FINANCIAL ACCOUNTING

EXPOSURE DRAFT

Proposed Accounting Standards Update

Issued: October 21, 2011
Comments Due: January 5, 2012

Financial Services—Investment Companies (Topic 946)

Amendments to the Scope, Measurement, and Disclosure Requirements

This Exposure Draft of a proposed Accounting Standards Update of Topic 946 is issued by the Board for public comment. Comments can be provided through an electronic feedback form accessible from the Investment Companies project page of the FASB website. Written comments can also be provided and should be addressed to:

Technical Director
File Reference No. 2011-200

Financial Accounting Standards Board
of the Financial Accounting Foundation

The *FASB Accounting Standards Codification*® is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of GAAP understand how and why GAAP is changing and when the changes will be effective.

Notice to Recipients of This Exposure Draft of a Proposed Accounting Standards Update

The Board invites individuals and organizations to send comments on all matters in this Exposure Draft of a proposed Accounting Standards Update. Responses from those wishing to comment on the Exposure Draft must be received by January 5, 2012. Interested parties can submit comments through an electronic feedback form or in the form of a written letter. The electronic feedback form can be accessed through the Investment Companies project page on the FASB's website at www.fasb.org (see Projects tab/Technical Plan and Project Updates page). Comments in the form of a written letter should be submitted by email to director@fasb.org, File Reference No. 2011-200. Those without email should send their written comments to "Technical Director, File Reference No. 2011-200, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116." Do not send responses by fax.

All comments received constitute part of the FASB's public file. The FASB will make all comments publicly available by posting them to the online public reference room portion of its website.

An electronic copy of this Exposure Draft is available on the FASB's website.

Financial Accounting Standards Board
of the Financial Accounting Foundation
401 Merritt 7, PO Box 5116, Norwalk, Connecticut 06856-5116

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Why Is the FASB Issuing This Proposed Accounting Standards Update (Update)?

Topic 946, Financial Services—Investment Companies, contains specialized accounting and disclosure requirements for investment companies. The requirements to qualify as an investment company under Topic 946 were included originally in the AICPA's Audit and Accounting Guide for investment companies.

In June 2007, the AICPA issued AICPA Statement of Position 07–1, *Clarification of the Scope of the Audit and Accounting Guide* Investment Companies *and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies,* to clarify practice issues on whether certain entities qualify as investment companies. However, in December 2007, SOP 07-1 was deferred indefinitely by the FASB for those entities that had not already adopted the SOP to allow the Board time to consider a number of implementation issues that arose from applying the SOP.

This proposed Update is a result of the efforts of the FASB and the International Accounting Standards Board (IASB) (collectively, the Boards) to develop a common, high-quality standard on consolidation policy. Investment companies carry all of their investments in operating entities at fair value, even if they hold a controlling financial interest in the investee. Therefore, the Boards agreed that, as part of the development of a consolidation standard, they would look to develop consistent criteria for determining whether an entity is an investment company. The amendments in this proposed Update would amend the guidance in Topic 946 for determining whether an entity is an investment company.

Who Would Be Affected by the Amendments in This Proposed Update?

The amendments in this proposed Update would affect entities currently within the scope of Topic 946 that do not meet the revised definition of an investment company in the proposed amendments. In addition, an entity that invests in real estate properties and meets the criteria to be an investment property entity under the proposed Accounting Standards Update, *Real Estate—Investment Property Entities (Topic 973),* would not be an investment company. The Board recommends that stakeholders review this proposed Update on investment companies concurrently with the proposed Update on investment property entities.

The proposed amendments also would affect those entities that do not meet the current criteria to be an investment company or are currently excluded specifically from the scope of Topic 946 (that is, real estate investment trusts) and would meet the revised criteria to be within the scope of Topic 946.

Finally, investment companies that have controlling financial interests in other investment companies would also be affected by the proposed amendments, because they would be required to consolidate their investment company subsidiaries. The proposed Accounting Standards Update, *Consolidation (Topic 810): Principal versus Agent Analysis*, may affect an investment company's assessment as to whether it holds a controlling financial interest in another investment company. The Board recommends that stakeholders review this proposed Update on investment companies concurrently with the proposed Update on consolidations.

What Are the Main Provisions?

The amendments in this proposed Update would affect the scope, measurement, presentation, and disclosure requirements for investment companies in U.S. generally accepted accounting principles (GAAP). The proposed amendments would:

1. Amend the investment company definition in Topic 946 and provide comprehensive guidance for assessing whether an entity is an investment company.
2. Require an investment company to consolidate another investment company or an investment property entity if it holds a controlling financial interest in the entity in a fund-of-funds structure. The investment company parent would retain the specialized guidance when consolidating another investment company or an investment property entity.
3. Amend the financial statements and financial highlights presentation requirements for situations in which an investment company consolidates a less-than-wholly-owned investment company or a less-than-wholly-owned investment property entity.
4. Prohibit an investment company that is able to exercise significant influence over another investment company or an investment property entity from accounting for its interest using the equity method of accounting. Rather, those investments would be measured at fair value.
5. Require additional disclosures including changes in an entity's status as an investment company, whether the investment company has provided support to any of its investees, and any significant restrictions on an investee's ability to transfer funds to the investment company.

How Would the Main Provisions Differ from Current U.S. Generally Accepted Accounting Principles (GAAP) and Why Would They Be an Improvement?

The amendments in this proposed Update would change the definition of an investment company. Specifically, the criteria within the definition would be expanded and additional implementation guidance would be provided. The proposed amendments would result in a more appropriate reflection of the characteristics of an investment company and capture the appropriate population of entities for which fair value for investments is the most relevant measurement attribute for the entity's financial statement users. In addition, the proposed amendments would improve the comparability of investment company financial statements prepared in accordance with U.S. GAAP and those prepared in accordance with the IASB's proposed amendments to IFRS in Exposure Draft 2011-4, *Investment Entities*.

The proposed amendments would require that an investment company account for its controlling financial interests in other investment companies and investment property entities in a fund-of-funds structure in accordance with Topic 810 on consolidations. Current U.S. GAAP generally does not permit consolidation of a controlling financial interest in a noninvestment company. However, Topic 946 is silent on consolidation of a controlling financial interest in another investment company. The proposed amendments would improve the consistency between investment companies that report under U.S. GAAP and also increase the transparency of the underlying assets and liabilities of an investment company's investees.

The proposed amendments also include additional disclosure requirements and changes to the financial highlights requirements that would provide financial statement users with additional useful information about an investment company's activities and obligations.

When Would the Amendments Be Effective?

The effective date will be determined after the Board considers the feedback on the amendments in this proposed Update. The proposed amendments would be effective for an entity's interim and annual reporting periods in fiscal years that begin after the effective date. Earlier application would be prohibited.

Upon adoption of the proposed amendments, an entity would discontinue the application of the guidance in Topic 946 if the entity no longer meets the criteria to be an investment company. The entity would present the change in its status as a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption by calculating the carrying amounts of its investees as though it had always accounted for its investments in conformity with other applicable

U.S. GAAP, if practicable. If not practicable, the entity would apply the proposed amendments as of the beginning of the period of adoption.

If an entity that historically was not an investment company meets the criteria of an investment company as a result of adopting the proposed amendments, the entity would report the effect of applying the guidance in Topic 946 as a cumulative-effect adjustment to net assets (or a similar account) as of the beginning of the period of adoption.

An investment company may be required to consolidate another investment company or an investment property entity as a result of the proposed amendments. In such situations, the investment company shall apply the requirements in Topic 810 prospectively when the proposed amendments become effective. Any difference between the net assets required to be recognized and the amount previously recognized shall be recognized as a cumulative-effect adjustment to net assets (or similar account) as of the beginning of the period of adoption.

How Do the Proposed Provisions Compare with International Financial Reporting Standards (IFRS)?

The amendments in this proposed Update are the result of the Boards' efforts to develop consistent criteria for an entity to be an investment company. Consequently, these proposed amendments would improve the comparability between entities that meet the criteria to be investment companies under U.S. GAAP and those that meet the criteria to be investment entities under the proposed amendments to IFRS. Although the proposed definition of an investment company under U.S. GAAP would be similar to the definition in the proposed amendments to IFRS, there are two significant differences in the proposed scope of entities that would be an investment company under U.S. GAAP compared with IFRS.

First, under the amendments in this proposed Update, an entity that is regulated as an investment company under the Securities and Exchange Commission's (SEC) Investment Company Act of 1940 would be an investment company. Because the regulatory requirements may differ depending on a particular jurisdiction, the IASB decided not to base its definition of an investment company on whether the entity qualifies as an investment company under local regulations.

The other significant difference in the investment company scope is that under the amendments in this proposed Update, if an investment company meets the criteria to be an investment property entity in the FASB's proposed Update on investment property entities, it would apply the requirements in that proposed Update. The IASB has not proposed specific guidance to define an investment property entity. Therefore, the entity would apply the proposed investment company requirements under IFRS that would require the entity to account for its investment properties in accordance with IAS 40, *Investment Property*.

In addition, although the definition of an investment company would be similar under the amendments in this proposed Update and the proposed amendments to IFRS, differences would exist between the accounting requirements for investment companies that report under U.S. GAAP and IFRS. For example, under the amendments in this proposed Update, an investment company would be required to consolidate another investment company in a fund-of-funds structure if it holds a controlling financial interest. Under the IASB's proposal, an investment company's controlling financial interest in another investment company would be measured at fair value, even in a fund-of-funds structure. The basis for conclusions to this proposed Update highlights some of the potential differences between U.S. GAAP and IFRS for accounting by investment companies.

In addition to differences in the standalone financial statements of an investment company, there also would be differences in how a noninvestment company parent would account for its interests in an investment company. Consistent with current U.S. GAAP, the amendments in this proposed Update would require a noninvestment company parent to retain the specialized accounting in Topic 946 for an investment company subsidiary in consolidation. In contrast, the IASB's proposal would not allow a noninvestment company parent to retain the specialized accounting for investment companies when consolidating an investment company subsidiary. However, under the amendments in this proposed Update and the IASB's proposal, the specialized accounting would be retained when a noninvestment company entity is accounting for its interest in an investment company over which it has significant influence.

The Boards will continue their discussions after considering the comments received on the amendments in this proposed Update.

Questions for Respondents

The Board invites individuals and organizations to comment on all matters in this proposed Update, particularly on the issues and questions below. Comments are requested from those who agree with the proposed guidance as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed guidance are asked to describe their suggested alternatives, supported by specific reasoning.

Scope

Question 1: The proposed amendments would require an entity to meet all six of the criteria in paragraph 946-10-15-2 to qualify as an investment company. Should an entity be required to meet all six criteria, and do the criteria appropriately identify those entities that should be within the scope of Topic 946 for investment companies? If not, what changes or additional criteria would you propose and why?

Question 2: The definition of an investment company in the proposed amendments includes entities that are regulated under the SEC's Investment Company Act of 1940. Are you aware of any entities that are investment companies under U.S. regulatory requirements that would not meet all of the proposed criteria in paragraph 946-10-15-2? If so, please identify those types of entities and which of the criteria they would not meet.

Question 3: The proposed amendments would remove the scope exception in Topic 946 for real estate investment trusts. Instead, a real estate investment trust that meets the criteria to be an investment property entity under the proposed Update on investment property entities would be excluded from the scope of Topic 946. Do you agree that the scope exception in Topic 946 for real estate investment trusts should be removed? In addition, do the amendments in the proposed Updates on investment companies and investment property entities appropriately identify the population of real estate entities that should be investment companies and investment property entities?

Question 4: The proposed amendments would require an entity to reassess whether it is as an investment company if there is a change in the purpose and design of the entity. Is this proposed requirement appropriate and operational? If not, why?

Nature of the Investment Activities

Question 5: An entity may be an investment company when it performs activities that support its investing activities. As a result, a real estate fund or real estate investment trust (that is not an investment property entity) could be an investment company if the entity (directly or indirectly through an agent) manages only its own properties. However, the entity would be precluded from being an investment company if the other activities were considered more than supporting the entity's investment activities (for example, construction). Is this requirement operational, and could it be consistently applied?

Question 6: The proposed implementation guidance includes examples of relationships or activities that would indicate that an entity obtains or has the objective of obtaining returns from its investments that are not capital appreciation or investment income. Do you agree with these examples? If not, how would you modify the examples while still addressing the Board's concerns identified in paragraphs BC15 and BC16?

Unit Ownership and Pooling of Funds

Question 7: To be an investment company, the proposed amendments would require an entity to have investors that are not related to the entity's parent (if there is a parent) and those investors, in aggregate, must hold a significant ownership interest in the entity. Is this criterion appropriate? If not, why?

