidiary at a non-investment company level is a long-standing requirement in US GAAP. However, US GAAP has industry-specific guidance for a number of industries, and the application of that industry-specific guidance by a subsidiary is retained by a parent entity, regardless of whether the parent entity is part of that industry. IFRSs generally do not contain such industry-specific guidance.

BC283 Some respondents to the *Investment Entities* ED noted that not retaining the fair value accounting of an investment entity subsidiary in its noninvestment entity parent's financial statements seems inconsistent with IAS 28 *Investments in Associates and Joint Ventures*. IAS 28 allows a parent that indirectly holds an investment in an associate through a venture capital organisation, mutual fund, unit trust or similar entity to measure that portion of the investment at fair value through profit or loss in accordance with IFRS 9 or IAS 39. The Board acknowledged the inconsistency but thought it was important to keep the retention of fair value accounting that is currently allowed for venture capital organisations, mutual funds, unit trusts and similar entities. The Board also noted that the difference between using the equity method and fair value measurement for investments in associates and joint ventures is smaller than that between consolidation and fair value measurement for investments in subsidiaries.

Transition

BC284 The Board proposed in the *Investment Entities* ED that the exception to consolidation should be applied prospectively. Some respondents disagreed with the proposal, arguing that retrospective application would result in more useful information. In addition, they noted that retrospective application should not be onerous because investment entities would be expected to have information about the fair value of their investments. Those respondents also argued that retrospective application would be consistent with the other transition requirements in IFRS 10.

BC285 The Board agreed with these arguments and decided to require retrospective application of the exception to consolidation, subject to specific transition reliefs, such as:

(a) a relief for when it is impracticable to identify the fair value of investments;

(b a relief for when an investment entity disposes of investments prior to the date of initial application; and

(c) a relief from providing comparative information for more than one period preceding the date of initial application.

BC286 The Board also noted that entities that adopt these amendments early may not have adopted IFRS 13, which has an effective date of 1 January 2013. Consequently, the Board decided that when an investment entity has not yet adopted IFRS 13, it may use the fair value amounts previously reported to investors or to management, as long as those amounts represent the amount for which the investment could have been exchanged between knowledgeable, willing parties in an arm's length transaction at the date of the valuation. The Board noted that if previously used fair value measurements are not available, it may be impracticable to measure fair value without using hindsight. In such cases, transition relief is available.

BC287 The Board also decided to require first-time adopters to apply the requirements retrospectively, subject to specific transition reliefs.

Effective date and early application

BC288 The Board decided on a 1 January 2014 effective date for the requirements for investment entities. The Board noted that because these requirements provide an exception to consolidation, they should have the same effective date as the revised consolidation requirements in IFRS 10 (annual periods beginning on or after 1 January 2013). However, given that the investment entities requirements were published in October 2012, the Board did not believe that a 1 January 2013 effective date would give adequate time for implementation between the publication and effective dates. However, the Board decided to permit early application of the investment entity requirements. The Board noted that it expects many entities to apply the requirements early. Some investments in subsidiaries may not have been consolidated in accordance with IAS 27 and SIC-12 but, without the exception to consolidation, would need to be consolidated in accordance with IFRS 10. The Board noted that it would be potentially confusing to users of financial statements and time-consuming for the investment entity to consolidate a subsidiary in one accounting period and then carry the same investee at fair value in the following period. In addition, investment entities should already have the fair value information needed for implementation. Finally, the exception to consolidation has been a long-standing request from the investment entity industry. Consequently, the Board believes that many investment entities will want to adopt the requirements early.

Joint deliberations with the FASB

BC289 The Board deliberated this project jointly with the FASB. US GAAP has had comprehensive accounting guidance for investment companies for many years (contained in Topic 946 *Investment Companies*). By deliberating this project jointly, the boards hoped to achieve as similar guidance as possible. To that end, they came up with similar definitions of investment entities and guidance on how to assess investment entity status.

BC290 However, the scope of the project was different for the IASB and the FASB. The IASB's Investment Entities project started during the deliberations on the Consolidations project and was only intended to provide an exception to consolidation for investment entities. The FASB was seeking to improve and converge the definition of an investment company with that of the IASB because it already has comprehensive accounting and reporting guidance for investment companies.

BC291 While the boards reached many common decisions, as a result of this scope difference, and other jurisdictional differences, the IASB and the FASB came to different decisions in a number of areas. These include:

(a) whether there should be a requirement that an investment entity measure and evaluate substantially all of its investments on a fair value basis rather than identifying such an activity as a typical characteristic of an investment entity;

(b) whether there should be a reference to existing regulatory requirements in the definition of an investment entity;

(c) whether an investment entity is permitted to provide investmentrelated services to third parties other than its own investors;

(d) the accounting by an investment entity parent for an investment entity subsidiary; and

(e) the accounting by a non-investment entity parent for an investment entity subsidiary.

Effects analysis for investment entities

BC292 The Board is committed to assessing and sharing knowledge about the likely costs of implementing proposed new requirements and the likely ongoing costs and benefits of each new IFRS—the costs and benefits are collectively referred to as 'effects'. The Board gains insight on the likely effects of the proposals for new or revised IFRSs through its formal exposure of proposals, analysis and consultations with relevant parties.

BC293 In evaluating the likely effects of introducing an exception to consolidation for investment entities to IFRS 10, the Board has considered the following factors:

(a) how the changes to IFRS 10 affect the financial statements of an investment entity;

(b) how those changes improve the comparability of financial information between different reporting periods for an investment entity and between different investment entities in a particular reporting period;

(c) how the changes will improve the quality of the financial information available to investors and its usefulness in assessing the future cash flows of an investment entity;

(d) how users will benefit from better economic decision-making as a result of improved financial reporting;

(e) the likely effect on compliance costs for preparers, both on initial application and on an ongoing basis; and

(f) whether the likely costs of analysis for users are affected.

