Project **Consolidation**

Topic **Investment Companies- Disclosures**

Please note this paper is identical to Agenda paper 4B from the main April joint meeting. No changes have been made. All references within are made to the paper number from the main April joint meeting

Introduction

1. At the February joint Board meeting, the boards tentatively agreed that there should be an exception to consolidation for investment companies. Accordingly, investment companies would be required to measure investments in entities that they control at fair value. At that meeting, the staff briefly discussed whether a reporting entity that qualifies as an investment company should be required to provide any of the disclosure requirements for consolidated subsidiaries.

2. This memo highlights some of the current guidance related to the presentation and disclosure requirements for investment companies in U.S. GAAP (FASB Accounting Standards Codification™ Topic 946, Financial Services—Investment Companies). In addition, this memo provides the staff's view on what additional disclosure requirements should be required for entities that are controlled by an investment company.

Current U.S. GAAP Requirements

3. In addition to the proposed disclosure requirements for financial instruments that are being developed as part of the Accounting for Financial Instruments project (AFI) and the disclosure requirements included elsewhere in the Codification that may be required, Topic 946 includes prescriptive presentation and disclosure requirements for investment companies. The presentation and disclosure requirements in Topic 946 include:

    - a schedule of investments as either a separate schedule or part of the investment company's statement of net assets. The schedule of investments provides information regarding the type of investments held, the related industry, country or geographic region of the investment, the value of the investments, etc.;
    - the investment company's statement of net assets and statement of operations are required to include specific line items;
    - investment companies that are subject to the registration and regulatory requirements of the Investment Company Act of 1940 (1940 Act) or have essentially the same characteristics as those subject to the 1940 Act as well as certain other investment companies are not required to provide a statement of cash flows if certain criteria are met; and
    - an investment fund's financial highlights schedule. This schedule presents per share investment income or loss, realized and unrealized gains and losses per share, distributions to shareholders, purchase premiums, redemption fees, payments by affiliates, expense and net investment income ratios, total return, and capital commitments. The financial highlights schedule provides users with information on operating performance and allows for comparability among investment companies.

4. Further, the SEC rules and regulations include additional presentation and disclosure requirements for registered investment companies in the U.S.

Staff Analysis and Recommendations

5. Based on discussions with users, it appears that they are particularly interested in disclosures related to the valuation methodology used for developing fair value and the underlying inputs. This information is already required by IFRS 7 *Financial Instruments: Disclosures* and Topic 820 *Fair Value Measurements and Disclosures* when reporting investments at fair value through profit or loss in accordance with IFRS 9 *Financial Instruments*/IAS 39 *Financial Instruments: Recognition and Measurement* or when reporting in accordance with U.S. GAAP requirements for Investment Companies in Topic 946. Accordingly, the staff does not propose any additional disclosure requirements for fair value measurements made by investment companies.

6. In agenda paper 4C, the staff have proposed that some disclosures be required for subsidiaries that are individually material to a consolidated group. These proposed disclosures related to entities that are not considered structured entities include:

   (a) information about the investment including (1) the name of the investment, (2) its country of incorporation or residence and (3) the proportion of ownership interest and, if different, proportion of voting rights held. Similar disclosures are currently required by Topic 946 as part of the schedule of investments prepared by investment companies, see paragraph 3 of this paper.

   (b) all significant judgments and assumptions in determining whether it controls another entity and any changes in its control assessments that require significant judgment and the reasons for those changes. The staff does not believe that this should be required as the investments of an investment company are measured at fair value, regardless of whether they are controlled or not.

   (c) whether the reporting entity has provided financial or other support (explicitly or implicitly) during the periods presented to the entity that it was not previously contractually required to provide or whether the reporting entity intends to provide that support, including (1) the type and amount of support and (2) the primary reasons for providing the support. The staff believes that this disclosure could potentially be relevant in understanding the relationship between an investment company and its investees and, therefore, the staff recommends that this disclosure be required.

The other disclosures proposed for subsidiaries in agenda paper 4C relating to non-controlling interests are not considered relevant as an investment company measures investments in entities that it controls at fair value.

7. The staff also received input that an investment company should disclose the nature and extent of any significant restrictions (resulting from borrowing arrangements or regulatory requirements) on the ability of investees to transfer funds to the reporting entity in the form of cash dividends, or repayment of loans or advances. The staff believes that this requirement would be useful to investors because such restrictions could potentially affect the investment company's income from, or appreciation of, investments.

Summarized financial information for controlled investments

8. The staff also received feedback from some users that investment companies should be required to include the latest summarized financial information for its controlled investees, including amounts of assets, liabilities, debt, revenues, expenses, and profit or loss.