Question 8: The proposed unit-ownership criterion would require an entity to have ownership interests in the form of equity or partnership interests to be an investment company. The entity would consider only those interests in determining whether it meets the proposed pooling-of-funds criterion. Therefore, a securitization vehicle, such as a collateralized debt obligation, may not qualify as an investment company under the proposed amendments because it may not meet the unit-ownership or the pooling-of-funds criterion. The entity would not consider interests held by its debt holders when evaluating these criteria to be an investment company. For entities that do not have substantive equity interests (for example, those considered variable interest entities under Subtopic 810-10), should the unit-ownership and pooling-of-funds criteria to be an investment company consider interests held by debt holders? Please explain.

Question 9: Certain entities may meet all of the other criteria to be an investment company but have only a single investor (for example, a pension plan). The amendments in FASB's proposed Update on investment property entities provides that if the parent of an entity is required to measure its investments at fair value under U.S. GAAP or the parent entity is a not-for-profit entity under Topic 958 that measures its investments at fair value, the entity would not need to meet the unit-ownership and pooling-of-funds criteria to be an investment property entity. Considering the Board's concerns identified in paragraph BC24, should the criteria in this proposed Update be amended to address situations in which the entity has a single investor?

Question 10: The unit-ownership and pooling-of-funds criteria in the proposed amendments do not consider the nature of the entity's investors for evaluating if an entity is an investment company. That is, the criteria do not differentiate between passive investors and other types of investors. Do you agree that the nature of the investors should not be considered in evaluating the unit-ownership and pooling-of-funds criteria?

Fair Value Management

Question 11: The proposed amendments would require that substantially all of an investment company's investments are managed, and their performance evaluated, on a fair value basis. Do you agree with this proposal? If not, why? Is this proposed amendment operational and could it be consistently applied? If not, why?

Interests in Other Entities

Question 12: The proposed amendments would retain the requirement that an investment company should not consolidate or apply the equity method for an interest in an operating company unless the operating entity provides services to the investment company. However, the proposed amendments would require an investment company to consolidate controlling financial interests in another investment company in a fund-of-funds structure. An investment company would not consolidate controlling financial interests in a master-feeder structure. Do you agree with this proposed requirement for fund-of-funds structures? If not, what method of accounting should be applied and why? Should a feeder fund also consolidate a controlling financial interest in a master fund? Please explain.

Question 13: The proposed amendments would require an investment company to consolidate a controlling financial interest in an investment property entity. Should an investment company be subject to the consolidation requirements for controlling financial interests in an investment property entity? If not, what method of accounting should be applied and why?

Question 14: The proposed amendments would prohibit an investment company from applying the equity method of accounting in Topic 323 to interests in other investment companies and investment property entities. Rather, such interests would be measured at fair value. Do you agree with this proposal? If not, why?

Presentation and Disclosure

Question 15: An investment company with a controlling financial interest in a less-than-wholly-owned investment company subsidiary or an investment property entity subsidiary would exclude in its financial highlights amounts attributable to the noncontrolling interest. Do you agree that the amounts attributable to the noncontrolling interest should be excluded from the calculation of the financial highlights? If not, why?

Question 16: If an investment company consolidates an investment property entity, the proposed amendments require the investment company to disclose an additional expense ratio that excludes the effects of consolidating its investment property entity subsidiaries from the calculation. Do you agree? If not, why?

Question 17: Do you agree with the additional proposed disclosures for an investment company? If not, which disclosures do you disagree with, and why? Would you require any additional disclosures and why?

Retention of Specialized Accounting

Question 18: The proposed amendments would retain the current requirement in U.S. GAAP that a noninvestment company parent should retain the specialized accounting of an investment company subsidiary in consolidation. Do you agree that this requirement should be retained? If not, why?

Effective Date and Transition

Question 19: An entity that no longer meets the criteria to be an investment company would apply the proposed amendments as a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption by calculating the carrying amounts of its investees as though it had always accounted for its investments in conformity with other applicable U.S. GAAP, unless it is not practicable. If not practicable, the entity would apply the proposed amendments as of the beginning of the period of adoption. Do you agree with this proposal? If not, why?

Question 20: How much time would be necessary to implement the proposed amendments?

Question 21: The proposed amendments would prohibit early adoption. Should early adoption be permitted? If yes, why?

Nonpublic Entities

Question 22: The proposed amendments would apply to both public and nonpublic entities. Should the proposed amendments apply to nonpublic entities? If not, how should the proposed amendments differ for nonpublic entities and why?

Amendments to the *FASB Accounting Standards Codification*®

Summary of Proposed Amendments to the Accounting Standards Codification

1. The following table provides a summary of the proposed amendments to the Accounting Standards Codification.

Codification Subtopic	**Action**	**Description of Changes**
Financial Services—Investment Companies—Overall (946-10)	Amend	The proposed amendments would amend the scope, measurement, and disclosure requirements for investment companies.
Financial Services—Investment Companies—Investment Company Activities (946-20)	Amend	The proposed amendments would require additional disclosures for investment companies.
Financial Services—Investment Companies—Presentation of Financial Statements (946-205)	Amend	The proposed amendments would require additional disclosures for investment companies.
Financial Services—Investment Companies—Balance Sheet (946-210)	Conforming Amendments	The substance of the requirements in this Subtopic would not be changed by the proposed amendments.
Financial Services—Investment Companies—Investments—Debt and Equity Securities (946-320)	Amend	The proposed amendments would clarify the initial measurement requirements for investment companies.

Codification Subtopic	Action	Description of Changes
Financial Services—Investment Companies—Investments—Equity Method and Joint Ventures (946-323)	Amend	The proposed amendments would prohibit an investment company from applying the equity method of accounting for its interests in other investment companies and investment property entities. Those interests would be measured at fair value.
Financial Services—Investment Companies—Investments—Other (946-325)	Add	The proposed amendments would provide guidance on the accounting for other investments held by investment companies.
Financial Services—Investment Companies—Property, Plant, and Equipment (946-360)	Add	The proposed amendments would provide additional measurement and disclosure guidance for real estate properties held by investment companies.
Financial Services—Investment Companies—Revenue Recognition (946-605)	Amend	The proposed amendments would require an investment company to recognize rental revenue related to real estate properties when lease payments are received or as lease payments become receivable in accordance with the contractual terms of the related lease.
Financial Services—Investment Companies—Consolidation (946-810)	Amend	The proposed amendments would require an investment company to consolidate a controlling financial interest in another investment company or an investment property entity.
Investments—Equity Method and Joint Ventures—Overall (323-10)	Conforming Amendments	The substance of the requirements in this Subtopic would not be changed by the proposed amendments.
Consolidation—Overall (810-10)	Conforming Amendments	The substance of the requirements in this Subtopic would not be changed by the proposed amendments.

Introduction

2. The Accounting Standards Codification is amended as described in paragraphs 3–32. In some cases, to put the change in context, not only are the amended paragraphs shown but so are the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is <u>underlined</u>, and deleted text is ~~struck out~~. The newly added Subtopics and Master Glossary terms are not underlined to enhance readability. Amendments are made to the current content instead of the pending content because the pending content in Subtopics 946-10, 946-323, and 946-810 is being superseded as of the effective date of this Update. Therefore, the pending content is not shown here as struck-out text.

Amendments to the Master Glossary

3. Add the following Master Glossary terms to Subtopic 946-10 as follows:

Affiliate

A party that, directly or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with an entity.

Parent

An entity that has a controlling financial interest in one or more subsidiaries. (Also, an entity that is the primary beneficiary of a variable interest entity.)

Related Parties

Related parties include:

a. Affiliates of the entity
b. Entities for which investments in their equity securities would be required, absent the election of the fair value option under the Fair Value Option Subsection of Section 825–10–15, to be accounted for by the equity method by the investing entity
c. Trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of management
d. Principal owners of the entity and members of their immediate families
e. Management of the entity and members of their immediate families
f. Other parties with which the entity may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests
g. Other parties that can significantly influence the management or operating policies of the transacting parties or that have an ownership interest in one of the transacting parties and can significantly influence

the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests.

4. Add the following Master Glossary term to Subtopics 946-205 and 946-810 as follows:

Parent

An entity that has a controlling financial interest in one or more subsidiaries. (Also, an entity that is the primary beneficiary of a variable interest entity.)

Amendments to Subtopic 946-10

5. Amend paragraphs 946-10-05-1 through 05-3, with a link to transition paragraph 946-10-65-2, as follows:

Financial Services—Investment Companies—Overall

Overview and Background

946-10-05-1 The Financial Services—Investment Companies Topic includes the following Subtopics:

a. Overall
b. Investment Company Activities
c. Presentation of Financial Statements
d. Balance Sheet
e. Income Statement
f. Statement of Cash Flows
g. Notes to Financial Statements
h. Cash and Cash Equivalents
i. Receivables
j. Investments—Debt and Equity Securities
k. Investments—Equity Method and Joint Ventures
kk. Investments—Other
kkk. Investments—Property, Plant, and Equipment
l. Liabilities
m. Equity
n. Revenue Recognition
o. Income Taxes
p. Consolidation
q. Foreign Currency Matters.

946-10-05-2 An investment company, as used in this Topic, generally is an entity that pools ~~shareholders'~~investors' funds to provide the ~~shareholders~~investors with professional investment management. Typically, an investment company sells its ~~shares to the public~~ownership units, invests the proceeds~~, mostly in securities,~~ to achieve its investment objectives, and ~~distributes~~ provides returns to its ~~shareholders~~investors from the net income earned on its investments and net gains realized on the ~~sale~~disposal of its investments. Investments typically consist of securities of other entities, but also may include commodities, securities based on indexes, securities sold short, derivative instruments, real estate properties, and other forms of investments. In this Topic, the term *investment company* refers to an entity with the attributes described in paragraph 946-10-15-2.~~ This term is not used to conform with the legal definition of an investment company in the federal securities laws.~~

946-10-05-3 Several kinds of investment companies exist: management investment companies, unit investment trusts, common (collective) trust funds, investment partnerships, certain separate accounts of life insurance companies, and offshore funds. Management investment companies may be open-end ~~funds, usually known as mutual funds,~~and **closed-end funds** (commonly known as mutual funds), special purpose funds, venture capital investment companies, small business investment companies, and business development companies. Investment companies are organized as corporations (in the case of mutual funds, under the laws of certain states that authorize the issuance of common shares redeemable on demand of individual shareholders), common law trusts (sometimes called business trusts), limited partnerships, limited liability investment partnerships and companies, and other more specialized entities, such as separate accounts of insurance companies that are not in themselves entities. ~~entities at all except in the technical definition of the Investment Company Act of 1940.~~

6. Amend paragraphs 946-10-15-1 through 15-3, with a link to transition paragraph 946-10-65-2, as follows:

Scope and Scope Exceptions

> Overall Guidance

946-10-15-1 The Financial Services-Investment Companies Topic only provides incremental industry-specific guidance for the entities defined in this Scope Section, or as further defined in the Scope Sections of the individual Financial Services—Investment Companies Subtopics. Entities within the scope of this Topic also shall ~~also~~ comply with the applicable guidance not included in this Topic. The Scope Section of the Overall Subtopic establishes the pervasive scope for all Subtopics of the Financial Services—Investment Companies Topic. Unless explicitly addressed within specific Subtopics, the following scope guidance applies to all Subtopics of the Financial Services—Investment

Companies Topic, with the exception of Subtopic 946-605, which has its own discrete scope.

> Entities

946-10-15-2 The accounting principles discussed in this ~~the Financial Services—Investment Companies~~ Topic apply to all investment companies. An entity is required to consider its purpose and design when determining whether it is an investment company. An investment company as ~~Investment companies~~ discussed in this Topic ~~Topic are~~is an entity that is regulated under the Investment Company Act of 1940 ~~required to report their investment assets at~~ ~~**fair value**~~ ~~and have~~ or is an entity that meets all of the following ~~attributes~~ criteria:

a. Nature of the ~~Investment~~ investment ~~activity~~ activities. The investment company's only substantive activities are investing in multiple investments for returns from ~~primary business activity involves investing its assets, usually in the securities of other entities not under common management, for current income,~~ capital appreciation, investment income (such as dividends or interest), or both.

aa. Express business purpose. The express business purpose of the investment company is investing to provide returns from capital appreciation, investment income (such as dividends or interest), or both.

b. Unit ownership. Ownership in the **{remove glossary link} investment company {remove glossary link}** is represented by units of investments, ~~such as shares of stock~~ in the form of equity or partnership interests, to which a portion of the ~~proportionate shares of~~ net assets ~~can be~~ are attributed.

c. Pooling of funds. The funds of the investment company's ~~owners~~ investors are pooled to avail ~~owners~~ 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.

cc. Fair value management. Substantially all of the investment company's investments are managed, and their performance evaluated, on a fair value basis.

d. 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 ~~is the primary reporting~~ entity.

The implementation guidance in Section 946-10-55 is an integral part of evaluating whether an entity meets each criterion above to be an investment company.