Financial statements of investment entities

BC294 Before the exception to consolidation for investment entities was issued, IFRS 10 (and its predecessor, IAS 27) required reporting entities to consolidate all controlled entities, regardless of the nature of the reporting entity. Consequently, the assets, liabilities and non-controlling interests of each subsidiary were aggregated with those of the parent to represent the group of entities as a single reporting entity.

BC295 Respondents to ED 10 argued that an investment entity often holds non-controlling investments in some entities that are reported at fair value, as well as subsidiaries that are consolidated in accordance with current principles in IFRS. Reporting investments on more than one basis hinders comparability within the financial statements, because all investments are held by an investment entity for a similar purpose— capital appreciation, investment income, or both. In addition, some of the items consolidated would be measured at historical cost, which distorts the performance assessment of the investment entity and does not reflect the way in which the business of the entity is managed.

BC296 The exception to consolidation will change the way in which an investment entity parent reports its interest in an entity that it controls. Rather than consolidating its subsidiaries, an investment entity is now required to recognise a subsidiary as a single-line investment measured at fair value through profit or loss in accordance with IFRS 9 (or IAS 39, if IFRS 9 has not yet been adopted).

BC297 Accordingly, the exception to consolidation will affect investment entities that hold, as investments, controlling interests in other entities. However, although the changes are important to those entities affected, the changes are only expected to affect a narrow range of entities. Only those entities that meet the definition of an investment entity and hold controlling interests in other entities will be affected by these changes.

BC298 The entities most likely to be affected are:

(a) private equity or venture capital funds; these have business models in which it is more likely that it would be beneficial to take a larger interest in a company, or control investees through debt and equity investment.

(b) master-feeder or fund-of-funds structures where an investment entity parent has controlling interests in investment entity subsidiaries.

BC299 Some pension funds and sovereign wealth funds may also be affected; these may meet the definition of an investment entity and may also hold controlling investments in other entities.

BC300 Other types of entities may meet the definition of an investment entity, such as mutual funds and other regulated investment funds, but are less likely to hold controlling investments in other entities. Instead, they tend to hold lower levels of investments in a wider range of entities. Consequently, the exception to consolidation is less likely to affect these entities.

Comparability

BC301 An investment entity's control of an investee may change from one reporting period to the next. Without the exception to consolidation, an investment entity could be required to consolidate an investment in one period and present it as an investment measured at fair value through profit or loss in the following period (or vice versa). This would reduce comparability between reporting periods. With the introduction of the exception to consolidation, an investment entity can report all investments at fair value, regardless of whether those investments are controlled. This will improve the comparability between reporting periods.

BC302 Many respondents to ED 10 and the *Investment Entities* ED pointed out that some national accounting requirements, including US GAAP, have historically had industry-specific guidance that requires investment entities to measure investments that they control at fair value. Some of these respondents argued that investment entities were actively choosing to adopt those national accounting requirements rather than IFRS so that they could measure all of their investments at fair value. Respondents also pointed out that some investment entities that followed IFRS provided non-GAAP information about the fair value of all of their investments. Consequently, comparability of the financial statements of different investment entities was hindered. The Board expects the introduction of the exception to consolidation to encourage adoption of IFRS among investment entities and to eliminate the need to provide non- GAAP information about fair value. This should improve the comparability of financial statements of different investment entities.

Usefulness of financial statements in assessing the future cash flows of an entity

BC303 Consolidated financial statements of an investment entity emphasise the financial position, operations and cash flows of the investee, rather than merely those of the investment entity. The exception to consolidation will reduce the information about the cash flows of those subsidiaries. However, the main business purpose of an investment entity is to invest funds solely for capital appreciation, investment income, or both. The relevant cash flows relating to these activities are those of the investment entity itself. Consolidating the cash flows of a subsidiary may hinder users' ability to predict the cash flows that may be passed on to investors. The Board therefore believes that these amendments will improve the quality of the financial information reported by an investment entity and will make that information more useful in assessing the future cash flows of the investment entity.

Better economic decision-making

BC304 One of the essential features of an investment entity is that, in order to make better investment decisions, it measures and evaluates substantially all of its investments on a fair value basis. Presenting consolidated financial statements does not reflect this method of management. Requiring an investment entity to account for its investments in subsidiaries at fair value provides a better insight into the information that management uses to evaluate the performance of its investments.

BC305 In addition, investors in an investment entity are typically entitled to a proportionate share of the net assets of the entity when they withdraw their investment. Reporting the fair value of substantially all of the net assets of the investment entity allows the investors to more easily identify the value of their share of those net assets. As a result, the Board expect significant benefits for most users of investment entity financial statements arising from the provision of more fair value information.

BC306 However, some respondents in some jurisdictions objected to the exception to consolidation because it undermines the control-based approach to consolidation used in IFRS 10. These respondents noted that an exception to consolidation would deprive financial statement users of information about the activities of subsidiaries and the economic effects of the relationships between an investment entity and its subsidiaries. In addition, some respondents expressed concern that an exception to consolidation may encourage structuring to avoid consolidation, which would result in a loss of such information to users.

BC307 The Board acknowledges these arguments, but notes that the exception to consolidation has been introduced in response to comments from users that the most useful information for an investment entity is the fair value of its investments. Users also commented that consolidated financial statements of an investment entity may hinder users' ability to assess an investment entity's financial position and results, because it emphasises the financial position, operations and cash flows of the investee, rather than those of the investment entity.

BC308 In developing these amendments, the Board deliberately restricted the population of entities that would qualify for the exception to consolidation. In particular, the Board prohibited the use of the exception to consolidation by non-investment entity parents of investment entities, in order to address respondents' concerns about structuring and to restrict the use of the exception to situations where fair value information would be more relevant than information arising from the consolidation of subsidiaries.

