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Deloitte Luxembourg
IFRS leadership team
December 2012

Deloitte Luxembourg IFRS Newsletter

Welcome to this edition of the IFRS Newsletter of Deloitte Luxembourg prepared by the Deloitte Luxembourg IFRS Centre of Excellence with contributions from the professionals of our firm.

Considering the Luxembourg business environment, we have decided to issue a separate Newsletter relating to upcoming new requirements for investment entities issued by IASB on 31 October 2012. These will be effected through a series of changes to IFRS 10, 12 and IAS 27 with endorsement by European Union expected in Q3 2013. Early adoption in Europe would be possible only once the standard has been endorsed. The requirements are to be applied retrospectively for reporting periods beginning on or after 1 January 2014, being the dates set by IASB. We also remind that IFRS 9 is not yet endorsed in European Union and therefore that IAS 39 is still to be applied for the fair value measurement mentioned below in European Union.

In this issue, we will discuss the definition of investment entities introduced by the IASB and the new fair value rules for investment entities.

As part of its Consolidation project, the International Accounting Standards Board (IASB) has been considering, whether entities that measure and manage their investments on a fair value basis (generally known as « investment entities ») should be given relief from the consolidation requirements of IFRS 10 “Consolidated Financial Statements”. The justification for granting such relief has been that for certain entities information on the fair value of their investment in a subsidiary is more relevant than consolidation of its individual assets and liabilities and the difficulty has been to circumscribe those specific “investment entities” where this is the case.

Following comments received on its Exposure Draft (ED), which was issued in August 2011, the IASB issued a series of amendments to IFRSs to give effect to new requirements for investment entities. The requirements include some notable differences from those proposed in the ED, particularly to the definition of an “investment entity” and its application. Under the new requirements, ownership interests in entities controlled by investment entities shall be accounted for at fair value through profit and loss (FVTPL) in accordance with IFRS 9 Financial Instruments (or IAS 39 Financial Instruments: Recognition and Measurement) rather than being consolidated. Therefore this is not an option but a requirement that where an entity qualifies as an ‘investment entity’ it does not consolidate its subsidiaries but measures its investments at fair value.

As a consequence, consideration of the criteria for meeting the definition of an ‘Investment entity’ is key and it will require a degree of judgements based on facts and circumstances. These changes may impact entities traditionally considered beyond the scope of traditional investment entities.

For additional information on these topics and on services we could provide to your entity, contact us at **luifrsdesk@deloitte.lu**. Deloitte has a range of tools and publications to assist in implementing and reporting under IFRS.

We hope you find this issue useful. As always, we value and welcome your comments and feedback.

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Overview of the model

The new requirements in IFRS 10 are principally concerned with establishing whether an entity qualifies as an “investment entity”. IFRS 10 emphasises that the definition does not set a “bright-line” but establishes the typical features of an entity that meets the notion of an investment entity. Accordingly, in applying the definition judgment will need to be exercised.

Where an entity qualifies as an “investment entity”, it is required not to consolidate a subsidiary in accordance with the consolidation provisions of IFRS 10 but instead to measure its investment in the investee at FVTPL (in accordance with IFRS 9 or, when that standard has not yet been adopted, IAS 39). The rationale for this exception to the principle of consolidation of controlled investees is that to consolidate entities that are controlled by an investment entity may reduce the comparability of different investments reported in an investment entity’s financial statements and that the fair value of the investment of the investee with changes in that value recognised in profit or loss provides more relevant information for users of the financial statements of investment companies.

Defining an “investment entity”

The exception to consolidation is based on the type of entity that owns the subsidiary. A parent shall determine whether it is an investment entity. An investment entity is an entity that:

- obtains funds from one or more investors for the purpose of providing those investor(s) with professional investment management services;
- commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and
- measures and evaluates performance of substantially all of its investments on a fair value basis.

An investment entity is expected, but not required, to have these typical characteristics:

- More than one investment
- More than one investor
- Investors that are not related to the parent entity or the investment manager
- Ownership interests in the form of equity or partnership interests.

The IASB notes that “if an entity does not display one or more of the typical characteristics, it indicates additional judgment is required in determining whether the entity meets the definition of an investment entity” (IFRS 10.BC 233), but this does not necessarily mean that the definition is not met. Additional disclosures are required in this case as per paragraph 9A of IFRS 12 “Disclosure of Interests in Other Entities”.