9. Some staff believe that summarized financial information should *not* be required because the appropriate measurement basis of these investments has been determined to be fair value. This is the basis for the boards' tentative decision to exempt investment companies from consolidation. Accordingly, the disclosure requirements in IFRS 7 and Topic 820 are adequate to provide users with information to support the fair value of investments. These staff do not believe that additional disclosures should be required only for some investments (controlled entities) that are measured at fair value (which may not be the most significant investments of the entity) when such additional financial information is not required for other investments that are measured at fair value (for example, amortised cost information is not provided to supplement debt measurement at fair value).

10. The staff that oppose requiring summarized financial information also note that the users who have indicated that they believe that summarized financial information should be presented are primarily concerned with the concentration risk of the investment company

to any one investment. Those staff believe that requiring a schedule of investments similar to the current U.S. GAAP requirement in Topic 946 would provide this information. Those staff also note the difficulties in preparing summarized financial information which are set out in paragraphs 13 and 14 below.

11. Other staff agree with users that summarized financial information should be required for controlled investees of investment companies to provide additional information about investments that otherwise would have been consolidated. These staff believe that summarized financial information would provide users with information to support the fair value of the investment, and to help them predict how that fair value might move in the future. Those staff would propose to require summarized financial information only for controlled investments that are individually material to the investment company. This is because users have informed us that the information is particularly useful in assessing concentration risk when an investment company has a small number of material investments.

12. Nevertheless, those staff supporting a requirement to provide summarized financial information agree that providing such information might be difficult for the reasons noted in paragraphs 13 and 14 below.

If summarized financial information is required, on what accounting basis should it be prepared?

13. Should the boards decide to propose disclosure of summarized financial information disclosures, the question arises as to what accounting basis the investment company should use to prepare the summarized financial information. Currently both U.S. GAAP and IFRS require summarized financial information prepared on a U.S. GAAP or IFRS basis for investments accounted for using the equity method (or proportionate consolidation). A reporting entity does not necessarily incur significant additional costs in providing this information because associates and joint ventures are already accounted for using the equity method (or proportionate consolidation) using the reporting entity's accounting basis. However, if summarized financial information for controlled investees of investment companies was required to be prepared on an IFRS or U.S. GAAP basis, significant additional costs might be incurred in providing this information, depending on

the nature of the controlled investee and when it reports to investors (e.g. a controlled investee that is a software developer might incur significant costs in preparing U.S. GAAP compliant revenue information; or the investee may not prepare financial statements at dates that coincide with the reporting dates of the investment company). Furthermore, in many situations, the auditors of the investees will be different from those of the investment company. If audited summarized financial statements of investees are required to be included in the investment company's financial statements, this may result in the investments company's auditor not being able to opine on the investment company's financial statements.

14. An alternative would be to ask for the most recently available summarized financial information, with adjustments made for any significant transactions entered into between the timing of preparation of that information and the date at which the investment is measured at fair value. This approach, however, could lead to the summarized financial information being difficult to understand if it is prepared for each controlled investee using different accounting policies. One way to address that concern could be to require that the investment company disclose the basis of preparation of the summarized financial information, describing the main accounting policies applied, although this could also create auditing issues.

15. Those staff supporting a requirement to provide summarized financial information recommend asking for the most recently available summarized financial information, with adjustments made for any significant transactions entered into between the timing of preparation of that information and the date at which the investment is measured at fair value. They would also recommend asking for disclosure of the basis of preparation. Those staff note that the reason for requiring the summarized financial information is to provide additional information about the fair value of the investment. It is *not* to suggest that fair value is *not* the most appropriate measurement basis for those investments. Therefore, they do not believe that it is necessary to require the summarized financial information to be prepared on an IFRS or U.S. GAAP basis. Those staff note that their recommendation does not address the auditing concerns set out in paragraphs 13 and 14 above.

Questions for the boards
1. Do the boards believe that, in addition to the information currently required to be disclosed, an investment company should be required to disclose whether it has provided any financial or other support to any of its controlled investees that it was not previously contractually required to provide? 2. Do the boards believe that an investment company should disclose the nature and extent of any significant restrictions on the ability of its controlled investees to transfer funds to the investment company? 3. Do the boards believe that the disclosure requirements for investment companies should include a requirement to disclose the most recently available summarized financial information for any individually material controlled investee that otherwise would have been consolidated? 4. Does the IASB want to include a requirement for an investment company to provide: (a) a schedule of investments that would include information regarding the type of investment held, the related industry, country or geographic region of the investment and the value of the investment? (b) a financial highlights schedule. This schedule presents per share investment income or loss, realized and unrealized gains and losses per share, distributions to shareholders, purchase premiums, redemption fees, payments by affiliates, expense and net investment income ratios, total return, and capital commitments?