Effect on compliance costs for preparers

BC309 The Board expects that the introduction of the exception to consolidation will result in significant compliance cost savings for preparers, particularly on an ongoing basis. This expectation is based on the feedback the Board has received from respondents to the *Investment Entities* ED and conversations with entities that are expected to qualify as investment entities.

BC310 On initial application, there may be some costs involved in identifying and documenting some of the additional disclosures introduced. In particular, investment entities will need to collect information to comply with the general disclosure requirements of IFRS 7, IFRS 13 and the amended requirements of IFRS 12. However, the Board has been told that the majority of investment entities will already have much of the fair value information that they need in order to comply with the new requirements, because they already measure substantially all of their investments on a fair value basis and many elect to provide this information to their investors already. The Board expects this to mitigate the initial and ongoing costs of applying the exception to consolidation.

BC311 In arriving at its decisions, the Board has considered those costs and believes that the benefits of the information produced as a result of its decisions would outweigh the costs of providing that information. In addition, the initial application costs will be more than offset by the cost savings resulting from the removal of the need to gather information from subsidiaries in order to consolidate details of their financial performance, position and cash flows on a line-by-line basis.

BC312 As described in paragraphs BC275–BC283, the Board decided not to expand the scope of the project to allow a non-investment entity parent to retain the fair value accounting of its investment entity subsidiary. Consequently, the compliance cost savings described above will not be available to non-investment entity parents. Because these entities are not within the scope of these amendments, they may incur ongoing costs because they will have two different bases of accounting within the group. At the investment entity subsidiary level, subsidiaries held by the investment entity will be measured at fair value, but at the non-investment entity parent level, those subsidiaries will be consolidated.

How the costs of analysis for users are affected

BC313 The likely effect of these amendments on the costs of analysis for users of financial statements is expected to be outweighed by the benefits of improved reporting, given that these amendments have been developed on request from users. However, the extent of the benefit will depend on existing practice.

BC314 In general, these amendments will provide improved information about the fair values of investments and the way in which the fair value is measured. Such information could reduce the cost of analysis by providing information more directly to users of financial statements. However, in many cases, investment entities already provide investors with fair value information, although this is often done in an alternative report rather than in the financial statements. This serves to emphasise that the main benefit of the changes is a reduction in costs to preparers because it eliminates what they see as a cumbersome reporting requirement that has little value.

BC315 For analysts or potential investors that use financial statements to analyse investment entities from different countries, the existing problems of diversity in accounting models creates costs that would be reduced by standardised accounting requirements.

BC316 In addition, the Board expects that the requirement to apply the exception to consolidation retrospectively will mitigate some of the transition costs for users. However, some of the transition reliefs will mean that users may receive less information on transition. In particular, the fact that investment entities will be required to provide only one period of comparative information may affect users who might otherwise receive more than one period of comparative information. However, again, the Board expects the benefits to outweigh the costs incurred as a result of the implementation of these amendments.

Summary

BC317 In summary, the cost savings resulting from implementing these amendments are expected to be significant for investment entities and the users of their financial statements. Additionally, the implementation of the investment entities amendments should result in the benefits of increased comparability between entities and across jurisdictions, and more relevant reporting of information used by investors in making economic decisions.

Consequential amendments to the Basis for Conclusions on other Standards

IFRS 1 *First-time Adoption of International Financial Reporting Standards*

The heading above paragraph BC31 is footnoted with the following text.

In October 2012 the Board issued *Investment Entities* (Amendments to IFRS 10, IFRS 12 and IAS 27), which stated that Appendix C of IFRS 1 should only apply to business combinations within the scope of IFRS 3 *Business Combinations*.

In paragraph BC63 'if no adjustments were made for consolidation procedures and for the effects of the business combination in which the parent acquired the subsidiary.' is footnoted with the following text.

In October 2012 the Board issued *Investment Entities* (Amendments to IFRS 10, IFRS 12 and IAS 27), which removed option D16(a) for investments in subsidiaries of investment entities, as defined in IFRS 10 *Consolidated Financial Statements*, required to be measured at fair value through profit or loss.

In paragraph BC63 'except to adjust for consolidation procedures and for the effects of the business combination in which the parent acquired the subsidiary' is footnoted with the following text.

In October 2012 the Board issued *Investment Entities* (Amendments to IFRS 10, IFRS 12 and IAS 27), which amended paragraph D17 to clarify its application to investment entities, as defined in IFRS 10.

IFRS 3 *Business Combinations*

In paragraph BC24 'one or more other businesses' is footnoted with the following text.

In October 2012 the Board issued *Investment Entities* (Amendments to IFRS 10, IFRS 12 and IAS 27), which removed from the scope of IFRS 3 *Business Combinations* the acquisition by an investment entity, as defined in IFRS 10 *Consolidated Financial Statements*, of an investment in a subsidiary required to be measured at fair value through profit or loss.

In paragraph BC384 'operations of the acquiree' is footnoted with the following text.

In October 2012 the Board issued *Investment Entities* (Amendments to IFRS 10, IFRS 12 and IAS 27), which required investment entities, as defined in IFRS 10, to measure their investments in subsidiaries, other than those providing investment-related services or activities, at fair value through profit or loss.

IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*

The footnote to paragraph BC24B is amended. New text is underlined.

… The requirement to consolidate a subsidiary until control is lost did not change. <u>In October 2012 the Board issued *Investment Entities* (Amendments to IFRS 10, IFRS 12 and IAS 27), which required investment entities, as defined in IFRS 10 *Consolidated Financial Statements*, to measure their investments in subsidiaries, other than those providing investment-related services or activities, at fair value through profit or loss.</u>

IFRS 9 *Financial Instruments* (as issued in November 2009)

In paragraph BC86 'in accordance with IFRS 9' is footnoted with the following text.

In October 2012 the Board issued *Investment Entities* (Amendments to IFRS 10, IFRS 12 and IAS 27), which required investment entities, as defined in IFRS 10 *Consolidated Financial Statements*, to measure their investments in subsidiaries, other than those providing investment-related services or activities, at fair value through profit or loss.

