Grant Thornton
An instinct for growth™

Technical Accounting Alert

IASB issues exception to consolidation for Investment Entities

Introduction

The IASB has issued *Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27),* and it is expected that the AASB will shortly amend its equivalent Australian IFRS standards being AASB 10, AASB 12 and AASB 127. The amendments provide an exception to the consolidation requirements in IFRS 10 *Consolidated Financial Statements* and require investment entities to measure particular subsidiaries at fair value through profit or loss, rather than consolidate them.

Private equity organisations, venture capital organisations, pension funds, sovereign wealth funds and other investment funds are likely to be particularly interested in the amendments.

Background

Many commentators have long held the view that consolidating the financial statements of an investment entity and its investees does not provide the most useful information. Their concern is that the reported investment performance of the investment entity is distorted by consolidating the trading activity of a small number of investees over which it holds a controlling interest. Consolidation in such circumstances makes it more difficult for investors to understand what they are most interested in – the value of the entity's investments. *Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27)* provides a solution to this problem.

The amendments

The amendments introduce an exception to IFRS 10's 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 IFRS 9 *Financial Instruments* (or IAS 39 *Financial Instruments: Recognition and Measurement* where IFRS 9 has not yet been adopted) instead of consolidating those subsidiaries in its consolidated and separate financial statements. In addition, the amendments introduce new disclosure requirements related to investment entities into IFRS 12 *Disclosure of Interests in Other Entities* and IAS 27 *Separate Financial Statements*.

Definition of an investment entity

An investment entity is defined as "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."

In assessing whether the above definition is met, an entity is required to consider whether it has the following characteristics which are typical of an investment entity:

- multiple investments
- multiple investors
- investors that are not related parties of the entity
- ownership interests in the form of equity or similar interests.

The absence of any of these characteristics does not necessarily preclude an entity from being classified as an investment entity, however additional disclosure would be required to justify how its activities are consistent with an investment entity.

Effective date

The amendments are effective from 1 January 2014 with early adoption permitted. This is one year later than the 1 January 2013 effective date of IFRS 10, but the IASB has permitted early adoption in order to allow investment entities to apply the Investment Entities amendments at the same time they first apply the rest of IFRS 10. We expect the AASB to adopt the same transitional provisions.

Grant Thornton *International* comment

We welcome the exemption from consolidation for investment entities. While we believe that consolidation generally provides the most relevant and useful information for a group, we believe that there is a class of investment entities for which fair value accounting is significantly more useful and the IASB has worked hard to define this class appropriately.

The timing of finalisation is significant given the proximity of IFRS 10's effective date. The exception to consolidation could have a huge impact for entities that meet the IASB's definition of an investment entity as it would spare them from much of the time and effort they would otherwise need to spend on reassessing their control conclusions under IFRS 10's new requirements.

Action required

Investment Entities should consider the impact that these amendments have on their activities.

Further information

For further information on any of the information included in this TA alert, please contact your local Grant Thornton Australia contact or a member of the National Audit Support team at NAS@grantthornton.com.au.