

Investment Entities

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

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MAIN FEATURES

- Introduce the exemption to the consolidation requirements in HKFRS 10 that all subsidiaries shall be consolidated for qualified investment entities
 - Report all investments (including investments in subsidiaries)
→ At **fair value**
- Introduce the definition of investment entities and set out the conditions for the exemption
- Introduce new disclosure requirement for investment entities in HKFRS 12
- Apply the amendments **retrospectively** for annual periods beginning on or after 1 January 2014. Early application is permitted at the same time when HKFRS 10 is firstly applied (i.e. 1 January 2013)

Background

In October 2012, the International Accounting Standard Board (IASB) issued the amendments to IFRS 10, IFRS 12 and IAS 27 related to the consolidation relief for qualified investment entities. Subsequently in December 2012, the Hong Kong Institute of Certified Public Accountant also issued the same amendments so as to maintain the convergence with IFRSs.



What is an investment entity?

Specifically, being an investment entity, a parent should meet all of the following criteria:

- a) it obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;
- b) it 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) it measures and evaluates the performance of **substantially all of its investments on a fair value basis.**

In assessing whether a parent meets the above definitions, we should further consider whether it displays the following typical characteristics of an investment entity. In case any of these characteristics cannot be met, additional judgement is required.

- a) it has more than one investment;
- b) it has more than one investor;
- c) it has investors that are not related parties of the parent; and
- d) it has ownership interests in the form of equity or similar interests

In case there are facts and circumstances indicate there are changes to one or more of the above criteria or typical characteristics, a parent shall **reassess** whether it is 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. The most common investments and the measurement basis are listed as below:

Types of investments	Measurement
Investment property	Elect to account for using fair value model
Investment in associates and joint ventures	Elect the exemption from apply the equity method
Financial assets	State at fair value using the requirements in HKFRS 9

An investment entity is not required to measure non-investment assets or liabilities at fair value

Separate financial statements or consolidated financial statements?

In accordance with HKFRS 10 Consolidated Financial Statements, an entity that is a parent, is required to consolidate all investees that they control (i.e. all subsidiaries). Under the amendments, if a parent is qualified as an investment entity, it is exempted from consolidating its subsidiaries. Instead, it shall measure an investment in subsidiary at fair value through profit or loss in accordance with HKFRS 9 or HKAS 39 if an entity has not yet applied HKFRS 9. Therefore, the separate financial statements shall be its only financial statements.

If a subsidiary provides services that relate to the parent's investment activities, the parent cannot apply the consolidation relief, i.e. the parent shall consolidate that subsidiary in its financial statements.

What is our impact?

Scenario I: Qualified as an investment entity at the date of initial application

(a) Investment in a subsidiary is previously measured at cost	(b) Investment in a subsidiary is previously measured at fair values through other comprehensive income	(c) Investment in a subsidiary is previously measured at fair values through profit or loss
<ul style="list-style-type: none"> ● Measure the investment at fair value through profit or loss ● Adjust retrospectively the annual period immediately preceding the date of initial application ● Adjust retained earnings at the beginning of the immediately preceding period for the difference between: <ul style="list-style-type: none"> ● the previously carrying amount of the investment; and ● the fair value of the investor's investment in the subsidiary 	<ul style="list-style-type: none"> ● Continue to measure the 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 immediately preceding period 	<ul style="list-style-type: none"> ● Shall not make adjustments to the previous accounting for an interest in a subsidiary

What is our impact?

Scenario II: Ceased to be an investment entity

Either

- Account for an investment in a subsidiary at cost
- Use the fair value of the subsidiary at the date of the change of status as the deemed cost

OR

- Continue to account for an investment in a subsidiary in accordance with HKFRS 9

New disclosure requirements

Major disclosures in the financial statements:

- The significant judgements and assumptions used to determine an entity meets the definition of an investment entity
- If an entity does not have one or more of the typical characteristics, the reason for concluding that it is nevertheless an investment entity
- When an entity either becomes or ceases to be an investment entity, the change of status and the reasons for the change
- When an entity becomes an investment entity, the effect of the change of status on the financial statements for the period presented
- The name, principal place of business and proportion of ownership interest held by the investment entity for each unconsolidated subsidiary

More disclosures requirements can be found at the following link:

<http://app1.hkicpa.org.hk/ebook/index.php>

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