



---

# Investment Companies and Investment Property Entities

## FASB Project Update

**November 2011 NCREIF Conference**

The views expressed in this presentation are those of the presenter. Official positions of the FASB are reached only after extensive due process and deliberations.



# Disclaimer

---

This presentation has been prepared by the staff of the FASB to help constituents understand the relevant projects.

The views expressed are those of the presenter and do not represent the views of the FASB.

FASB decisions are reached only after extensive due process and deliberations.



# Investment Companies

---

- Status
- Criteria - Definition
- Measurement
- Disclosure
- Transition and Effective Date



## Investment Companies: Status

---

- Joint project with the IASB to provide comprehensive guidance for assessing whether an entity is an investment company for accounting purposes
- Final standard will amend the definition, measurement requirements, and require additional disclosures
- IASB: Exposure draft issued in August 2011
- FASB: Exposure draft issued in October 2011
- Comment period end in January 5, 2012



# Investment Companies: Criteria

Criterion	Current Guidance	FASB ED
<i>Investment activities</i>	Primary business activity involves investing its assets, usually in securities of other entities not under common management, for current income, capital appreciation, or both.	Only substantive activities are investing in multiple investments for returns from capital appreciation, investment income (such as dividends or interest), or both.  The entity and its affiliates shall not obtain benefits from its investees that would be unavailable to other investors or nonaffiliated parties of the investee.



# Investment Companies: Criteria

Criterion	Current Guidance	FASB ED
<i>Express business purpose</i>	Substantively addressed through investment activity criteria	Express commitment that the purpose of the entity is investing to provide returns from capital appreciation, investment income, or both.
<i>Unit ownership</i>	Ownership in the investment company is represented by units of investments, such as shares of stock or partnership interests, to which proportionate shares of net assets can be attributed.	Ownership in the entity is represented by units of investments, in the form of equity or partnership interests, to which a portion of the net assets are attributed.
<i>Pooling of funds</i>	The funds of the investment company's owners are pooled to avail owners of professional investment management.	The funds of the entity's investors are pooled to avail investors of professional investment management. The entity has investors who are not related to the parent (if there is a parent) and those investors, in aggregate, hold a significant ownership interest.



# Investment Companies: Criteria

Criterion	Current Guidance	FASB ED
<i>Fair value management</i>	Not specifically addressed as criteria	Substantially all investments are managed, and their performance evaluated, on a fair value basis.
<i>Reporting entity</i>	The investment company is the primary reporting entity.	The investment company provides financial results about its investment activities to its investors. The entity can be but does not need to be a legal entity.

Investment companies regulated under the Investment Company Act of 1940 are within the scope.



# Investment Companies: Measurement

FASB	IASB
<ul style="list-style-type: none"><li>• <b>Consolidate</b> controlling financial interests in another investment company and an investment property entity in accordance with Topic 810 in a fund-of-funds structure</li><li>• Consolidation not permitted for controlling interests in an operating entity unless the entity provides services</li><li>• Non-investment company parent of an investment company subsidiary <b>shall retain</b> fair value accounting applied by investment company subsidiary</li><li>• <b>Fair value</b> for all other investments</li></ul>	<ul style="list-style-type: none"><li>• Consolidation <b>not permitted</b> for controlling interests unless the entity provides services</li><li>• Non-investment company parent of an investment company <b>shall not</b> retain fair value accounting applied by the investment company subsidiary</li><li>• Generally <b>fair value</b> for all other investments in accordance with <b>IFRS 9</b></li></ul>



# Investment Companies: Disclosure

---

- Investment company shall disclose:
  - Any support provided if not contractually required
  - Nature and extent of significant restrictions on the ability of investee to transfer funds to the investment company in the form of cash dividends or repayment of loans or advances
- Financial highlights calculated using consolidated amounts excluding amounts attributable to noncontrolling interests
- Investment company with real estate properties would provide property-specific disclosures required by an investment property entity.



# Investment Companies: Transition and Effective Date

- Entities that no longer meet the definition of an investment company should discontinue application of the guidance prospectively
- Entities that were not previously considered investment companies but meet the revised definition recognize a cumulative effect adjustment to opening net assets at the effective date
- Effective date determined after exposure
- Early adoption prohibited



# Investment Property Entities

---

- Background
- Scope – Entity Definition
- Investment Property Definition
- Measurement
- Interests in Other Entities
- Presentation
- Disclosure
- Transition and Effective Date
- Comparison of IAS 40 and FASB ED



# Investment Property Entities: Background

12

- No guidance in U.S. GAAP for investment properties
  - IAS 40, *Investment Property*, provides an option to measure investment properties at fair value or cost (entity policy election)
  - IASB Leases ED exempted lessors from using proposed lease guidance if they elect the fair value model under IAS 40
- Varied accounting practices by real estate entities
- Fair value requirement rather than option
  - User concerns regarding comparability
- Scope of requirement
  - Modeled off the Investment Company Definition



# Investment Property Entities: Scope – Entity Definition

- *Nature of the Business Activities.* Substantially all of the entity's business activities are investing in a real estate property or properties.
- *Express Business Purpose.* The express business purpose of the entity is to invest in a real estate property or properties for total return including an objective to realize capital appreciation, for example, through disposal of its real estate property or properties. Real estate properties held by an entity for either of the following purposes do not meet this criterion:
  - The entity's own use in the production or supply of goods or services or for administrative purposes
  - Development for sale in the ordinary course of business upon completion



# Investment Property Entities: Scope – Entity Definition

- *Unit Ownership.* Ownership in the entity is represented by units of investments, in the form of equity or partnership interests, to which a portion of net assets are attributed.
- *Pooling of Funds.* The funds of the entity's investors are pooled to avail the investors of professional investment management. The entity has investors that are not related to the parent (if there is a parent) and those investors, in aggregate, hold a significant ownership interest in the entity.
- *Reporting Entity.* The entity reports financial results about its investing activities to its investors. The entity can be but does not need to be a legal entity.