IFRS 9 *Financial Instruments* (as issued in October 2010)

In paragraph BC5.25(a) 'in accordance with IFRS 9' is footnoted with the following text.

In October 2012 the Board issued *Investment Entities* (Amendments to IFRS 10, IFRS 12 and IAS 27), which required investment entities, as defined in IFRS 10 *Consolidated Financial Statements*, to measure their investments in subsidiaries, other than those providing investment-related services or activities, at fair value through profit or loss.

IFRS 13 *Fair Value Measurement*

Paragraph BC238(a) is footnoted with the following text.

In October 2012 the Board issued *Investment Entities* (Amendments to IFRS 10, IFRS 12 and IAS 27), which required investment entities, as defined in IFRS 10 *Consolidated Financial Statements*, to measure their investments in subsidiaries, other than those providing investment-related services or activities, at fair value through profit or loss. In their redeliberations on the Investment Entities project, the Board considered providing a net asset value practical expedient. However, the Board decided against this because there are different calculation methods in different jurisdictions and it is outside the scope of the Investment Entities project to provide fair value measurement guidance for investments in investment entities.

IAS 28 *Investments in Associates and Joint Ventures*

Paragraph BC9 is footnoted with the following text.

In October 2012 the Board issued *Investment Entities* (Amendments to IFRS 10, IFRS 12 and IAS 27), which required investment entities, as defined in IFRS 10 *Consolidated Financial Statements*, to measure their investments in subsidiaries, other than those providing investment-related services or activities, at fair value through profit or loss. The amendments did not introduce any new accounting requirements for investments in associates or joint ventures.

IAS 39 *Financial Instruments: Recognition and Measurement*

In paragraph BC24A 'paragraph 2(g) of IAS 39.' is footnoted with the following text.

In October 2012 the Board issued *Investment Entities* (Amendments to IFRS 10, IFRS 12 and IAS 27), which amended paragraph 2(g) to clarify that the exception should only apply to forward contracts that result in a business combination within the scope of IFRS 3 *Business Combinations*.

Illustrative Examples

These examples accompany, but are not part of, the IFRS.

Example 1

IE1 An entity, Limited Partnership, is formed in 20X1 as a limited partnership with a 10-year life. The offering memorandum states that Limited Partnership's purpose is to invest in entities with rapid growth potential, with the objective of realising capital appreciation over their life. Entity GP (the general partner of Limited Partnership) provides 1 per cent of the capital to Limited Partnership and has the responsibility of identifying suitable investments for the partnership. Approximately 75 limited partners, who are unrelated to Entity GP, provide 99 per cent of the capital to the partnership.

IE2 Limited Partnership begins its investment activities in 20X1. However, no suitable investments are identified by the end of 20X1. In 20X2 Limited Partnership acquires a controlling interest in one entity, ABC Corporation. Limited Partnership is unable to close another investment transaction until 20X3, at which time it acquires equity interests in five additional operating companies. Other than acquiring these equity interests, Limited Partnership conducts no other activities. Limited Partnership measures and evaluates its investments on a fair value basis and this information is provided to Entity GP and the external investors.

IE3 Limited Partnership has plans to dispose of its interests in each of its investees during the 10-year stated life of the partnership. Such disposals include the outright sale for cash, the distribution of marketable equity securities to investors following the successful public offering of the investees' securities and the disposal of investments to the public or other unrelated entities.

Conclusion

IE4 From the information provided, Limited Partnership meets the definition of an investment entity from formation in 20X1 to 31 December 20X3 because the following conditions exist:

(a) Limited Partnership has obtained funds from the limited partners and is providing those limited partners with investment management services;

(b) Limited Partnership's only activity is acquiring equity interests in operating companies with the purpose of realising capital appreciation over the life of the investments. Limited Partnership has identified and documented exit strategies for its investments, all of which are equity investments; and

(c) Limited Partnership measures and evaluates its investments on a fair value basis and reports this financial information to its investors.

IE5 In addition, Limited Partnership displays the following typical characteristics of an investment entity:

(a) Limited Partnership is funded by many investors;

(b) its limited partners are unrelated to Limited Partnership; and

(c) ownership in Limited Partnership is represented by units of partnership interests acquired through a capital contribution.

IE6 Limited Partnership does not hold more than one investment throughout the period. However, this is because it was still in its start-up period and had not identified suitable investment opportunities.

Example 2

IE7 High Technology Fund was formed by Technology Corporation to invest in technology start-up companies for capital appreciation. Technology Corporation holds a 70 per cent interest in High Technology Fund and controls High Technology Fund; the other 30 per cent ownership interest in High Technology Fund is owned by 10 unrelated investors. Technology Corporation holds options to acquire investments held by High Technology Fund, at their fair value, which would be exercised if the technology developed by the investees would benefit the operations of Technology Corporation. No plans for exiting the investments have been identified by High Technology Fund. High Technology Fund is managed by an investment adviser that acts as agent for the investors in High Technology Fund.

Conclusion

IE8 Even though High Technology Fund's business purpose is investing for capital appreciation and it provides investment management services to its investors, High Technology Fund is not an investment entity because of the following arrangements and circumstances:

(a) Technology Corporation, the parent of High Technology Fund, holds options to acquire investments in investees held by High Technology Fund if the assets developed by the investees would benefit the operations of Technology Corporation. This provides a benefit in addition to capital appreciation or investment income; and

(b) the investment plans of High Technology Fund do not include exit strategies for its investments, which are equity investments. The options held by Technology Corporation are not controlled by High Technology Fund and do not constitute an exit strategy.

