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

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

HKICPA Standard Setting Department Staff Summary (January 2013)

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The HKICPA Standard Setting Department welcomes your comments and feedback, which should be sent to commentletters@hkicpa.org.hk.

Introduction

1. *Investment Entities* (amendments to HKFRS 10, HKFRS 12 and HKAS 27 (2011)) 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.

2. The amendments are effective from 1 January 2014 with early adoption permitted, which is one year later than the 1 January 2013 effective date of HKFRS 10. An early adoption is permitted in order to allow investment entities to apply the amendments at the same time they first apply the rest of HKFRS 10.

Reasons for issuing *Investment Entities*

3. The objective of the Hong Kong Institute of Certified Public Accountants (HKICPA) in issuing the amendments is to maintain international convergence arising from the issuance of the relevant amendments by the International Accounting Standards Board (IASB).

4. The amendments are issued in response to suggestions made by preparers and users of financial statements 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.

Main features of amendments

5. In response to this, *Investment Entities* was issued in December 2012. These amendments include:

   - The creation of a definition of an investment entity;
   - The requirement that such entities measure investments in subsidiaries at fair value through profit or loss in accordance with HKAS 39 *Financial Instruments:*

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Recognition and Measurement (or HKFRS 9 *Financial Instruments*) instead of consolidating them;

- New disclosure requirements for investment entities; and
- Requirements for an investment entity's separate financial statements.

6. The new requirements contained in the amendments are principally concerned with establishing whether an entity qualifies as an 'investment entity'. Paragraph 27 of HKFRS 10 states that 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.

7. The application guidance accompanying HKFRS 10 requires an entity to consider all facts and circumstances when assessing whether it is an investment entity, including its purpose and design. In this connection, the application guidance describes the elements of the definition in more detail as follows:

   Business purpose
   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. An investment entity may also participate in the following investment-related activities, either directly or through a subsidiary, if these activities are undertaken with a view to maximising the investment return (capital appreciation and/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.

   Exit strategies
   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 instruments.

   Earnings from investments
   If an 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 (unrelated to the investee), then the entity is not considered to be investing solely for capital appreciation, investment income, or both and thus would not qualify as being an investment entity.

Fair value measurement
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 is more relevant 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 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 reports fair value information internally to the entity's key management personnel, who use fair value as the primary measurement attribute to evaluate the performance of substantially all of its investments and to make investment decisions.

In order to meet this requirement, an investment entity would:
a) Elect to account for any investment property using the fair value model in HKAS 40 *Investment Property*;
b) Elect to apply the exemption from the equity method in HKAS 28 (2011) *Investment in Associates and Joint Ventures* for its investments in associates and joint ventures; and
c) Measure its financial assets at fair value using the requirements in HKAS 39/HKFRS 9.

8. In assessing whether an entity meets the definition of an investment entity as described in paragraph 27, the entity must consider whether it has the following characteristics:

a) It has more than one investment – an investment entity typically holds several investments to diversify its risk and maximise it returns;
b) It has more than one investor – an investment entity would typically 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;
c) It has investors that are not related parties of the entity; and
d) It has ownership interests in the form of equity or similar interests (for example, partnership interests, to which proportionate shares of the net assets of the investment entity are attributed).

The absence of any of these characteristics does not necessarily disqualify an entity from being classified as an investment entity, however, it has to provide additional disclosure required by HKFRS 12 in disclosing its reasons for concluding that it is nonetheless an investment entity.

9. The amended HKFRS 12 requires disclosure of information about:

a) Significant judgements and assumptions that the investment entity has made in determining that it meets the definition of an investment entity;
b) Information on each unconsolidated subsidiary;
c) The nature and extent of any significant restrictions of unconsolidated subsidiaries to transfer funds to the investment entity;
d) Financial or other support provided to unconsolidated subsidiaries during the reporting period where there wasn't a contractual obligation to do so; and
e) Any structured entity that it controls.

Other references on *Investment Entities*

1. BDO HKFRS/IFRS Update

   http://www.bdo.com.hk:8080/cmstree.GetCmsAsset.do?cmsAssetType=2&fileName=bdo_hkfrss_update_12_2012.pdf&targetId=124&tempId=

2. Deloitte IFRS in Focus

   http://www.iasplus.com/en/publications/ifrs-in-focus/2012/ifrs-in-focus-2014-fair-value-rules-2014-new-requirements-for-investment-entities

3. Ernst & Young "IFRS developments"

   http://www.ey.com/Publication/vwLUAssets/IFRS_Developments_Issue_44/$File/Devel44_BC_October2012_print.pdf

4. KPMG 'Financial Reporting Update'

   http://www.kpmg.com/CN/en/IssuesAndInsights/ArticlesPublications/Newsletters/Financial-Reporting-Update/Documents/Financial-Reporting-Update-1212-72.htm

5. KPMG 'In the headlines'

   http://www.kpmg.com/CN/en/IssuesAndInsights/ArticlesPublications/Newsletters/In-the-headlines/Documents/In-the-headlines-O-201211-15.pdf

6. KPMG 'First impressions'

   http://www.kpmg.com/CN/en/IssuesAndInsights/ArticlesPublications/Pages/First-Impressions-Consolidation-relief-for-investment-funds-O-201211.aspx

7. IASB Project Summary on *Investment Entities*

   http://www.ifrs.org/Current-Projects/IASB-Projects/Consolidation/Documents/Investment-Entities-Amdments-to-IFRS-10-12-and-IAS-27-summary-and-feedback.pdf

8. PricewaterhouseCoopers – HKFRS news

   http://www.pwchk.com/home/eng/hkfrs_news_novdec2012.html

9. PricewaterhouseCoopers – Practical guide to IFRS 10

   https://pwcinform.pwc.com/inform2/show?action=informContent&id=1218143212180154