Changes in facts and circumstances require reassessing whether the entity still meets the definition.

In satisfying the business purpose aspect of the definition, the notion of an investment time frame is critical. The investment entity should not hold its investments indefinitely but is expected to have some exit strategy for their realisation. Exit strategies need not to be documented for each investment but an entity will have to “identify different potential strategies for different types or portfolios of investments, including a substantive time frame for exiting the investments” (IFRS 10. B85F). Holding debt securities (other than those that have the potential to be held indefinitely) to maturity can be considered an exit strategy.

The existence of benefits other than capital appreciation and/or investment income may indicate that the business purpose aspect of the definition is not met. Such benefits include:

- The acquisition, use, exchange or exploitation of the processes, assets or technology of an investee
- Joint arrangements or other agreements between the entity or another group member and an investee
- Financial guarantees or assets provided by investee to serve as collateral for borrowing arrangements of the entity
- An option held by a related party of the entity to purchase an ownership interest in an investee of the entity
- Transactions between the entity or another group member and an investee that are not on normal market terms or represent a substantial portion of the investee's or the entity's business activity

The fair value aspect of the definition requires that investments in subsidiaries are measured and evaluated on a fair value basis. That is, the entity provides investors with fair value information and its key management personnel use fair value information as the primary basis for evaluating the performance of substantially all of its investments. Accordingly, Investment entities shall not apply IFRS 3, "Business Combinations" when it obtains control.

The new requirements are not prescribing an investment entity accounting model and do not explicit accounting requirements for other investments held by investment entities. An entity is required to account for any investment property, investments in associates and joint ventures and financial assets using the fair value model set out in IAS 40 "Investment Property", IAS 28 "Investments in Associates and Joint Ventures" and IFRS 9 (IAS 39) respectively, but not required to measure and manage its financial liabilities on a fair value basis.

Investments in associates and joint ventures

The consequential amendments to other standards do not include the changes to IAS 28 "Investments in Associates and Joint Ventures" which were proposed in the exposure draft. The "investment entity" provisions are achieved by electing to measure such investments at fair value under IAS 28.18 where the investment is held by an entity that is venture capital organisation, mutual fund, unit trust and similar entities including investment-linked insurance funds.

Non-investment entities

Non-investment entities are not provided with relief from consolidation and the general requirements of IFRS 10 apply even if they have subsidiaries that are themselves investment entities.

This means that non-investment entity parent company will consolidate all of its subsidiaries, including those controlled via a subsidiary that is an investment entity.

Where an investment entity group includes a subsidiary that provides only services, it does not 'taint' the investment entity treatment for the group it just means that the servicing subsidiary itself is required to be consolidated but other subsidiaries are still measured at fair value.

Disclosures (Amendments to IFRS 12)

Disclosure requirements for investment entities are set out in IFRS 12 “Disclosure of Interests in Other Entities”. An investment entity is required to disclose information about significant judgments and assumptions in determining that it has met the definition of an investment entity. In particular: (a) that it is an investment entity and as such has not consolidated controlled investees, and (b) how it has met the definition and typical characteristics to be an investment entity, with specific reasons given if it has not met one or more of them. An entity beginning or ceasing to be considered an investment entity triggers disclosure with information required on both the reason for the change and the impact on the financial statements.

An investment entity is required to provide details about each unconsolidated subsidiary including subsidiary’s name, nature and extend of any significant restrictions on it to transfer funds to the investment entity, any support or intention to provide support to the investment entity (or its subsidiaries) has provided an unconsolidated entity without having a contractual obligation to do so, principal place of business and proportion of ownership. Disclosures are also required for any structured entity that it controls.

Transition and effective date

The investment entity requirements are to be applied retrospectively and are effective for reporting periods beginning on or after 1 January 2014, although early application is permitted. The retrospective application with limited transition reliefs.

In Europe, the amendments shall be applied only after their endorsement by the European Financial Reporting Advisory Group (EFRAG), which is expected to be in Q3 2013.

Convergence with US GAAP

The IASB and the FASB had a joint project on “investment entities” and whilst there were joint deliberations on the development of proposals, the FASB decided not to provide guidance on the measurement of such interests and instead decided to allow investment companies to continue with current industry practice.

The Deloitte Luxembourg IFRS Centre of Excellence

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If you want to stay inform and receive upcoming IFRS course details, please confirm your interest by mail to **LU IFRS Desk**.

Do not hesitate to visit our **IFRS webpage**.