Example 3

IE9 Real Estate Entity was formed to develop, own and operate retail, office and other commercial properties. Real Estate Entity typically holds its property in separate wholly-owned subsidiaries, which have no other substantial assets or liabilities other than borrowings used to finance the related investment property. Real Estate Entity and each of its subsidiaries report their investment properties at fair value in accordance with IAS 40 *Investment Property*. Real Estate Entity does not have a set time frame for disposing of its property investments, but uses fair value to help identify the optimal time for disposal. Although fair value is one performance indicator, Real Estate Entity and its investors use other measures, including information about expected cash flows, rental revenues and expenses, to assess performance and to make investment decisions. The key management personnel of Real Estate Entity do not consider fair value information to be the primary measurement attribute to evaluate the performance of its investments but rather a part of a group of equally relevant key performance indicators.

IE10 Real Estate Entity undertakes extensive property and asset management activities, including property maintenance, capital expenditure, redevelopment, marketing and tenant selection, some of which it outsources to third parties. This includes the selection of properties for refurbishment, development and the negotiation with suppliers for the design and construction work to be done to develop such properties. This development activity forms a separate substantial part of Real Estate Entity's business activities.

Conclusion

IE11 Real Estate Entity does not meet the definition of an investment entity because:

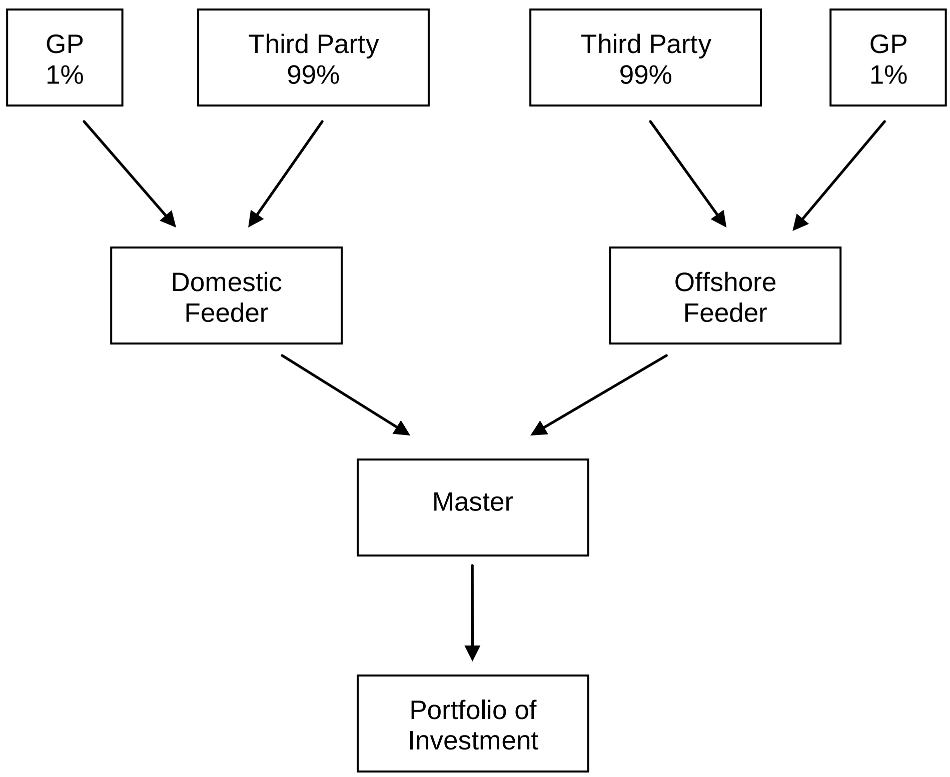
(a) Real Estate Entity has a separate substantial business activity that involves the active management of its property portfolio, including lease negotiations, refurbishments and development activities, and marketing of properties to provide benefits other than capital appreciation, investment income, or both;

(b) the investment plans of Real Estate Entity do not include specified exit strategies for its investments. As a result, Real Estate Entity plans to hold those property investments indefinitely; and

(c) although Real Estate Entity reports its investment properties at fair value in accordance with IAS 40, fair value is not the primary measurement attribute used by management to evaluate the performance of its investments. Other performance indicators are used to evaluate performance and make investment decisions.

Example 4

IE12 An entity, Master Fund, is formed in 20X1 with a 10-year life. The equity of Master Fund is held by two related feeder funds. The feeder funds are established in connection with each other to meet legal, regulatory, tax or similar requirements. The feeder funds are capitalised with a 1 per cent investment from the general partner and 99 per cent from equity investors that are unrelated to the general partner (with no party holding a controlling financial interest).



IE13 The purpose of Master Fund is to hold a portfolio of investments in order to generate capital appreciation and investment income (such as dividends, interest or rental income). The investment objective communicated to investors is that the sole purpose of the Master-Feeder structure is to provide investment opportunities for investors in separate market niches to invest in a large pool of assets. Master Fund has identified and documented exit strategies for the equity and non-financial investments that it holds. Master Fund holds a portfolio of short- and medium-term debt investments, some of which will be held until maturity and some of which will be traded but Master Fund has not specifically identified which investments will be held and which will be traded. Master Fund measures and evaluates substantially all of its investments, including its debt investments, on a fair value basis. In addition, investors receive periodic financial information, on a fair value basis, from the feeder funds. Ownership in both Master Fund and the feeder funds is represented through units of equity.

Conclusion

IE14 Master Fund and the feeder funds each meet the definition of an investment entity. The following conditions exist:

(a) both Master Fund and the feeder funds have obtained funds for the purpose of providing investors with investment management services;

(b) the Master-Feeder structure's business purpose, which was communicated directly to investors of the feeder funds, is investing solely for capital appreciation and investment income and Master Fund has identified and documented potential exit strategies for its equity and non-financial investments.

(c) although the feeder funds do not have an exit strategy for their interests in Master Fund, the feeder funds can nevertheless be considered to have an exit strategy for their investments because Master Fund was formed in connection with the feeder funds and holds investments on behalf of the feeder funds; and

(d) the investments held by Master Fund are measured and evaluated on a fair value basis and information about the investments made by Master Fund is provided to investors on a fair value basis through the feeder funds.