~~Further, an investment company (other than a separate account of an insurance company as defined in the Investment Company Act of 1940) must be a separate legal entity to be within the scope of the Financial Services—Investment Companies Topic. That is, the guidance in this Topic should be applied only if the~~

~~investment is held by an investment company that is a separate legal entity. Though many aspects of venture capital investment companies, including small business investment companies and business development companies, differ from aspects of other types of investment companies, the provisions of this Topic generally apply.~~

946-10-15-3 The guidance in this Topic does not apply to ~~real estate investment trusts~~ investment property entities, which ~~have some of the attributes of investment companies but~~ are covered by ~~other generally accepted accounting principles (GAAP)~~Topic 973. **[See the FASB's proposed Update on investment property entities.]**

7. Add paragraphs 946-10-25-1 through 25-3, with a link to transition paragraph 946-10-65-2, as follows:

Recognition

> Reassessment

946-10-25-1 The initial determination of whether an entity is an investment company within the scope of this Topic shall be made upon formation of the entity. The entity shall reassess whether it meets (or does not meet) the criteria of an investment company in this Topic only if there is a subsequent change in the purpose and design of the entity.

946-10-25-2 An entity that no longer meets the criteria to be an investment company under this Topic shall discontinue applying the guidance in this Topic and shall account for the change in its status prospectively by accounting for its investments in accordance with other Topics as of the date of the change in status. The fair value of the investment at the date of the change in status (as opposed to the reporting date) shall be the investment's initial carrying amount.

946-10-25-3 An entity that subsequently meets the criteria to be an investment company under this Topic shall account for the effect of the change in status from the date of the change in status. The effect of applying this Topic shall be recognized as a cumulative-effect adjustment to net assets at the date of the change in status. The cumulative-effect adjustment shall be included in the net asset value at the beginning of the period in the per-share information included in the financial highlights. The adjustment to net assets represents both of the following:

a. The difference between the fair value and the carrying amount of the entity's investees (or parent's portion of the assets minus liabilities for consolidated investments) at the date of the change in status
b. Any changes in the fair value of the investees' net assets previously recognized in accumulated other comprehensive income.

8. Amend paragraphs 946-10-50-1 through 50-2 by adding the following new text, with a link to transition paragraph 946-10-65-2, as follows:

Disclosure

946-10-50-1 An entity with a change in status (as described in paragraphs 946-10-25-1 through 25-3) shall disclose the fact that a change in status occurred and the reasons for that change.

946-10-50-2 An entity that previously was not an investment company under this Topic and becomes an investment company under this Topic shall disclose the effect of the change in status on the reported amounts of investments as of the date of the change in status.

9. Amend paragraphs 946-10-55-1 through 55-32 and related headings by adding the following new text, with a link to transition paragraph 946-10-65-2, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

> > Definition of an Investment Company

946-10-55-1 This Section provides guidance on implementing the definition of an investment company and is organized as follows:

- a. Nature of the investment activities
- b. Express business purpose
- c. Unit ownership
- d. Pooling of funds
- e. Fair value management
- f. Reporting entity.

> > > Nature of the Investment Activities

946-10-55-2 An investment company should have no substantive activities other than its investing activities and should not have significant assets or liabilities other than those relating to its investment activities, subject to the exceptions in the following paragraph.

946-10-55-3 If an investment company provides (or holds an investment in an entity that provides) services that relate only to the investment company's own investment activities (for example, investment advisory or transfer agent services), even if those activities are substantive, the investment company can still meet the nature-of-the-investment-activities criterion. An investment company also may provide services to other entities only if those activities are not substantive.

> > > > Multiple Investments

946-10-55-4 An investment company is required to hold multiple investments at the same time, directly or indirectly through another investment company. For example, a feeder fund could hold multiple investments indirectly through a master fund in a master-feeder structure, or an investment company could hold multiple investments indirectly in a fund-of-funds structure if the underlying fund holds multiple investments. Investments typically consist of securities of other entities, but also may include commodities, securities based on indexes, securities sold short, derivative instruments, real estate properties, and other forms of investments.

946-10-55-5 Although an investment company must hold multiple investments, an investment company is not required to hold multiple investments at all times throughout its existence. For example, an entity is not precluded from being an investment company in each of the following situations, provided it meets the other criteria of an investment company in paragraph 946-10-15-2:

a. The entity's initial offering period has not expired.
b. The entity has not yet identified suitable investments and, therefore, has not yet fully executed its investment plan to acquire multiple investments.
c. The entity has not yet made other investments to replace those it has disposed of.
d. The entity is in the process of liquidation.

946-10-55-6 Investment companies may hold a single investment in circumstances in which they are formed (for legal, regulatory, tax, or other reasons) in conjunction with another investment company that holds multiple investments (directly or indirectly). For example, investment companies sometimes establish subsidiary investment companies to hold certain individual investments for legal reasons. An entity is not precluded from being an investment company in these circumstances, if the entity otherwise meets the definition of an investment company.

> > > > Returns

946-10-55-7 An entity would not meet the nature-of-the-investment-activities criterion if the entity or its **affiliates** obtain or have the objective of obtaining returns from its investments other than capital appreciation or investment income in entities other than an investment company or an investment property entity as defined in Topic 973. Examples of relationships and activities between (1) the entity or its affiliates and (2) an investee or its affiliates (other than an investment company or an investment property entity as defined in Topic 973) that demonstrate that an entity is investing for other than capital appreciation or investment income include the following:

a. The entity or its affiliates acquire, use, exchange, or exploit the processes, intangible assets, or technology of the investee or its affiliates.
b. There are other arrangements to jointly develop, produce, market, or provide products or services.
c. There are transactions that meet any of the following:
   1. They are on terms that are unavailable to entities that are not affiliates of the investee.
   2. They are not at fair value at the measurement date or are not conducted at arm's length.
   3. They represent a significant portion of the investee's or the entity's business activity, including business activities of affiliates of the entity or affiliates of the investee.
d. The entity or its affiliates have disproportionate rights, or exclusive rights, to purchase or otherwise acquire assets, technology, products, or services of an investee or its affiliates (for example, an affiliate of the entity holds an option to purchase an asset from an investee of the entity if the asset's development is deemed successful).
e. The investee or its affiliates provide financing guarantees or assets to serve as collateral for borrowing arrangements of the entity or its affiliates to provide returns or with the objective of providing returns other than capital appreciation or investment income. This paragraph does not prohibit an investment company from using its investments in its investees as collateral for any of its borrowings.
f. An affiliate of the entity holds an option to purchase ownership interests in the entity's investees from the entity at an amount other than fair value.

> > > Express Business Purpose

946-10-55-8 The definition of an investment company requires the entity to have made a commitment to a group of investors or potential investors that the purpose of the entity is investing for returns from capital appreciation, investment income (such as dividends or interest), or both. An entity that has an express business purpose that includes activities other than investing for returns from capital appreciation, investment income (such as dividends or interest), or both does not meet the definition of an investment company.

946-10-55-9 Evidence of the entity's business purpose may be included in the entity's offering memorandum, publications distributed by the entity, and other corporate or partnership documents that indicate the investment objectives of the entity. Evidence of the entity's express business purpose also may include the manner in which the entity presents itself to other parties (such as potential investors or potential investees). For example, an entity that presents its business to its investors as having the objective of investing for capital appreciation has an express business purpose that is consistent with the express business purpose of an investment company. Alternatively, an entity that presents itself as an investor whose objective is jointly developing, producing, or marketing products with its investees has an express business purpose that is inconsistent with the business purpose of an investment company.

946-10-55-10 An entity's express business purpose also is evidenced through its investment plans. Accordingly, an investment company whose express business purpose includes realizing capital appreciation should have an exit strategy for how it plans to realize the capital appreciation of its investments. Although the investment company may not yet have determined the specific method or timing of disposing of an investment, the fact that the investment company has identified potential exit strategies through which it can realize capital appreciation provides evidence that its express business purpose is consistent with the definition of an investment company. Disposal of investments only during liquidation or to satisfy investor redemptions are not exit strategies. Therefore, an entity should have a plan to dispose of its investments before liquidation when its express business purpose includes realizing capital appreciation. An investment company whose express business purpose is only to invest for returns from investment income does not require an exit strategy for its investments.

> > > Unit Ownership

946-10-55-11 The definition of an investment company requires that investors acquire ownership units in the form of equity or partnership interests in the investment company. Each unit of ownership represents a specifically identifiable portion of the net assets of the investment company, although each unit does not have to represent a proportionate interest in all of the underlying investments of the investment company.

946-10-55-12 Having multiple classes of equity instruments, such as shares with distinct rights, does not preclude an entity from being an investment company.

> > > Pooling of Funds

946-10-55-13 An investment company sells its ownership interests to investors and invests the proceeds to achieve its investment objectives. To meet the definition of an investment company, an entity must have investors that are not **related parties** of the entity's **parent** (if there is a parent) and those investors, in aggregate, must hold a significant ownership interest in the entity. Investors that are related to the parent should be combined and treated as a single investor, along with the parent, for the purposes of applying this criterion. An entity is not precluded from meeting the pooling-of-funds criterion in each of the following situations:

a. The entity's initial offering period has not expired, and the entity is actively identifying suitable investors.

b. The entity is actively identifying suitable investors to replace those that have redeemed their ownership interest.
c. The entity is in the process of liquidation.

946-10-55-14 If the parent (or its related parties) has an implicit or explicit arrangement that would require them to acquire another investor's ownership interests in the investment company at an amount other than fair value, those investments should be combined and treated as if they were owned by the parent for the purposes of evaluating this criterion. Examples of when investments would be combined and treated as if they were owned by the parent include each of the following:

a. The parent or its related parties write a put option to acquire another investor's ownership interests in the entity.
b. The parent finances another investor's ownership interests, and the ownership interests are collateral for the debt.

946-10-55-15 An entity with a single investor parent may be formed (for legal, regulatory, tax, or other business reasons) in conjunction with its parent (for example, a master feeder structure or a blocker fund). In some cases, the parent entity may have its own investors that are not related and that hold significant ownership interests in the parent entity. Provided that the entity meets all of the other criteria for an investment company, having a single investor that is itself an investment company would not preclude the entity from meeting the definition of an investment company. See Example 4 in paragraphs 946-10-55-29 through 55-32.

> > > Fair Value Management

946-10-55-16 Substantially all of the investments of an investment company must be managed and their performance evaluated on a fair value basis. This evaluation is based on the way the investment company manages and evaluates performance rather than on the nature of its investments. The investment company activities must demonstrate that fair value is the primary measurement attribute used to make a decision about the financial performance of those assets. An exception to this requirement would be assets held by the entity that are used to service the investment company's own investments (see paragraph 946-10-55-3).

> > > Reporting Entity

946-10-55-17 An entity can be but does not need to be a legal entity to be an investment company. The economic substance of the entity, rather than its legal form, should be evaluated to determine whether the entity is a reporting entity that provides investors with periodic financial results about its investing activities.

> Illustrations

946-10-55-18 The following Examples illustrate the scope and application of this Subtopic.

> > Example 1

946-10-55-19 Entity LP is formed in 20X1 as a limited partnership with a 10-year life. The offering memorandum provides that Entity LP's purpose is to invest in entities with rapid growth potential, with the objective of realizing capital appreciation over its life. Entity GP (the general partner of Entity LP) provides 1 percent of the capital to Entity LP and has the responsibility of identifying suitable investments for the partnership. Approximately 75 limited partners, that are not related to Entity GP, provide 99 percent of the capital to the partnership.

946-10-55-20 Entity LP begins its investment activities in 20X1. However, no suitable investments are identified by the end of 20X1. In 20X2, Entity LP acquires a controlling financial interest in one entity, Entity ABC. However, Entity LP is unable to close any other investment transactions until 20X3, at which time it acquires equity interests in five additional operating companies. Other than acquiring these equity interests, Entity LP conducts no other activities. Entity LP manages its investments on a fair value basis, and information about its investments is provided to Entity GP on a fair value basis.

946-10-55-21 Entity LP has plans to dispose of its interests in each of its investees during the 10-year stated life of the partnership. Such disposals include the sale for cash of the equity interest or the distribution of marketable equity securities to investors following the successful public offering of the investees' securities.

946-10-55-22 Entity LP meets the definition of an investment company from formation in 20X1 to December 31, 20X3. All of the following conditions exist:

a. Entity LP's only activity is acquiring equity interests in operating companies with the purpose of realizing capital appreciation over the life of the investments.
b. Although Entity LP does not hold multiple investments until 20X3, during each of 20X1, 20X2, and 20X3, its express business plan is to hold multiple investments, and it is actively pursuing investment opportunities during these periods.
c. Ownership in Entity LP is represented by units of partnership interests acquired through capital contributions to which the net assets are attributed.
d. Entity LP is funded by multiple investors that are not related to each other or to Entity GP.
e. The performance of the investments is evaluated on a fair value basis.
f. Entity LP is an entity reporting financial results about its activities to its investors.