# Investment Property Entities: Exemption From Certain Criteria

15

- A subsidiary whose parent entity is required to account for its investments at fair value under U.S. GAAP or whose parent entity is a not-for-profit entity under Topic 958 that measures its investments at fair value are not subject to the *unit ownership* and *pooling of funds* criteria
  - Examples include real estate entities owned by:
    - Pension funds
    - Endowment funds
    - Investment companies
    - Investment property entities



# Investment Property Definition

---

- Real estate property, including any property improvements or integral equipment, held by an investment property entity for investing purposes rather than for either of the following purposes:
  - The entity's own use in the production or supply of goods or services or for administrative purposes
  - Development for sale in the ordinary course of business upon completion
- A right-of-use asset is recognized as an investment property at the commencement or acquisition of the lease if the underlying asset meets the definition of an investment property



# Investment Property Entities: Measurement

17

- Initial Measurement - Transaction price, including transaction costs
- Subsequent Measurement - Fair value through net income
- Noninvestment property assets measured in accordance with other U.S. GAAP
- No practicability exception to fair value for investment properties under construction
- Rental revenue on investment properties recognized when lease payments are received or as the lease payments become receivable in accordance with the contractual terms of the related lease



# Investment Property Entities: Interests in Other Entities

- Consolidate controlling financial interests in:
  - Another investment property entity
  - An investment company (Topic 946)
  - An operating entity that provides services to the investment property entity
- Other controlling financial interests at fair value through net income
- Interests with significant influence at fair value through net income, except an operating entity that provides services
- Interests without control or significant influence measured in accordance with other U.S. GAAP



# Investment Property Entities: Presentation

- Follow general presentation requirements in the Presentation Area of the FASB Accounting Standards Codification®
- An investment property entity would present the following items separately on the face of the financial statements related to investment property investments:
  - Rental revenue
  - Rental operating expenses
  - Fair value of investment properties
  - Debt



# Investment Property Entities: Disclosure

20

- Investment property entities required to disclose:
  - Direct operating expenses, separately for investment properties that generated rental revenue during the period and investment properties that did not generate rental revenue during the period
  - Any restrictions on the ability to increase rent, collect rental revenue, or collect proceeds on the sale of investment property
  - Any contractual obligations related to investment property.
- All other relevant disclosures under U.S. GAAP still apply (fair value and lessor disclosures)



# Investment Property Entities: Transition and Effective Date

---

21

- Adjustment to the opening balance of retained earnings in the period of adoption
- Early adoption prohibited
- Effective date to be determined after exposure process
- Exposure draft issued in October with the comment period ending on January 5, 2012



# Comparison of IAS 40 and FASB ED on Investment Property Entities

	IAS 40	FASB ED
Scope	<ul style="list-style-type: none"> <li>Applies to <b>all entities</b> on a property-by-property basis.</li> </ul>	<ul style="list-style-type: none"> <li>Applies to an <b>entity</b> that meets <b>certain criteria</b></li> </ul>
Definition	<ul style="list-style-type: none"> <li><b>Investment Property</b> (land or building—or part of a building—or both) held to earn rentals or for capital appreciation or both</li> </ul>	<ul style="list-style-type: none"> <li><b>Investment Property Entity</b> that invests in real estate properties for total return including an objective for capital appreciation</li> </ul>
Measurement	<ul style="list-style-type: none"> <li><b>Option</b> to measure investment property either at fair value or at cost</li> </ul>	<ul style="list-style-type: none"> <li><b>Requirement</b> to measure real estate investment properties at fair value</li> </ul>



# Comparison of IAS 40 and FASB ED on Investment Property Entities

	IAS 40	FASB ED
Fair value changes	<ul style="list-style-type: none"> <li>In net income</li> </ul>	<ul style="list-style-type: none"> <li>In net income</li> </ul>
Realized gains (losses)	<ul style="list-style-type: none"> <li>In net income</li> </ul>	<ul style="list-style-type: none"> <li>In net income</li> </ul>
Rental income	<ul style="list-style-type: none"> <li>Not specified (generally straight-line)</li> </ul>	<ul style="list-style-type: none"> <li>Contractual basis</li> </ul>
Right-of-use assets (investment properties)	<ul style="list-style-type: none"> <li>At fair value through net income</li> </ul>	<ul style="list-style-type: none"> <li>At fair value through net income</li> </ul>
Right-of-use assets (noninvestment properties)	<ul style="list-style-type: none"> <li>At amortized cost, consistent with the leases standard</li> </ul>	<ul style="list-style-type: none"> <li>At amortized cost, consistent with the leases standard</li> </ul>



# Questions & Answers

---

