

## Consolidation of investments or reporting at fair value – a big issue for investment companies

### What is the issue?

The International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) are considering changing how an investment company accounts for investments in entities it controls. Exposure draft 10 *Consolidated financial statements* (ED 10), issued in December 2008, proposed that all controlled subsidiaries should be consolidated in full. However, the IASB and FASB are now considering allowing funds to recognise investments that are controlled (subsidiaries) as assets at fair value.

Impact on profit and loss	✓
Impact on balance sheet	✓
Impact on disclosures	✓
Impact on stakeholder communication	✓

### Who does it affect?

Entities that are mutual funds, unit investment trusts, hedge funds and private equity funds. These entities could be considered investment companies if the Boards' tentative decisions are incorporated into the consolidation standard.

### Why are the Boards' considering changing the proposals for investment companies?

The financial objectives of an investment company are very different from those of a multi-national business operating through controlled subsidiaries. Investment companies usually hold investments in other entities with an expectation of realising the investment at a profit in three to five years or to receive income from the investment. An investment company does not integrate investments, even when controlled, into its own operations. Investments are generally managed in accordance with a documented investment strategy to improve fair value and management information is prepared on the same basis. Users of the financial statements of these investment companies claim that the most useful information about the performance of these investments is fair value. Generally speaking, consolidated financial statements are considered to be less useful when evaluating the investment company's performance.

### What are the potential changes?

The Boards have tentatively decided that there should be an exception to the normal consolidation basis for investment companies. Investments should be accounted for as single assets at fair value, with fair value changes recognised in the income statement. The IASB has tentatively agreed to amend the current wording in ED 10.

Both Boards also believe the term "investment company" should be defined in IFRS. Last week the IASB and FASB tentatively agreed that an investment company is an entity that meets the following criteria.

- Its primary business purpose is investing for current income, capital appreciation, or both (and substantially all of the entity's activities are carried out to achieve this).
- It does not benefit (and nor do its affiliates) from investees in a way that is unavailable to other investors or unrelated parties of the investee
- It has identified potential exit strategies and a defined time / date range that it expects to exit from the investment/s
- Its investments are managed and evaluated (internally and externally) on a fair value basis
- It is a reporting entity whose ownership is represented by units of investments
- The funds of the entity's owners are pooled so that owners can avail themselves collectively of professional investment management
- None of the providers of debt to the investees of the entity have direct recourse to the entity's other investees.

### PwC insight. Tentative decisions would provide welcome relief...but will they be endorsed?

Accounting for subsidiaries as investments at fair value through the income statement would give very different information compared to full consolidation. The amount of work involved in preparing consolidated financial statements could be significantly reduced; although the amount of disclosures would probably increase.

We encourage entities to monitor developments in this area. If the issue is re-exposed for comment, it will be important for preparers and users to assess whether the proposals are practical and will lead to improved financial information.