> > Example 2

946-10-55-23 Entity HTF, a high technology fund, was formed by six technology companies to invest in technology start-up companies for capital appreciation. Three of the investors in Entity HTF hold options to acquire controlling financial interests in the investments held by Entity HTF, at their fair value, if the technology developed by the investees would benefit the operations of the investors. No plans for exiting the investments have been identified by Entity HTF. Entity HTF is managed by an investment adviser that is otherwise not related to the investors. Nonetheless, the investors in Entity HTF provide significant advice to the investment adviser about potential investments.

946-10-55-24 Even though Entity HTF's business purpose and investment activities are investing for capital appreciation, and pooling of funds exists, Entity HTF is not an investment company because the investment plans of Entity HTF do not include exit strategies for its investments. Although the investors of Entity HTF hold options to acquire controlling financial interests in investees held by Entity HTF if the assets developed by the investees would benefit the operations of the investors, the call rights are not controlled by Entity HTF and do not constitute an exit strategy. If Entity HTF had identified a separate exit strategy to dispose of its investments, the call rights may question the substance of Entity HTF's exit strategy.

> > Example 3

946-10-55-25 Entity LP, a limited partnership with a 25-year life, was formed to own and operate retail properties. The general partner, Entity GP, initially has a 52 percent interest in Entity LP. The limited partners include a number of unrelated investors, both individuals and companies. The limited partners do not have the right to replace or remove the general partner, except for cause (for example, fraud).

946-10-55-26 Entity GP has a controlling financial interest in Entity LP and, therefore, is an affiliate of Entity LP. Entity LP acquires land for development through contributions of properties from Entity GP.

946-10-55-27 Entity GP's interest in Entity LP is increased on the basis of the value of the contributed properties. The properties are developed into retail centers through development agreements with Entity GP. After development, the properties are managed by Entity GP. Entity GP also develops, owns, and operates other retail properties. Upon termination of Entity LP, the properties may be sold to third parties, or Entity GP may acquire properties from Entity LP at values determined by independent appraisals.

946-10-55-28 Entity LP is evaluated under Topic 973 and determined to not be an investment property entity. Entity LP is then evaluated under Topic 946 and determined to not be an investment company because of the following:

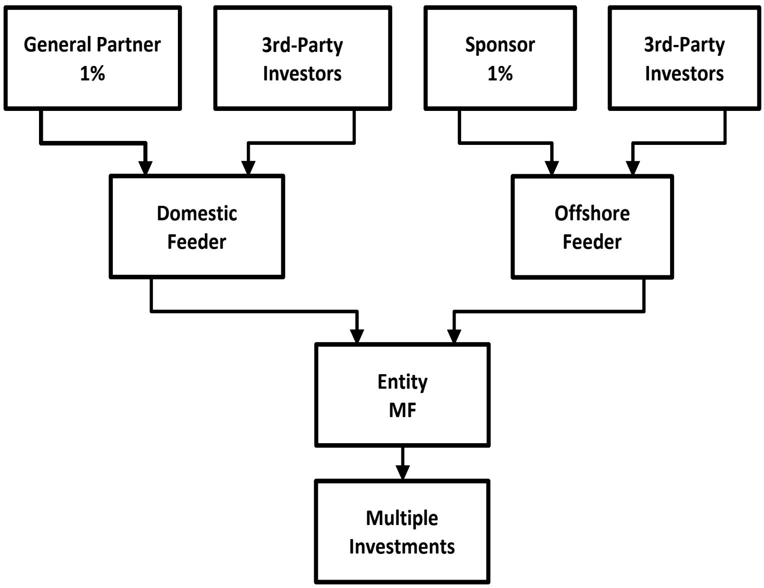
a. The business purpose and activities of Entity LP include developing retail properties. The nature of the partnership's activities would be considered other than investing for capital appreciation, investment income, or both.
b. Entity LP's substantive activities are considered other than for capital appreciation or investment income because Entity GP (an affiliate of Entity LP) is actively involved in the development and operation of the properties. Even though these transactions may be on terms that are available to entities that are not related parties of the investee (at a price that would be paid in an orderly transaction between market participants at the measurement date), the development and operations of the properties represent a significant portion of the investee's business activities.

> > Example 4

946-10-55-29 Entity MF, a master fund, is formed in 20X1 with a 10-year life. The equity of Entity MF is held by two affiliated feeder funds. The feeder funds are established to meet legal, regulatory, tax, or other requirements. The domestic feeder partnership is capitalized with a 1 percent investment from the general partner and 99 percent from unaffiliated investors (with no party holding a controlling financial interest). The offshore feeder fund is capitalized with a 1 percent investment from the sponsor and 99 percent from unaffiliated investors (with no party holding a controlling financial interest). The general partner of the domestic onshore partnership and the sponsor of the offshore feeder are the same entity.

946-10-55-30 The following diagram illustrates this Example.

[For ease of readability, the diagram is not underlined as new text.]



946-10-55-31 The purpose of Entity MF is to hold multiple investments to generate returns from capital appreciation and investment income (such as dividends or interest). The feeder funds have communicated to potential investors that the purpose of the master-feeder structure is to provide investment opportunities for investors in separate market niches to invest in a large pool of assets. Entity MF has identified exit strategies for the investments that it holds. In addition, the investments in the master fund are managed, and their performance evaluated, on a fair value basis.

946-10-55-32 Entity MF and the feeder funds meet the definition of an investment company. All of the following conditions exist:

a. Entity MF's only activities are holding multiple investments for returns from capital appreciation and investment income (such as dividends or interest). Even though the sole investment held by the feeder funds is their investment in Entity MF, the feeder funds meet the multiple-investments criteria because they were formed in conjunction with Entity MF, which holds multiple investments.

b. Entity MF's business purpose, which was communicated directly to investors of the feeder funds, is investing for returns from capital appreciation and investment income (such as dividends or interest).
c. Ownership in Entity MF and the onshore feeder fund are represented by partnership interests to which the net assets are attributed. Ownership in the offshore feeder fund is represented by equity interests to which the net assets are attributed.
d. Even though Entity MF is wholly capitalized by the feeder funds, it was formed in conjunction with the feeder funds, which are funded by investors that are not related to each other or the general partner.
e. The investments made by Entity MF are managed, and their performance evaluated, on a fair value basis.
f. Entity MF and the feeder funds are entities reporting financial results about their activities to their investors.

10. Amend paragraph 946-10-65-1 and add paragraph 946-10-65-2 and its related heading as follows:

Transition and Open Effective Date Information

> Transition and Effective Date of Certain Scope, Equity Method, and Consolidation Guidance

946-10-65-1 ~~The effective date of the pending content that links to this paragraph is delayed indefinitely.~~ An entity that early adopted ~~that~~ the pending content that links to this paragraph before December 15, 2007, is permitted but not required to continue to apply the provisions of that pending ~~content.~~ content until the effective date of Accounting Standards Update No. 2012-XX, as specified in paragraph 946-10-65-2. After the effective date of Update No. 2012-XX, the pending content that links to this paragraph is superseded and may no longer be applied. No other entity may adopt the provisions of the pending content that links to this paragraph, with the following exception. If a parent entity that early adopted the pending content that links to this paragraph chooses not to rescind its early adoption, an entity consolidated by that parent entity that is formed or acquired after that parent entity's adoption of that pending content must apply the provisions of that pending content in its standalone financial statements. If an entity that early adopted the provisions of the pending content that links to this paragraph voluntarily rescinds its early adoption as permitted by this paragraph, that entity shall account for that change according to the provisions of Subtopic 250-10.

> Transition Related to Accounting Standards Update No. 2012-XX, *Financial Services—Investment Companies (Topic 946): Amendments to the Scope, Measurement, and Disclosure Requirements*

946-10-65-2 The following represents the transition and effective date information related to Accounting Standards Update No. 2012-XX, *Financial*

Services—Investment Companies (Topic 946): Amendments to the Scope, Measurement, and Disclosure Requirements:

a. The pending content that links to this paragraph shall be effective for an entity's interim and annual reporting periods that begin after (date to be inserted after exposure). Earlier application is prohibited.

Entities that no longer meet the criteria to be investment companies

b. An entity shall no longer apply the guidance in Topic 946 if it no longer meets the criteria to be an investment company. If an entity is required to consolidate a subsidiary because the entity does not meet the revised definition of an investment company, the initial measurement of the assets, liabilities, and noncontrolling interests of the subsidiary depends on whether the determination of their carrying amounts is practicable. In this context, *carrying amounts* refers to the amounts at which the assets, liabilities, and noncontrolling interests would have been carried in the consolidated financial statements if the requirements of the pending content that links to this paragraph had been effective when the entity acquired its controlling financial interest in the subsidiary.
c. Similarly, for those investments that are required to be accounted for using the equity method as a result of the entity no longer meeting the criteria to be an investment company, the initial measurement of the investments depends on whether the determination of the investment's carrying amount is practicable. In this context, *carrying amount* refers to the amount at which the equity method investee would have been carried in the consolidated financial statements if the requirements of the pending content that links to this paragraph had been effective when the entity acquired its equity method investment.
d. If determining the carrying amounts is not practicable, the entity shall use the fair value of an investment at the date that the pending content that links to this paragraph becomes effective in applying Topic 805 or 323 at that date.
e. For all other investments that are required to be accounted for under other GAAP as a result of the entity no longer meeting the criteria to be an investment company, the initial measurement of those investments shall be the fair value at the date of adoption.
f. An entity that is required to consolidate a subsidiary as a result of the initial application of the pending content that links to this paragraph may elect the fair value option provided by the Fair Value Option Subsections of Subtopic 825-10 only if the entity elects the option for all financial assets and financial liabilities of that subsidiary that are eligible for this option under those Fair Value Option Subsections. This election shall be made upon the adoption of the pending content that links to this paragraph on a subsidiary-by-subsidiary basis. In addition, an entity may elect the fair value option for its investments that are required to be

accounted for using the equity method of accounting or other GAAP as a result of the initial application of the pending content that links to this paragraph.

g. At the date of adoption, for those entities that no longer meet the criteria to be an investment company, the difference between the net assets required to be recognized and the amount previously recognized shall be recognized as a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption. An entity shall describe the transition method(s) applied and shall disclose the amount and classification in its statement of financial position of the consolidated assets or liabilities by the transition method(s) applied.

Entities that become investment companies

h. If an entity that historically did not meet the criteria to be an investment company under Topic 946 does meet the criteria as a result of the pending content that links to this paragraph, it shall report the effect of applying the pending content that links to this paragraph as of the date that the content is first effective. The effect of applying the proposed amendments shall be recorded as an adjustment to opening net assets (or a similar account). The adjustment to opening net assets (or similar account) shall be included in the net asset value at the beginning of the period in the per-share information included in the financial highlights. The adjustment to net assets (or a similar account) represents both of the following:
   1. The difference between the fair value and the carrying amount of the entity's investees (or parent's portion of the assets minus liabilities for consolidated investments) at the date of adoption
   2. Any changes in the fair value of the investees' net assets previously recorded in accumulated other comprehensive income.

Consolidation of another investment company or an investment property entity

i. An investment company may be required to consolidate another investment company or an investment property entity as a result of initially applying the pending content that links to this paragraph. In such situations, the investment company shall apply the requirements in Topic 810 prospectively when the pending content that links to this paragraph becomes effective.

j. An entity that is required to consolidate another investment company or an investment property entity as a result of the initial application of the pending content that links to this paragraph may elect the fair value option provided by the Fair Value Option Subsections of Subtopic 825-10 only if the entity elects the option for all financial liabilities of that investment company subsidiary and all financial assets and financial liabilities of an investment property entity subsidiary that are eligible for this option under those Fair Value Option Subsections. This election shall be made upon the adoption of the pending content that links to this paragraph on a subsidiary-by-subsidiary basis.

k. At the date of adoption, any difference between the net assets required to be recognized and the amount previously recognized shall be recognized as a cumulative-effect adjustment to net assets (or similar account) as of the beginning of the period of adoption.

Amendments to Subtopic 946-20

11. Add paragraphs 946-20-50-15 through 50-16 and their related headings, with a link to transition paragraph 946-10-65-2, as follows:

Financial Services—Investment Companies—Investment Company Activities

Disclosure

> Financial Support

946-20-50-15 An investment company shall disclose whether it has provided financial support during the periods presented to any of its investments that it was not previously contractually required to provide support to or whether it intends to provide such support, including the following:

a. The type and amount of support provided, including situations in which the investment company assisted the investee in obtaining financial support

b. The primary reasons for providing the support.

> Dividend Restrictions

946-20-50-16 An investment company shall disclose the nature and extent of any significant restrictions on the ability of investees to transfer funds to the investment company in the form of cash dividends, or interest, or repayment of loans or advances.

