Project **Consolidation**

Topic **Investment Companies—Appendix A**

**ED 10 states in the Basis for Conclusions:**

BC22 The Board decided not to amend the scope of IAS 27 either to expand or to restrict the entities required to prepare consolidated financial statements.

BC 23 Some, including many investment companies, asked the Board to reconsider the scope of the proposed IFRS. They argued that investment companies should not be required to consolidate the investments they control because they manage those investments on a net basis and, in their view, presenting the underlying assets and liabilities of their investments is misleading and uninformative. Instead, they suggest that the investments should be recognised net and measured at fair value. They emphasise that US GAAP has a scope exception that exempts an investment company from consolidating its investments.

BC 24 The Board observed that those who argue that the investments should not be consolidated appear to suggest that consolidations fails to reflect the intentions of the management of the investment company and therefore fails to represent how the business is operated. Although those intentions are relevant and important to users of financial statements, recognition and measurement principles in IFRSs are rarely developed on the basis of the intentions of management. Rather, they are developed on the basis of reporting what currently exists and, in doing so, aim to enhance comparability between entities.

BC25 The Board noted that the concept of control is crucial to how an investment is characterised in the financial statements. If an investment entity is controlled by the investor then that entity is a subsidiary of the investor and, by definition, part of the group. In contrast, excluding an investment from consolidation would mean that the investment is treated as if it were not part of the group.

BC26 The Board observed further that introducing a scope exemption for investment companies would also create practical challenges. Although investment companies are legally defined in the US, there is no comparable international definition. The Board noted that many who asked for a scope exemption would not meet the US definition of an investment company.

BC27 The Board therefore decided that it should not propose exempting investment companies from the principle that a reporting entity's consolidated financial statements should include all entities that the reporting entity controls. The Board confirmed its reasoning set out in paragraph BC27 in the Basis for Conclusions on IAS 27:

> The Board concluded that for investments under the control of private equity entities, users' information needs are best served by financial statements in which those investments are consolidated, thus revealing the extent of the operations of the entities they control. The Board noted that a parent can either present information about the fair value of those investments in the notes to the consolidated financial statements or prepare separate financial statements in addition to its consolidated financial statements, presenting those investments at cost or at fair value. By contrast, the Board decided that information needs of users of financial statements would not be well served if those controlling investments were measured only at fair value. This would leave unreported the assets and liabilities of a controlled entity. It is conceivable that an investment in a large, highly geared subsidiary would have only a small fair value. Reporting that value alone would preclude a user from being able to assess the financial position, results and cash flows of the group.