IE15 Master Fund and the feeder funds were formed in connection with each other for legal, regulatory, tax or similar requirements. When considered together, they display the following typical characteristics of an investment entity:

(a) the feeder funds indirectly hold more than one investment because Master Fund holds a portfolio of investments;

(b) although Master Fund is wholly capitalised by the feeder funds, the feeder funds are funded by many investors who are unrelated to the feeder funds (and to the general partner); and

(c) ownership in the feeder funds is represented by units of equity interests acquired through a capital contribution.

Amendments to guidance on other IFRSs

The following amendments to guidance on IFRSs are necessary in order to ensure consistency with IFRS 10 and the related amendments to other IFRSs. Amended paragraphs are shown with new text underlined and deleted text struck through.

IFRS 1 *First-time Adoption of International Financial Reporting Standards*

IGA1 The heading above paragraph IG26 and paragraph IG26 are amended as follows:

~~IAS 27~~ <u>IFRS 10</u> *Consolidated ~~and Separate~~ Financial Statements*

IG26 A first-time adopter consolidates all subsidiaries (as defined in ~~IAS 27~~ <u>IFRS 10</u>), unless ~~IAS 27~~ <u>IFRS 10</u> requires otherwise.

IFRS 4 *Insurance Contracts*

IGA2 In paragraph IG2 the 'Treatment in phase 1' entry for contract type 1.28 is amended as follows:

> If the entities present individual or separate financial statements, they treat the contract as an insurance contract in those individual or separate financial statements (see IAS 27 *~~Consolidated and~~ Separate Financial Statements*). …

IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*

IGA3 The paragraph above example 13 is amended as follows:

> A subsidiary acquired with a view to sale is not exempt from consolidation in accordance with ~~IAS 27~~ <u>IFRS 10</u> *Consolidated ~~and Separate~~ Financial Statements*. However, …

IAS 39 *Financial Instruments: Recognition and Measurement*

IGA4 The answers to Questions F.1.4 and F.1.6 are amended as follows:

F.1.4 Yes, if the derivative contracts are internal to the entity being reported on. … The principles of preparing consolidated financial statements in ~~IAS 27.24~~ <u>paragraph B86 of IFRS 10 *Consolidated Financial Statements*</u> require ~~that~~ <u>a parent to 'eliminate in full intragroup assets and liabilities, equity, income, expenses and cash flows'</u> ~~'intragroup balances, transactions, income and expenses shall be eliminated in full'~~.

…

F.1.6 It depends. ~~IAS 27~~ <u>IFRS 10</u> requires all internal transactions to be eliminated in consolidated financial statements. As stated in …

IFRIC 17 *Distributions of Non-cash Assets to Owners*

IGA5 Paragraph IE4 is amended as follows:

IE4 However, if Company A distributes to its shareholders shares of Subsidiary B representing only a non-controlling interest in Subsidiary B and retains control of Subsidiary B, the transaction is not within the scope of the Interpretation. Company A accounts for the distribution in accordance with ~~IAS 27~~ IFRS 10 *Consolidated* ~~*and Separate*~~ *Financial Statements* ~~(as amended in 2008)~~. Company A controls Company B both before and after the transaction.

Consequential amendment to the guidance on implementing another Standard arising from the issuance of *Investment Entities* (Amendment to IFRS 10, IFRS 12 and IAS 27)

IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*

The paragraph above 'Example 13' is amended. New text is underlined.

A subsidiary acquired with a view to sale is not exempt from consolidation in accordance with IFRS 10 *Consolidated Financial Statements*, unless the acquirer is an investment entity, as defined in IFRS 10, and is required to measure the investment in that subsidiary at fair value through profit or loss. However, if it meets the criteria in paragraph 11, it is presented as a disposal group classified as held for sale. Example 13 illustrates these requirements.

Example 13

...

HKFRS 12
Revised ~~July~~ December 2012

Effective for annual periods
beginning on or after 1 January 2013

Hong Kong Financial Reporting Standard 12

Disclosure of Interests in Other Entities

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

CONTENTS

Appendix D
Amendments to HKFRS 10, HKFRS 12 and HKAS 27 (2011) – *Investment Entities*

The following sets out amendments required for this Standard resulting from amendments to HKFRS 10, HKFRS 12 and HKAS 27 (2011) that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Standard and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

In the Introduction, paragraph IN12 is added.

IN12 *Investment Entities* (Amendments to HKIFRS 10, HKFRS 12 and HKAS 27 (2011)), issued in December 2012, introduced an exception to the principle in HKFRS 10 *Consolidated Financial Statements* that all subsidiaries shall be consolidated. The amendments define an investment entity and require a parent that is an investment entity to measure its investment in particular subsidiaries at fair value through profit or loss in accordance with HKFRS 9 *Financial Instruments* (or HKAS 39 *Financial Instruments: Recognition and Measurement*, if HKFRS 9 has not yet been adopted) instead of consolidating those subsidiaries in its consolidated and separate financial statements. Consequently, the amendments also introduced new disclosure requirements for investment entities in this HKFRS and HKAS 27 (2011) *Separate Financial Statements*.

Paragraph 2 is amended. New text is underlined and deleted text is struck through.

2 To meet the objective in paragraph 1, an entity shall disclose:

(a) the significant judgements and assumptions it has made in determining<u>:</u>

<u>(i)</u> the nature of its interest in another entity or arrangement<u>;</u>~~, and in determining~~

<u>(ii)</u> the type of joint arrangement in which it has an interest (paragraphs 7–9)<u>;</u>

<u>(iii)</u> <u>that it meets the definition of an investment entity, if applicable (paragraph 9A); and</u>

(b) ...

After paragraph 9, a heading and paragraphs 9A–9B are added.