Amendments to Subtopic 946-205

12. Amend paragraph 946-205-50-1, with a link to transition paragraph 946-10-65-2, as follows:

Financial Services—Investment Companies—Presentation of Financial Statements

Disclosure

> Financial Highlights

946-205-50-1 Financial highlights shall be presented either as a separate schedule or within the notes to financial statements for each class of common shares outstanding. <u>See Subtopic 946-810 for incremental guidance on calculating financial highlights for consolidated financial statements.</u>

Amendments to Subtopic 946-210

13. Amend paragraphs 946-210-50-8 through 50-9, with a link to transition paragraph 946-10-65-2, as follows:

Financial Services—Investment Companies—Balance Sheet

Disclosure

> > Investments in Other Investment Companies

946-210-50-7 This guidance applies to all investment companies.

946-210-50-8 Investments in other <u>unconsolidated</u> investment companies (investees), such as investment partnerships, limited liability companies, and funds of funds, shall be considered investments for purposes of applying paragraph 946-210-50-1(a) through (b) and 946-210-50-6.

946-210-50-9 If the reporting investment company's proportional share of any investment owned by any individual <u>unconsolidated</u> investee exceeds 5 percent of the reporting investment company's net assets at the reporting date, each such investment shall be named and categorized as discussed in paragraph 946-210-50-6. These investee disclosures shall be made either in the condensed schedule of investments (as components of the investment in the investee) or in a note to that schedule.

946-210-50-10 If information about the investee's portfolio is not available, that fact shall be disclosed.

Amendments to Subtopic 946-320

14. Amend paragraph 946-320-30-1, with a link to transition paragraph 946-10-65-2, as follows:

Financial Services—Investment Companies—Investments—Debt and Equity Securities

Initial Measurement

946-320-30-1 ~~Paragraph not used.~~ <u>An investment company shall initially measure its investments at their transaction price. The transaction price shall include commissions and other charges that are part of the purchase transaction.</u>

15. Amend paragraph 946-320-40-1, with a link to transition paragraph 946-10-65-2, as follows:

Derecognition

> Determining Cost and Realized Gains and Losses

946-320-40-1 The cost of investment securities held in the portfolio of ~~a registered~~ <u>an</u> investment company and the net realized gains or losses thereon shall be determined, for financial accounting purposes, on the specific identification or average-cost methods. An investment company shall use only one method for all securities. ~~Cost includes commissions and other charges that are a part of securities purchase transactions.~~

Amendments to Subtopic 946-323

16. Amend paragraph 946-323-05-1 by adding the following new text, with a link to transition paragraph 946-10-65-2, as follows:

Financial Services—Investment Companies—Investments—Equity Method and Joint Ventures

Overview and Background

946-323-05-1 This Subtopic provides guidance for investment companies on applying the equity method of accounting.

17. Amend paragraphs 946-323-45-1 through 45-2, with a link to transition paragraph 946-10-65-2, as follows:

Other Presentation Matters

> Application of the Equity Method

946-323-45-1 Except as discussed in the following paragraph, use of the equity method of accounting by an **{remove glossary link} investment company {remove glossary link}** ~~of a non-investment-company investee~~ is not appropriate.

946-323-45-2 An exception to the general principle in the preceding paragraph occurs if the investment company has an investment in an operating entity that provides services to the investment company, for example, an investment adviser or transfer ~~agent.~~ agent (see paragraph 946-10-55-3). In those cases, the purpose of the investment is to provide services to the investment company rather than to realize a gain on the sale of the investment. If an investment company holds a noncontrolling ownership interest in such an operating entity that otherwise qualifies for use of the equity method of accounting, the investment company should use the equity method of accounting for that investment, rather than measuring the investment at fair value. ~~the **fair value** of the investee's assets and liabilities.~~

Addition of Subtopic 946-325

18. Add Subtopic 946-325, with a link to transition paragraph 946-10-65-2, as follows:

[For ease of readability, the new Subtopic is not underlined.]

Financial Services—Investment Companies—Investments—Other

Overview and Background

946-325-05-1 This Subtopic provides guidance for an investment company's other investments.

Scope and Scope Exceptions

946-325-15-1 This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic; see Section 946-10-15.

Initial Measurement

946-325-30-1 An investment company shall initially measure its other investments at their transaction price. The transaction price shall include commissions and other charges that are part of the purchase transaction.

Subsequent Measurement

946-325-35-1 An investment company shall subsequently measure its other investments at fair value.

Add Subtopic 946-360

19. Add Subtopic 946-360, with a link to transition paragraph 946-10-65-2, as follows:

[For ease of readability, the new Subtopic is not underlined.]

Financial Services—Investment Companies—Property, Plant, and Equipment

Overview and Background

946-360-05-1 This Subtopic provides guidance for an investment company's investments in real estate properties.

Scope and Scope Exceptions

946-360-15-1 This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic; see Section 946-10-15.

Initial Measurement

946-360-30-1 An investment company shall initially measure real estate properties at their transaction price. The transaction price shall include all of the following:

a. Professional fees
b. Property transfer taxes
c. Other transaction costs that are part of the purchase transaction.

Subsequent Measurement

946-360-35-1 An investment company shall subsequently measure its investments in real estate properties at fair value in accordance with Topic 820.

946-360-35-2 When determining the fair value of real estate properties, an investment company shall not double count assets or liabilities that are recognized as separate assets or liabilities. For example:

a. Equipment such as elevators or air conditioning often is an integral part of a building and is generally included in the fair value of the real estate property rather than recognized separately as property, plant, and equipment.
b. The fair value of real estate property excludes prepaid rent or rent receivable because a market participant would not include those cash flows in determining the amount to sell the property in an orderly transaction.

Derecognition

946-360-40-1 A real estate property shall be derecognized upon disposal in accordance with the derecognition guidance in Subtopics 360-10 and 360-20.

Other Presentation Matters

946-360-45-1 An investment company shall present separately both of the following items in its statement of changes in net assets (or similar financial statement):

a. Rental revenue from real estate properties

b. Rental operating expenses from real estate properties.

946-360-45-2 An investment company shall present separately both of the following items in its statement of assets and liabilities (or similar financial statement):

a. The fair value of real estate properties held (which shall not include any debt associated with the real estate properties)
b. Any debt.

Disclosure

946-360-50-1 An investment company that holds investments in real estate, directly or indirectly through a consolidated subsidiary, shall disclose all of the following:

a. The amounts recognized in net income (or a similar performance indicator) for direct operating expenses, separately for real estate properties that generated rental revenue during the period and real estate properties that did not generate rental revenue during the period.
b. Any restrictions on the ability to increase rent, collect rental income, or collect proceeds on the sale of real estate properties.
c. Any contractual obligations related to real estate properties.

Amendments to Subtopic 946-605

20. Amend paragraph 946-605-05-1, with a link to transition paragraph 946-10-65-2, as follows:

Financial Services—Investment Companies—Revenue Recognition

Overview and Background

946-605-05-1 <u>This Subtopic addresses the revenue recognition by an investment company of rental revenue from real estate properties.</u> This Subtopic <u>also</u> addresses all of the following matters involving revenue recognition by investment advisers:

a. Investment adviser's offering costs when both 12b-1 fees and contingent-deferred sales fees are not received
b. Distributor transfer of rights to certain future distribution fees
c. Distribution fees and costs for mutual funds with no front-end sales fee.

21. Amend paragraphs 946-605-15-1 though 15-2 and add paragraph 946-605-15-3, with a link to transition paragraph 946-10-65-2, as follows:

Scope and Scope Exceptions

> Overall Guidance

946-605-15-1 Except as discussed in paragraph 946-605-15-3, this ~~This~~ Subtopic has its own discrete scope, which is separate and distinct from the pervasive scope for this Topic as outlined in Section 946-10-15.

> Entities

946-605-15-2 Except as discussed in the following paragraph, the ~~The~~ guidance in this Subtopic applies to all investment advisers and **distributors** within the scope of either the Overall Subtopic (see Section 946-10-15) or Subtopic 940-10 (see Section 940-10-15).

946-605-15-3 The guidance in paragraph 946-605-25-9 follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic; see Section 946-10-15.

22. Add paragraph 946-605-25-9 and its related heading, with a link to transition paragraph 946-10-65-2, as follows:

Recognition

> Rental Revenue from Real Estate Properties

946-605-25-9 An investment company shall recognize rental revenue arising from a lease of a real estate property when lease payments are received or as lease payments become receivable in accordance with the contractual terms of the related lease.

Amendments to Subtopic 946-810

23. Amend paragraph 946-810-05-1 by adding the following new text, with a link to transition paragraph 946-10-65-2, as follows:

Financial Services—Investment Companies—Consolidation

Overview and Background

946-810-05-1 This Subtopic provides guidance for investment companies on applying the consolidation requirements in Topic 810.

24. Amend paragraph 946-810-15-1 by adding the following new text, with a link to transition paragraph 946-10-65-2, as follows:

Scope and Scope Exceptions

946-810-15-1 This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic; see Section 946-10-15.

25. Amend paragraphs 946-810-45-2 through 45-3 and amend paragraph 946-810-45-4 by adding the following new text, with a link to transition paragraph 946-10-65-2, as follows:

Other Presentation Matters

> Consolidation by Investment Companies

946-810-45-2 Paragraph 810-10-15-10(a)(3) states that, except as discussed in the following paragraph, consolidation by an **{remove glossary link} investment company {remove glossary link}** of ~~a non-investment-company~~ an investee is not appropriate.

946-810-45-3 An exception to the general principle in the preceding paragraph occurs if the investment company has an investment in any of the following:

a. An ~~an~~ operating entity that provides services to the investment company, for example, an investment adviser or transfer ~~agent.~~ agent (see paragraph 946-10-55-3). In those cases, the purpose of the investment is to provide services to the investment company rather than to realize a gain on the sale of the investment. If an ~~individual~~ investment company holds a controlling financial interest in such an operating entity, consolidation is ~~appropriate~~ required.
b. An entity that is an investment company in accordance with this Topic in a fund-of-funds structure. If an investment company holds a controlling financial interest in such an entity, consolidation is required.
c. An entity that is an investment property entity in accordance with Topic 973 in a fund-of-funds structure. If an investment company holds a controlling financial interest in such an entity, consolidation is required.

946-810-45-4 An investment company that is required to consolidate another entity shall apply the guidance in Section 810-10-45.

26. Amend paragraph 946-810-50-1 by adding the following new text and heading, with a link to transition paragraph 946-10-65-2, as follows:

Disclosure

> Financial Highlights

946-810-50-1 If an investment company consolidates an investment property entity or another investment company, the financial highlights shall be calculated using consolidated amounts excluding amounts attributable to noncontrolling interests. In addition to the expense ratio included in the financial highlights calculated in accordance with this paragraph, the investment company also shall disclose an expense ratio that excludes the effects of consolidating its investment property entities. An investment company is required to provide a reconciliation of the amounts used in calculating its financial highlights and the amounts in the consolidated financial statements. See paragraph 946-810-55-6.

27. Amend paragraphs 946-810-55-1 through 55-6 by adding the following new text and related headings, with a link to transition paragraph 946-10-65-2, as follows:

Implementation Guidance and Illustrations

> Illustrations

> > Presentation of Noncontrolling Interests in the Financial Statements

946-810-55-1 This Example illustrates the application of the presentation and disclosure requirements in Subtopic 810-10 by a unitized nonregistered investment company with a fund-of-funds structure, Entity XYZ, with a less-than-wholly-owned investment property entity subsidiary (40 percent interest held by the noncontrolling interest holders). The Example does not include all of the required disclosures that may be included in the notes to the consolidated financial statements. In addition, certain disclosures required for registered investment companies for compliance with SEC rules and regulations are not presented in the Example because they are not otherwise required by U.S. generally accepted accounting principles.

946-810-55-2 In accordance with the requirements of Subtopic 810-10, Entity XYZ would present the noncontrolling interest in the consolidated statement of assets and liabilities as follows.

[For ease of readability, this table and the other four tables in this Section are not underlined as new text.]

Entity XYZ Consolidated Statement of Assets and Liabilities
As of December 31, 20X1

Assets		
Investments in securities, at fair value (cost $16,292,000)	$	16,453,000
Investments in real estate, at fair value (cost $2,141,000)		3,139,000
Cash		60,000
Other assets		626,000
Total assets		20,278,000
Liabilities		
Mortgage notes payable		1,230,000
Demand loan payable to bank		223,000
Payables		
Investment securities purchased		52,000
Other		4,000
Accrued expenses		8,000
Redemptions payable		145,000
Total liabilities		1,662,000
Net assets	$	18,616,000
Analysis of net assets:		
Net assets attributable to Entity XYZ shareholders (equivalent to $6.19 per share based on 2,871,000 shares of capital stock outstanding)	$	17,776,000
Net assets attributable to noncontrolling interest		840,000
Net assets	$	18,616,000

946-810-55-3 The condensed consolidated schedule of investments for Entity XYZ would be presented as follows.