Investment entity status

9A When a parent determines that it is an investment entity in accordance with paragraph 27 of HKFRS 10, the investment entity shall disclose information about significant judgements and assumptions it has made in determining that it is an investment entity. If the investment entity does not have one or more of the typical characteristics of an investment entity (see paragraph 28 of HKFRS 10), it shall disclose its reasons for concluding that it is nevertheless an investment entity.

9B When an entity becomes, or ceases to be, an investment entity, it shall disclose the change of investment entity status and the reasons for the change. In addition, an entity that becomes an investment entity shall disclose the effect of the change of status on the financial statements for the period presented, including:

(a) the total fair value, as of the date of change of status, of the subsidiaries that cease to be consolidated;

(b) the total gain or loss, if any, calculated in accordance with paragraph B101 of HKFRS 10; and

(c) the line item(s) in profit or loss in which the gain or loss is recognised (if not presented separately).

After paragraph 19, a heading and paragraphs 19A–19G are added.

Interests in unconsolidated subsidiaries (investment entities)

19A An investment entity that, in accordance with HKFRS 10, is required to apply the exception to consolidation and instead account for its investment in a subsidiary at fair value through profit or loss shall disclose that fact.

19B For each unconsolidated subsidiary, an investment entity shall disclose:

(a) the subsidiary's name;

(b) the principal place of business (and country of incorporation if different from the principal place of business) of the subsidiary; and

(c) the proportion of ownership interest held by the investment entity and, if different, the proportion of voting rights held.

19C If an investment entity is the parent of another investment entity, the parent shall also provide the disclosures in 19B(a)–(c) for investments that are controlled by its investment entity subsidiary. The disclosure may be provided by including, in the financial statements of the parent, the financial statements of the subsidiary (or subsidiaries) that contain the above information.

19D An investment entity shall disclose:

(a) the nature and extent of any significant restrictions (eg resulting from borrowing arrangements, regulatory requirements or contractual arrangements) on the ability of an unconsolidated subsidiary to transfer funds to the investment entity in the form of cash dividends or to repay loans or advances made to the unconsolidated subsidiary by the investment entity; and

(b) any current commitments or intentions to provide financial or other support to an unconsolidated subsidiary, including commitments or intentions to assist the subsidiary in obtaining financial support.

19E If, during the reporting period, an investment entity or any of its subsidiaries has, without having a contractual obligation to do so, provided financial or other support to an unconsolidated subsidiary (eg purchasing assets of, or instruments issued by, the subsidiary or assisting the subsidiary in obtaining financial support), the entity shall disclose:

(a) the type and amount of support provided to each unconsolidated subsidiary; and

(b) the reasons for providing the support.

19F An investment entity shall disclose the terms of any contractual arrangements that could require the entity or its unconsolidated subsidiaries to provide financial support to an unconsolidated, controlled, structured entity, including events or circumstances that could expose the reporting entity to a loss (eg liquidity arrangements or credit rating triggers associated with obligations to purchase assets of the structured entity or to provide financial support).

19G If during the reporting period an investment entity or any of its unconsolidated subsidiaries has, without having a contractual obligation to do so, provided financial or other support to an unconsolidated, structured entity that the investment entity did not control, and if that provision of support resulted in the investment entity controlling the structured entity, the investment entity shall disclose an explanation of the relevant factors in reaching the decision to provide that support.

After paragraph 21, paragraph 21A is added.

21A An investment entity need not provide the disclosures required by paragraphs 21(b)–21(c).

After paragraph 25, paragraph 25A is added.

25A An investment entity need not provide the disclosures required by paragraph 24 for an unconsolidated structured entity that it controls and for which it presents the disclosures required by paragraphs 19A–19G.

In Appendix A, a term is added. New text is underlined.

The following terms are defined in HKAS 27 (as amended in 2011), HKAS 28 (as amended in 2011), HKFRS 10 and HKFRS 11 *Joint Arrangements* and are used in this HKFRS with the meanings specified in those HKFRSs:

- associate
- consolidated financial statements
- control of an entity
- equity method
- group
- <u>investment entity</u>
- joint arrangement
- ...

In Appendix C, paragraph C1B is added.

C1B *Investment Entities* (Amendments to HKFRS 10, HKFRS 12 and HKAS 27 (2011)), issued in December 2012, amended paragraph 2 and Appendix A, and added paragraphs 9A–9B, 19A–19G, 21A and 25A. An entity shall apply those amendments for annual periods beginning on or after 1 January 2014. Early adoption is permitted. If an entity applies those amendments earlier, it shall disclose that fact and apply all amendments included in *Investment Entities* at the same time.

Appendix ~~D~~E
Amendments to other HKFRSs

This appendix sets out amendments to other HKFRSs that are a consequence of issuing HKFRS 12. An entity shall apply the amendments for annual periods beginning on or after 1 January 2013. If an entity applies HKFRS 12 for an earlier period, it shall apply the amendments for that earlier period. Amended paragraphs are shown with new text underlined and deleted text struck through.

HKAS 1 *Presentation of Financial Statements*

D1 Paragraphs 119 and 124 are amended and paragraph 139H is added as follows.

119 … An example is disclosure of whether ~~a venturer recognises its interest in a jointly controlled entity using proportionate consolidation or the equity method (see HKAS 31 *Interests in Joint Ventures*)~~ an entity applies the fair value or cost model to its investment property (see HKAS 40 *Investment Property*). Some HKFRSs specifically require disclosure of particular accounting policies, including choices made by management between different policies they allow. …

124 Some of the disclosures made in accordance with paragraph 122 are required by other HKFRSs. For example, ~~HKAS 27 requires an entity to disclose the reasons why the entity's ownership interest does not constitute control, in respect of an investee that is not a subsidiary even though more than half of its voting or potential voting power is owned directly or indirectly through subsidiaries~~ HKFRS 12 *Disclosure of Interests in Other Entities* requires an entity to disclose the judgements it has made in determining whether it controls another entity. HKAS 40 ~~*Investment Property*~~ requires…

139H HKFRSs 10 and 12, issued in June 2011, amended paragraphs 4, 119, 123 and 124. An entity shall apply those amendments when it applies HKFRSs 10 and 12.