Entity XYZ Condensed Consolidated Schedule of Investments
As of December 31, 20X1

	Shares	Fair Value	Percentage of Net Assets
Common stock			
Consumer durable goods			
Allied Manufacturing Corporation	285,000	$ 8,453,000	45%
Baker Industries, Inc.	45,000	6,207,000	33%
Consumer Goods Company	17,000	1,321,000	7%
Other		472,000	3%
Total common stock (cost $16,292,000)		16,453,000	88%
Real estate properties			
1 Liberty Tower, New York, NY [(a)]		2,179,000	12%
Lot 162, East Township, Philadelphia, PA [(a)]		960,000	5%
Total real estate properties (cost $2,141,000)		3,139,000	17%
Total investments (cost $18,433,000)		$ 19,592,000	105%

(a) A portion of this investment is attributable to noncontrolling interest.

946-810-55-4 In accordance with Subtopic 810-10, Entity XYZ would present the change in net assets from operations attributable to the noncontrolling interest and the amount attributable to Entity XYZ shareholders on the face of the statement of operations as follows.

Entity XYZ Consolidated Statement of Operations
Year Ended December 31, 20X1

Investment income		
Dividends	$ 742,000	
Interest	209,000	
Rental income	850,000	
Total investment income		1,801,000
Expenses		
Investment advisory fee	70,000	
Interest	55,000	
Professional fees	30,000	
Custodian and transfer agent fees	16,000	
Incentive fee	95,000	
Property taxes	35,000	
Other real estate related expenses	72,000	
Total expenses		(373,000)
Net investment income		1,428,000
Net realized gain	186,000	
Net increase in unrealized appreciation	365,000	
Net realized and unrealized gain		551,000
Net increase in net assets resulting from operations		1,979,000
Less: Net increase in net assets attributable to noncontrolling interest		(316,000)
Net increase in net assets attributable to Entity XYZ shareholders		$ 1,663,000

946-810-55-5 In accordance with Subtopic 810-10, Entity XYZ would provide a reconciliation of the net assets attributable to Entity XYZ shareholders and the net assets attributable to the noncontrolling interest from the beginning of the period to the end of the period in its statement of changes in net assets as follows.

Entity XYZ Consolidated Statement of Changes in Net Assets

Year Ended December 31, 20X1

	Entity XYZ Shareholders	Noncontrolling Interest	Total
Net assets—January 1, 20X1	$ 14,652,000	$ 564,000	$ 15,216,000
Increase (decrease) in net assets from operations			
Net investment income	1,144,000	284,000	1,428,000
Net realized gain	176,000	10,000	186,000
Net increase in unrealized appreciation	343,000	22,000	365,000
Net increase in net assets resulting from operations	1,663,000	316,000	1,979,000
Capital share transactions	1,461,000	(40,000)	1,421,000
Total increase	3,124,000	276,000	3,400,000
Net assets—December 31, 20X1	$ 17,776,000	$ 840,000	$ 18,616,000

946-810-55-6 <u>The following financial highlights table illustrates the calculation of the financial highlights excluding the amounts attributable to noncontrolling interests. It also illustrates the calculation of the expense ratio that excludes the effects of consolidating the investment property entity and the required reconciliation of the amounts used in this calculation and the financial statements.</u>

Entity XYZ Financial Highlights
Year Ended December 31, 20X1

Per-share operating performance (for a share of capital stock of Entity XYZ outstanding throughout the period):

Net asset value, beginning of year	$	5.55
Income from investment operations:		
Net investment income		0.42
Net realized and unrealized gain on investment transactions		0.22
Total from investment operations		0.64
Net asset value, end of year	$	6.19

Total return of Entity XYZ shareholders

Total return before incentive fee	12.14%
Incentive fee	(0.62%)
Total return after incentive fee	11.52%

Ratio to average net assets:

Consolidated net investment income	8.83%

	Consolidated	Excluding Investment Property Entity Subsidiary
Expenses excluding incentive fees	0.84%	1.35%
Incentive fee	0.57%	0.57%
Total expenses	1.41% (a)	1.92% (b)

An individual investor's results may differ from the amounts shown above as a result of the timing of capital share transactions. Total return is calculated on basis of the change in net asset value during the year. Per-share information is calculated on the basis of the monthly average net assets throughout the year.

Expense Ratio Reconciliation

(a) This amount represents the expense ratio calculated when excluding the effects of noncontrolling interests in investment property entity subsidiaries.

Consolidated expenses	$	373,000
Consolidated expenses attributable to the noncontrolling interest		(56,000)
Entity XYZ shareholder's expenses	$	317,000
Consolidated average net assets	$	17,280,000
Less: Average net assets of the consolidated investment property subsidiary attributable to the noncontrolling interest		(743,000)
Entity XYZ shareholder's average net assets	$	16,537,000

(b) This amount represents the expense ratio calculated when excluding the effects of consolidating investment property entity subsidiaries.

Consolidated expenses	$	373,000
Investment property subsidiary's expenses		(140,000)
Entity XYZ-only expenses	$	233,000
Consolidated average net assets	$	17,280,000
Less: Average net assets of the consolidated investment property subsidiary		(1,857,000)
Add: Average fair value of the investment in the investment property entity		1,104,000
Entity XYZ average net assets	$	16,527,000

Amendments to Subtopic 323-10

28. Amend paragraph 323-10-15-4, with a link to transition paragraph 946-10-65-2, as follows:

Investments—Equity Method and Joint Ventures—Overall

Scope and Scope Exceptions

> Instruments

323-10-15-3 The guidance in the Investments—Equity Method and Joint Ventures Topic applies to investments in **common stock** or **in-substance common stock** (or both common stock and in-substance common stock), including investments in common stock of **corporate joint ventures** (see paragraphs 323-10-15-13 through 15-19 for guidance on identifying in-substance common stock). Subsequent references in this Subtopic to common stock refer to both common stock and in-substance common stock that give the **investor** the ability to exercise **significant influence** (see paragraph 323-10-15-6) over operating and financial policies of an **investee** even though the investor holds 50% or less of the common stock or in-substance common stock (or both common stock and in-substance common stock).

323-10-15-4 The guidance in this Topic does not apply to any of the following:

a. An investment accounted for <u>as a derivative instrument </u>in accordance with Subtopic 815-10
b. An investment in common stock held by <u>a nonbusiness entity, such as an estate, trust, or individual</u> ~~any of the following entities~~:
   1. <u>Subparagraph superseded by Accounting Standards Update No. 2012-XX.</u>~~An investment company registered under the Investment Company Act of 1940~~
   2. <u>Subparagraph superseded by Accounting Standards Update No. 2012-XX.</u>~~An investment company that would be included under the Investment Company Act of 1940 (including a small business investment company) except that the number of stockholders is limited and the securities are not offered publicly~~
   3. <u>Subparagraph superseded by Accounting Standards Update No. 2012-XX.</u>~~A nonbusiness entity, such as an estate, trust, or individual.~~
c. An investment in common stock within the scope of ~~Topic 810.~~ <u>Topic 810</u>
<u>d.</u> <u>Except as discussed in paragraph 946-323-45-2, an investment held by an investment company within the scope of Topic 946.</u>

29. Add paragraph 323-10-25-7 and its related heading, with a link to transition paragraph 946-10-65-2, as follows:

Recognition

<u>> Retention of Specialized Accounting in Applying the Equity Method</u>

<u>**323-10-25-7** An entity shall retain the guidance in an industry-specific Topic for the purposes of applying the equity method of accounting to an investee subject to that industry-specific Topic.</u>

30. Supersede paragraph 323-10-45-4, with a link to transition paragraph 946-10-65-2, as follows:

Other Presentation Matters

> Equity Method Investments in an Investment Company

323-10-45-4 <u>Paragraph superseded by Accounting Standards Update No. 2012-XX</u>.~~Subtopic 946-323 discusses the circumstances in which the specialized accounting in Topic 946 shall not be retained by a noninvestment company equity method investor of an investment company. In those cases, Subtopic 810-~~

~~10 applies to the investments held by the investment company equity method investee for the purposes of the equity method investor's financial statements.~~

Amendments to Subtopic 810-10

31. Amend paragraph 810-10-15-12, with a link to transition paragraph 946-10-65-2, as follows:

Consolidation—Overall

Scope and Scope Exceptions

810-10-15-12 The guidance in this Topic does not apply in any of the following circumstances:

a. An employer shall not consolidate an employee benefit plan subject to the provisions of Topic 712 or 715
b. Subparagraph superseded by Accounting Standards Update No. 2009-16
c. Subparagraph superseded by Accounting Standards Update No. 2009-16
d. Investments in a noninvestment company investee or a master fund in a master-feeder structure that are accounted for at fair value in accordance with the specialized accounting guidance in Topic 946 are not subject to consolidation according to the requirements of this Topic
e. A reporting entity shall not consolidate a governmental organization and shall not consolidate a financing entity established by a governmental organization unless the financing entity meets both of the following conditions:
    1. Is not a governmental organization
    2. Is used by the business entity in a manner similar to a ~~(VIE)~~VIE in an effort to circumvent the provisions of the Variable Interest Entities Subsections.

32. Amend paragraph 810-10-25-15 (using the current content because the pending content will be superseded at the effective date of this proposed Update), with a link to transition paragraph 946-10-65-2, as follows:

Recognition

810-10-25-15 ~~The application of guidance in an industry-specific Topic of this Codification to a subsidiary within the scope of that industry-specific Topic shall be retained in consolidation of that subsidiary.~~ An entity shall retain the guidance in an industry-specific Topic for the purposes of consolidating an investee subject to that industry-specific Topic.

The amendments in this proposed Update were approved for publication by five members of the Financial Accounting Standards Board. Mr. Smith voted against publication of the amendments. His alternative view is set out at the end of the Basis for Conclusions. Mr. Buck abstained from voting.

Members of the Financial Accounting Standards Board:

Leslie F. Seidman, *Chairman*
Daryl E. Buck
Russell G. Golden
Thomas J. Linsmeier
R. Harold Schroeder
Marc A. Siegel
Lawrence W. Smith

Background Information, Basis for Conclusions, and Alternative View

Introduction

BC1. The following summarizes the FASB's and IASB's (Boards) considerations in reaching the conclusions in this proposed Update. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

BC2. The amendments in this proposed Update would amend the definition of an investment company in Topic 946. It also would amend the accounting requirements for an investment company's interest in another investment company and its interest in an investment property entity, as defined in the proposed Update on investment property entities. It would require additional disclosures related to changes in the entity's status as an investment company and additional information about an investment company's activities and obligations.

Background Information

BC3. Topic 946 contains specialized accounting and disclosure requirements for investment companies. The requirements to qualify as an investment company originally were included in the AICPA's investment companies Guide and were subsequently codified in Topic 946.

BC4. In June 2007, the AICPA issued SOP 07-1 to clarify when an entity is within the scope of the investment company guide and whether the specialized industry accounting principles in Topic 946 should be retained by a parent or an equity method investor when accounting for its interest in an investment company. However, in December 2007, the SOP was indefinitely deferred for those entities that had not already adopted the SOP when the FASB issued FASB Staff Position SOP 07-1-1, *Effective Date of AICPA Statement of Position 07-1*. The deferral allowed the FASB time to consider a number of issues on the SOP's implementation.

BC5. In December 2008, the IASB published Exposure Draft 10, *Consolidated Financial Statements.* The scope of ED 10 was the same as that of IAS 27, *Consolidated and Separate Financial Statements*. IAS 27 requires reporting entities to consolidate all controlled entities, regardless of the nature of the reporting entity. In 2005, during a revision of IAS 27, the IASB considered the needs of users of financial statements about the consolidation of controlled investments by investment companies and concluded that an investment company should consolidate entities that it controls. ED 10 did not debate this issue again. However, respondents to ED 10 questioned the usefulness of financial statements of investment companies that consolidate entities that the investment company controls. They pointed out that some other national accounting requirements, including U.S. GAAP, historically have had an exemption from consolidation that requires investment companies to measure investments that they control at fair value.

BC6. Ultimately, the IASB acknowledged that consolidated financial statements may not provide the most useful information for these types of entities. The IASB decided that an entity that is considered an investment company should be exempt from consolidating entities that it controls and should measure investments in such controlled entities at fair value through profit or loss.

BC7. To eliminate the indefinite deferral of SOP 07-1 and address the issues that the SOP was trying to clarify, the FASB and the IASB agreed that, as part of the development of a consolidation standard, they would develop a converged definition of an investment company that would be applied for all U.S. entities and all foreign entities that apply IFRS.

Definition

BC8. The Boards decided to use the current U.S. GAAP requirements in Topic 946 together with the guidance deferred in SOP 07-1 as the basis for developing the criteria for identifying an investment company. The Boards discussed defining an investment company on the basis of whether the entity is a registered investment company under local regulatory requirements, such as the Investment Company Act of 1940 for U.S. entities. The Boards initially decided that the definition of an investment company should not be linked to local regulatory requirements. The Boards were concerned that the regulatory requirements in different jurisdictions may result in similar entities meeting the criteria to be an investment company in one jurisdiction but not in another.

BC9. The FASB ultimately decided that an investment company that is regulated under the Investment Company Act of 1940 should be within the scope of Topic 946 regardless of whether that entity meets the proposed investment company definition developed with the IASB. The FASB was concerned that some entities that are required to comply with the SEC's regulatory requirements for investment companies may not meet the proposed U.S. GAAP definition of an investment company. The FASB recognizes that defining an investment company on the basis of U.S. regulatory requirements is not convergent with the IASB's proposal, but this approach would avoid situations in which an entity would be required to present assets and liabilities under two measurement bases because it is considered an investment company for regulatory purposes but not for U.S. GAAP financial reporting purposes.

BC10. The FASB also considered adopting an approach similar to SOP 07-1 and providing a broad definition of an investment company and specific factors or indicators that would be used to apply judgment in determining whether an entity meets the broad definition. However, the FASB rejected this approach because it could result in inconsistent application of the guidance and some entities inappropriately qualifying for investment company accounting.

BC11. The FASB also decided to remove the scope exception in Topic 946 for real estate investment trusts. The FASB was concerned that this scope exception is based on whether an entity has made a designation to be treated as a real estate investment trust under the Internal Revenue Service (IRS) tax code. Because this project is a joint project with the IASB, and income tax requirements are different for each tax jurisdiction, the FASB concluded that an entity's election as a real estate investment trust should not affect whether the entity is an investment company. The FASB also considered that it has a separate project on its agenda to define an investment property entity, which is expected to include certain real estate investment trusts. In that project, the FASB decided that an investment property entity would be excluded from the scope of Topic 946.

Nature of the Investment Activities

BC12. The Boards considered whether an investment company's business activities should *primarily* be investing activities or whether *all of* its substantive activities should be investing activities. Topic 946 states that an investment company's *primary* business activities involve investing in assets for capital appreciation, investment income (such as dividends or interest), or both. The Boards noted that *primary* in U.S. GAAP has been interpreted inconsistently with respect to the amount of noninvestment activities that can be conducted by an investment company. The Boards concluded that, by definition, an investment company has one substantive activity—investing for capital appreciation, investment income (such as dividends or interest), or both. Having other substantive operations calls into question whether the entity exists for reasons other than to invest for capital appreciation or investment income. To clarify the intention behind the criterion, the Boards decided that the investment company's *only substantive activities* was a preferable phrase to indicate that an investment company should not have substantive activities other than its investing activities.

BC13. The Boards recognized that an investment company may undertake some substantive noninvesting activities (for example, holding an interest in an operating entity that provides services to the investment company) solely to support the investing activities of the investment company. The Boards concluded that if the services relate only to the investment company's own investment activities, even if those activities were substantive, the entity could still meet the substantive activities requirement.

BC14. The FASB agreed that if an entity were allowed to perform activities that support its investing activities, then a real estate fund or real estate investment trust (that is not an investment property entity) could be an investment company provided the entity (directly or indirectly through an agent) manages only properties that it owns. However, if the other activities did more than support the entity's investment activities (for example, construction or warehousing activities), this would preclude the entity from being an investment company. The FASB acknowledges that judgment is required to determine where on the spectrum an entity's activities lie and whether the activities are significant enough to preclude an entity from being an investment company. However, rather than prescribing the types of activities or properties that would prevent an entity from being an investment company, the FASB decided that the assessment should be based on facts and circumstances.

BC15. The Boards noted particular concerns for some venture capital investment companies. The Boards were concerned that, under the current definition in U.S. GAAP, an entity that meets the definition of an investment company could be inserted into a larger corporate structure to achieve a particular accounting outcome. For example, a parent entity could use an "internal" investment company subsidiary to invest in entities that may be incurring losses at the time (for example, research and development activities on behalf of the overall group) and would record its investments at fair value, rather than reflecting the underlying activities of the investee.

BC16. To address these concerns and to emphasize the business purpose of an investment company, the Boards decided to include examples in paragraph 946-10-55-7 of when an entity obtains returns other than from capital appreciation or investment income. In the Boards' view, these examples illustrate the relationships and activities that differentiate an investment company from an investment of an operating conglomerate.

BC17. The Boards also discussed whether an entity's involvement in the day-to-day activities (or the ability to be involved in the day-to-day activities) of its investees should preclude the entity from meeting the criteria of an investment company. The Boards considered including a requirement that would permit an entity to perform management activities to the extent that they are consistent with an investment manager's fiduciary duties. Such activities could include representation on the board of directors or advisory services provided in areas of the investment company's expertise (for example, assistance with an investment offering).

BC18. The Boards ultimately decided not to focus on an investment company's involvement in the day-to-day management of its investee. The Boards concluded that an investment company may be involved in the day-to-day management activities of its investees for purposes of maximizing the overall value of an investment (rather than generating strategic benefits). The Boards considered such involvement to be consistent with the activities of an investment company. In addition, the Boards noted that focusing on the involvement in the day-to-day activities (or the ability to be involved in the day-to-day activities) may create an inconsistency with the control principle under both U.S. GAAP and IFRS when the investment company has a controlling financial interest in the investee. The concern is that a limitation on active management is counterintuitive to controlling another entity; one cannot claim to control another entity without being involved, or having the ability to be involved, in the day-to-day management of that entity. Finally, the Boards were concerned that diversity may evolve when an investment company is only involved in the day-to-day management for some of its investees or only on a temporary basis.

BC19. The Boards also decided that an entity should hold or plan to hold investments in multiple investees to be an investment company. Investment companies typically invest in multiple investees as a means of diversifying their portfolio and maximizing their returns. Therefore, investing in multiple investees is an important characteristic of an investment company. The Boards considered whether specific guidance should be provided on the number of investments that an investment company should hold. They concluded that it was unnecessary to provide a specific definition of multiple investments but that it should be more than one investment (either directly or indirectly through another investment company). The Boards believe that entities would be able to apply judgment in determining whether the number of investments made by an entity is sufficient to conclude that the entity is an investment company.

Express Business Purpose

BC20. The Boards decided that to provide evidence of the business purpose of an investment company, an investment company should make a commitment to its investors (or potential investors) that the business purpose of the entity is only investing in order to generate and distribute investment income, capital appreciation, or both. The Boards noted that evidence of the entity's express business purpose may be included in the entity's offering memorandum, publications distributed by the entity, and other corporate or partnership documents that indicate the investment objectives of the entity. Evidence of the entity's express business purpose also may include the manner in which the entity presents itself to other parties (such as potential investors or potential investees).

BC21. In developing the criteria for an investment company, the Boards decided that an investment exit strategy is essential to an investment company whose investment objectives include realizing returns from capital appreciation because the investment company must have a plan to ultimately dispose of their investments to realize the capital appreciation. Although the exit strategy may vary depending on the nature and objectives of the investment, the maturity or development of the investee, market conditions, or other circumstances, potential exit strategies provide evidence of the entity's express business purpose of realizing capital appreciation.

BC22. The proposed amendments would not require an exit strategy for investments that are held only for returns from investment income (for example, investments in municipal bonds) because the investment company does not plan to realize changes in the price of the investments through disposal. However, the FASB still believes that fair value is the most relevant measurement attribute for all investments held by investment companies because investors transact on the basis of net asset value per share, which is calculated using the fair value of the investment company's underlying investments. Therefore, the FASB believes that an entity investing only for returns from investment income should not be precluded from being an investment company provided that it meets the other criteria, including the fair-value-management criterion.

Pooling of Funds

BC23. Topic 946 currently requires that the funds of an investment company's investors must be pooled together to provide the investors with professional investment management. In their discussions, the Boards considered the nature and composition of the entity's investors and whether those should be a factor in determining whether an entity is an investment company. They also considered whether they should require that an investment company have a minimum number of investors or that a prescribed percentage of the investors be passive investors. The Boards did not propose such a requirement because they noted that an entity could be structured to meet this requirement without substantively changing the nature of the entity.

BC24. The Boards noted that a typical investment company would have significant external equity investors or partners and concluded that investors not related to the parent of an investment company (if there is a parent) should collectively have a significant ownership in the investment company. The Boards were concerned that without such a requirement, an investment company could be inserted into a larger corporate structure to achieve a particular accounting outcome, while the parent could own almost all of that investment company. Investors that are related to the parent would be treated, along with the parent, as a single investor for the purposes of evaluating compliance with the pooling-of-funds criterion.

BC25. The Boards noted that the external investors criterion could be met while still enabling the parent to have all of the exposure to the underlying investees if the parent enters into side arrangements with the investment company's other investors. Because of this concern, the Board decided that if the parent entity or its related parties have an implicit or explicit arrangement that could result in the parent being required to acquire another investor's interests in the entity for an amount that is not fair value, those investments should be combined and treated as if they were held by the parent entity.

Fair Value Management

BC26. The most useful information for users of investment company financial statements is the fair value of its investments, including an understanding of how the investment company calculates fair value. Fair value is the critical component of the information used for analyzing the performance of investments made by investment companies. Therefore, the Boards decided to include a criterion that to be an investment company, substantially all of the entity's investments should be managed, and their performance evaluated, on a fair value basis.

BC27. The Boards believe that although other performance metrics may be used to evaluate the performance of an investment company's investments, emphasis on fair value should be evident in the operations and management of an investment company. Furthermore, information about the investment company's investments should be provided internally on a fair value basis to the entity's key management personnel because fair value provides the most decision-useful information.

BC28. The FASB decided that when evaluating this criterion, the entity should consider how it transacts with its investors. For example, some open-ended funds transact with investors on the basis of a net asset value per share, which is calculated using the fair value of the entity's underlying investments. In addition, the entity should consider how the fees it pays to its investment manager (or a similar party) are calculated and whether these fees are based on the fair value of the entity's net assets.

BC29. The FASB also concluded that money market funds, which currently report their investments at amortized cost, would be considered to be managing their investments on a fair value basis. This conclusion is based on money market funds being managed to minimize the differences between the carrying value and the fair value of their investments to maintain a constant net asset value.

Reporting Entity

BC30. The definition of an investment company in Topic 946 contains a criterion that the reporting entity must be the primary reporting entity. The Boards initially considered requiring an investment company to be a separate legal entity. However, that requirement may cause entities to be excluded that otherwise would meet the characteristics of an investment company. For example, some entities, such as partnerships, are considered legal entities in one jurisdiction but may not be considered legal entities in other jurisdictions.

BC31. In addition, the FASB believes that a portion of an entity should be permitted to meet the reporting-entity criterion if the economic activities of that portion can be distinguished objectively from the rest of the entity and the financial results of that portion of the entity are useful in making decisions about whether to provide resources to that portion. For example, separate accounts of life insurance companies may not be separate legal entities. However, investors in the separate accounts base their investment decisions on the financial results of their separate accounts. Conversely, a branch or division of an entity whose performance is only evaluated by management internally on a standalone basis would not meet this criterion.

BC32. Accordingly, the Boards decided that an investment company can but need not be a separate legal entity. Furthermore, the Board believes that the entity must report financial results to its investors who rely on the fair value of the entity's investments to make their investment decisions to be an investment company.

Parent of an Investment Company

BC33. The Boards considered whether a noninvestment company parent of an investment company should retain the fair value accounting of its investment company subsidiary when preparing its consolidated financial statements. In FASB Emerging Issues Task Force (EITF) Issue No. 85-12, *Retention of Specialized Accounting for Investments in Consolidation* (codified in Subtopic 810-10), the EITF discussed whether consolidated financial statements should retain specialized industry accounting principles applicable to investment company subsidiaries. The EITF reached a consensus that, assuming the specialized industry accounting principles are appropriate at the subsidiary level, those principles should be retained in consolidation.

BC34. The FASB agreed with the conclusions reached by the EITF that assuming the specialized industry accounting principles are appropriate at the subsidiary level those principles should be retained in consolidation. In addition, the FASB believes that this approach improves the visibility into the investments held by the subsidiary entity. Accordingly, the FASB decided that a noninvestment company parent of an investment company should retain the specialized industry accounting principles of its investment company subsidiaries when preparing consolidated financial statements. However, the IASB decided not to allow a noninvestment company parent of an investment company to retain the proposed accounting for investment companies when preparing consolidated financial statements. Therefore, under the IASB's proposal, if an investment company subsidiary of a noninvestment company parent holds a controlling financial interest in an entity, the specialized accounting in the investment company subsidiary's financial statements would be reversed in consolidation and the investment company's investees would be consolidated in the noninvestment company parent's financial statements.