HKAS 24 *Related Party Disclosures*

D2 Paragraph 15 is amended and paragraph 28A is added as follows.

15 The requirement to disclose related party relationships between a parent and its subsidiaries is in addition to the disclosure requirements in HKAS 27 and~~, HKAS 28 *Investments in Associates* and HKAS 31 *Interests in Joint Ventures*~~ HKFRS 12 *Disclosure of Interests in Other Entities*.

28A HKFRS 10, HKFRS 11 *Joint Arrangements* and HKFRS 12, issued in June 2011, amended paragraphs 3, 9, 11(b), 15, 19(b) and (e) and 25. An entity shall apply those amendments when it applies HKFRS 10, HKFRS 11 and HKFRS 12.

Appendix ~~E~~F
Comparison with International Financial Reporting Standards

This comparison appendix, which was prepared in June 2011 and deals only with significant differences in the standards extant, is produced for information only and does not form part of the standards in HKFRS 12.

The International Financial Reporting Standard comparable with HKFRS 12 is IFRS 12 *Disclosure of Interests in Other Entities*.

There are no major textual differences between HKFRS 12 and IFRS 12.

HKFRS 12 BC
Revised ~~July~~ December 2012

Basis for Conclusions on
Hong Kong Financial Reporting Standard 12

Disclosure of Interests in Other Entities

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Appendix

Amendments to Basis for Conclusions on IFRS 10, IFRS 12 and IAS 27 – *Investment Entities*

This appendix contains amendments to the Basis for Conclusions on IFRS 12 that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of the Conclusions and this appendix will be deleted.

Paragraph BC13 is footnoted with the following text.

Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27), issued in October 2012, introduced an exception to the principle that all subsidiaries shall be consolidated. The amendments define an investment entity and require a parent that is an investment entity to measure its investments in particular subsidiaries at fair value through profit or loss instead of consolidating those subsidiaries. In addition, the amendments introduce new disclosure requirements related to investment entities in IFRS 12 *Disclosure of Interests in Other Entities* and IAS 27 *Separate Financial Statements*. The amendments are discussed in paragraphs BC215–BC317 of IFRS 10 *Consolidated Financial Statements*, and the disclosure requirements are discussed in paragraphs BC61A–BC61H of this IFRS.

After paragraph BC61, a heading and paragraphs BC61A – BC61H are added.

Investment entities

BC61A *Investment Entities* (Amendments to IFRS 10, IFRS 12 and IAS 27) introduced a requirement for investment entities to measure their investments in particular subsidiaries at fair value through profit or loss instead of consolidating them. The Board also decided on specific disclosure requirements for investment entities.

BC61B In deciding on the appropriate disclosure requirements for investment entities, the Board noted that investment entities would be required to make the disclosures already contained in other Standards. In particular, the disclosure requirements in IFRS 7 *Financial Instruments: Disclosures*, IFRS 13 *Fair Value Measurement* and IAS 24 *Related Party Disclosures* are likely to be relevant for users of investment entity financial statements.

BC61C Users told the Board that disclosures relating to the valuation methodology used for measuring fair value and the underlying inputs are essential to their analyses. This information is already required by IFRS 7 and by IFRS 13 when reporting investments at fair value through profit or loss or other comprehensive income in accordance with IFRS 9 *Financial Instruments* or IAS 39 *Financial Instruments: Recognition and Measurement*. Accordingly, the Board decided that it was not necessary to propose any additional disclosure requirements relating to the fair value measurements made by investment entities.

BC61D In the Exposure Draft *Investment Entities* (the *Investment Entities* ED), the Board proposed that an investment entity would be required to meet a disclosure objective that addressed all of an investment entity's investing activities. The *Investment Entities* ED also gave a number of examples of ways in which an investment entity could meet that disclosure objective. Respondents generally supported the disclosure guidance. However, the Board noted that it was outside the scope of the Investment Entities project to require all investment entities to provide disclosures about their investing activities. Consequently, the Board decided to remove the disclosure objective and the examples on how to meet the objective from the final requirements.

Because the Investment Entities project focuses on providing an exception to consolidation, the Board decided to limit additional disclosures to information about unconsolidated subsidiaries.

BC61E The Board also decided to require an investment entity to disclose the fact that it has applied the exception to consolidation, noting that such a disclosure would represent useful information. Moreover, the Board decided to require an investment entity to disclose when it does not display one or more of the typical characteristics of an investment entity, along with a justification of why it still meets the definition of an investment entity.

BC61F The Board considered whether all of the disclosures in this IFRS should apply to the investments in unconsolidated subsidiaries, associates and joint ventures of investment entities. The Board decided that some (eg summarised financial information and information about non-controlling interests) are not applicable to investment entities and are inconsistent with the assertion that fair value information is the most relevant information for investment entities. Consequently, the Board decided to specify the IFRS 12 requirements applicable to the unconsolidated subsidiaries, associates and joint ventures held by investment entities.

BC61G Consistently with the principles in this IFRS, the Board decided to require an investment entity to disclose when any explicit or implicit financial support has been provided to entities that it controls. The Board concluded that it would help users of financial statements to understand an investment entity's exposure to risk.

BC61H The Board decided that an investment entity should disclose the nature and extent of any significant restrictions (eg resulting from borrowing arrangements or regulatory requirements) on the ability of investees to transfer funds to the investment entity in the form of cash dividends, or repayment of loans or advances. The Board considered this requirement to be useful for investors because such restrictions could potentially affect distributions to investors of the investment entity's returns from investments.