BC35. The FASB considered providing guidance on how to account for issues that could arise when a parent retains the fair value accounting of an investment company subsidiary, for example, situations in which an investee of an investment company holds an ownership interest in the parent of the investment company. The FASB ultimately decided that because such situations are not widespread, specific guidance to address these issues should not be developed. However, the FASB believes that extensive disclosures should be provided if such situations arise in practice.

Interests in Other Entities

BC36. The FASB decided that an investment company should be subject to the consolidation requirements in Topic 810 when it holds a controlling financial interest in another investment company in a fund-of-funds structure. Often an investment company will establish a wholly owned investment company subsidiary for tax, legal, or regulatory purposes. The FASB was concerned that by not requiring an investment company to consolidate its wholly owned subsidiaries, transparency into a subsidiary's underlying investments and obligations to which the parent investment company has economic exposure would be reduced. The FASB further decided that a distinction should not be made between a wholly owned and a majority-owned subsidiary and, therefore, the guidance in Topic 810 should be applied to any controlling financial interest in another investment company.

BC37. The FASB considered whether the proposed consolidation requirements also should apply to master-feeder structures. The FASB decided that a feeder fund should not be required to consolidate controlling financial interests in its master fund because the current presentation and disclosure requirements for master-feeder structures, such as including the master fund's financial statements as part of the feeder fund's financial statements, address concerns regarding transparency into the underlying investments and obligations of the master fund.

BC38. The FASB had initially agreed to an approach similar to the IASB's proposal. Under the IASB's proposal, an investment company would measure its investment in another investment company subsidiary at fair value but would provide additional disclosures to enhance the transparency of the subsidiary's operations. The FASB ultimately decided against this approach because of concerns that this approach would result in an investment company not consolidating wholly owned subsidiaries.

BC39. The FASB also decided that an investment company should consolidate an investment property entity when it holds a controlling financial interest in such an entity. The FASB believes that, rather than purchasing real estate properties directly, a wholly owned subsidiary often is established for legal or tax purposes to purchase the real estate property. Requiring consolidation ensures that investors are provided with similar information for both directly held properties and those held through an investment property entity subsidiary.

BC40. Although consolidating a less-than-wholly-owned investment company or investment property entity would result in the parent investment company including noncontrolling interests in its financial statements, the FASB believes that the presentation and disclosure requirements in Subtopic 810-10, along with the amendments to the required financial highlights, provide users with appropriate information.

BC41. The FASB concluded that an investment company should not apply the equity method of accounting to an interest in an investment company or an investment property entity in which it can exercise significant influence. Instead, those interests would be measured at fair value. The FASB does not believe that requiring an investment company to apply the equity method would significantly affect the entity's financial statements, because the investee's underlying investments are generally recorded at fair value.

Disclosure

BC42. Users told the Boards that disclosures of the valuation methodology used for measuring fair value and the underlying inputs are essential to their analyses. This information is already required by Topic 820, Fair Value Measurement, IFRS 7, *Financial Instruments: Disclosures*, and IFRS 13, *Fair Value Measurement.* Accordingly, the Boards decided that it was not necessary to propose any additional disclosure requirements on the fair value measurements made by investment companies.

BC43. The Boards decided to require an investment company to disclose when any explicit or implicit financial support has been provided by the investment company to any of its investees. The Boards concluded that it would help users of financial statements understand an investment company's exposure to risk.

BC44. The Boards also decided that an investment company should disclose the nature and extent of any significant restrictions (for example, those resulting from borrowing arrangements or regulatory requirements) on an investee's ability to transfer funds to the investment company in the form of cash dividends, interest, or the repayment of loans or advances. The Boards considered this requirement useful for investors because such restrictions potentially could affect distributions to the investment company's investors.

BC45. The Boards considered requiring disclosure of the most recently available summarized financial information for any individually material investment in an operating entity that the investment company controls. However, they decided that because the investment company exception from consolidation is based on the Boards' view that the most useful information for users is fair value information, requiring summarized financial information would be inconsistent with that decision.

Effective Date and Transition

BC46. The FASB will determine the effective date after it considers the feedback on the proposed amendments. The FASB plans to consider the effective dates for both the proposed Update on investment property entities and the proposed Update on consolidations when determining the effective date for this proposed Update. However, the Boards intend to provide sufficient time to implement the proposed changes and are seeking input on this issue in the proposed Update.

BC47. The Boards decided that an entity that was not previously considered an investment company but that meets the proposed investment company criteria should apply the new guidance prospectively because retrospective application would be impracticable. Given the nature of an investment company, retrospective application could involve looking back several years to determine what the fair value for multiple assets (some of which the entity may no longer hold) might have been. The Boards thought this application was too onerous, particularly because U.S. GAAP has requirements to disclose the fair values of consolidated investments.

BC48. The FASB decided that an entity that is currently applying the investment company guidance in Topic 946 and does not meet the proposed criteria for an investment company should discontinue applying the guidance in Topic 946. This change should be applied as a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption by calculating the carrying amounts of the entity's investees as though it had always accounted for its investments in conformity with other applicable U.S. GAAP, if practicable. If not practicable, the entity should apply the proposed amendments as of the date of adoption. The FASB also decided to allow an entity to restate its prior-year financial statements.

BC49. The FASB decided that early adoption of the proposed amendments would be prohibited. The FASB acknowledged that the evaluation to determine whether an entity qualifies for the indefinite effective date deferral provided in Accounting Standards Update No. 2010-10, *Consolidation (Topic 810): Amendments for Certain Investment Funds,* from the consolidation requirements in Accounting Standards Update No. 2009-17, *Consolidations (Topic 810): Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities,* is based (in part) on whether the entity being evaluated meets the current criteria of an investment company in Topic 946. The FASB was concerned that if an entity were to early adopt the proposed amendments, before the FASB replaces the indefinite deferral in Update 2010-10, the entity would be required to be evaluated under the revised definition of an investment company to determine if it still qualifies for the deferral. In addition, an entity would be excluded from the scope of this proposed Update if it is an investment property entity under the proposed Update on investment property entities. The FASB decided to prohibit early adoption of the amendments in the proposed Update on investment property entites. Because the determination of whether an entity is within the scope of Topic 946 will be based on whether the entity is an investment property entity, the FASB also decided to prohibit early adoption of the amendments in this proposed Update. The IASB decided to allow early adoption in certain circumstances.

Convergence with IFRS

BC50. Although the amendments in this proposed Update are the result of the FASB and the IASB's joint efforts to develop consistent criteria for defining an investment company, the following differences would exist between investment companies reporting under U.S. GAAP and IFRS:

a. Initial measurement—Topic 946 requires an investment company to initially measure its investments at their transaction price, which includes commissions and other charges that were part of the purchase transaction. Under the IASB's investment company proposal, investments would initially be measured at their fair value, unless the investment is an investment property as defined in IAS 40. IAS 40 requires an investment property to be initially measured at cost, including any transaction costs.
b. Disposal of securities—Topic 946 requires an investment company to determine the cost of disposed securities using the average cost of the securities or specifically identifying the cost of each security sold. IFRS does not prescribe how to calculate the cost of disposed securities. Accordingly, the amount of realized gain (or loss) on the disposal of a security could be different under U.S. GAAP and IFRS depending on the method used to determine the cost of the security that was disposed of.
c. Investment company and investment property entity subsidiaries—The amendments in this proposed Update would require an investment company parent to consolidate an entity if it has a controlling financial interest in the entity and the entity is an investment company or an investment property entity in a fund-of-funds structure. Under the IASB's proposal, an investment company's interest in another investment company would be measured at fair value, even in a fund-of-funds structure. Also, IFRS does not include the concept of an investment property entity; therefore, an investment company's interest in an entity that would be considered an investment property entity under U.S. GAAP also would be measured at fair value under the IASB proposal.

d. Required financial statements—Under the IASB proposal, an investment company would be required to present comparative financial statements and the related footnotes. Topic 946 does not require comparative financial statements and only requires a statement of cash flows in certain circumstances. In addition, the IASB proposal does not include a requirement to provide a statement of changes in net assets or a schedule of investments. Rather, it requires additional information only for controlled investees.
e. Disclosure requirements—Topic 946 contains a number of disclosure requirements that are not included in the IASB proposal. Rather, the IASB proposal contains a disclosure principle that may result in the disclosure of similar information under IFRS and U.S. GAAP. For example, Topic 946 includes requirements on what information should be included in an investment company's financial highlights and how to calculate the information. Entities may ultimately disclose more, less, or different information depending on their professional judgment in applying the disclosure principle in the IASB proposal when compared with the disclosure requirements in U.S. GAAP. In addition, there are disclosure requirements in other areas of IFRS (for example, the sensitivity analysis in IFRS 7) that are not required by U.S. GAAP.
f. Financial statement line items—Topic 946 contains specific financial statement presentation requirements for investment companies. For example, Topic 946 includes specific presentation requirements for realized gains and losses, unrealized gains and losses, and the provision for income taxes. The IASB proposal does not include the same financial statement presentation requirements. This would result in different financial statement captions for investment companies applying U.S. GAAP or IFRS and may affect the comparability of financial information.
g. Other GAAP differences—Other differences would arise as a result of references to other U.S. GAAP and IFRS requirements. For example, under IAS 32, open-end multiple class funds would generally classify investor ownership interests as liabilities, with distributions paid to investors reflected as a finance cost. Topic 946 requires an equity issuance of an open-end fund to be reflected as a shareholder transaction.

Benefits and Costs

BC51. The objective of financial reporting is to provide information that is useful to existing and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Existing and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs of implementing new guidance are borne primarily by existing investors. The FASB's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to measure objectively the costs of implementing new guidance or to quantify the value of improved information in financial statements.

BC52. The FASB believes that the changes to the definition of an investment company clarifies the scope of Topic 946 and would not change significantly that scope in practice. In addition, the FASB believes that the benefits of the proposed amendments include:

a. Making the definition of an investment company more understandable and simplifying whether an entity is within the scope of Topic 946
b. Continuing to include entities that typically have followed and should continue to follow investment company accounting
c. Retaining requirements that the FASB believes are essential to appropriately identify an investment company.

Alternative View

BC53. Mr. Smith disagrees with the publication of this proposed Update, primarily because it retains the current U.S. GAAP requirement that noninvestment companies retain the specialized accounting in Topic 946 regarding consolidation of an investment company subsidiary. This aspect of the proposed Update is not consistent with the IASB's proposal, which would require the parent of an investment company that is not itself an investment company to consolidate all entities controlled by the investment company when preparing the parent's consolidated financial statements. Mr. Smith agrees with the conclusions of the IASB on this issue.

BC54. Mr. Smith does not believe that it is appropriate for a noninvestment company to be able to avoid the fundamental requirements of consolidation accounting by holding interests in companies it controls merely through the creation of an intermediary investment company. The fundamental objectives of consolidation accounting are summarized in paragraph 810-10-10-1: "There is a presumption that consolidated financial statements are more meaningful than separate financial statements and that they are usually necessary for a fair presentation when one of the entities in the consolidated group directly or *indirectly* has a controlling financial interest in the other entities" (emphasis added). Mr. Smith agrees with the application of specialized accounting for reporting entities that meet the scope requirements in the proposed Update because he believes that the specialized accounting provides financial statement users with information that is more relevant to investors in the investment company than what would be available if the investment company consolidated the entities it controls. However, Mr. Smith believes that the specialized accounting fails to be more relevant to investors in a noninvestment company that (indirectly) controls companies controlled by an investment company subsidiary. Allowing the noninvestment company parent to continue to apply the specialized accounting results in controlled subsidiaries being presented differently in the noninvestment company financial statements depending on whether the subsidiaries are held by the investment company or not.

BC55. While the proposed amendment to paragraph 946-10-55-10 requires the investment company to have an exit strategy regarding its investments, Mr. Smith notes that the FASB eliminated the "temporary investment" exclusion from consolidation requirements previously allowed in ARB 51, as amended by Statement 94, with the issuance of Statement 144 in 2001. Mr. Smith notes that there are no specific requirements in the proposed Update about the length of time an investment company may hold its interest in controlled subsidiaries or the length of time a noninvestment company parent can continue to control an investment company subsidiary. Consequently, a noninvestment company could avoid consolidating the companies it controls through its control of its investment company subsidiary for a considerable length of time. Mr. Smith fails to see how this reporting is useful to users of the consolidated financial statements of the parent noninvestment company.

Amendments to the XBRL Taxonomy

Investment companies regulated under the SEC's Investment Company Act of 1940 are currently not required to file an XBRL exhibit with the SEC. As a result, guidance in Topic 946 is not included in the U.S. GAAP Financial Reporting Taxonomy (UGT). Therefore, no changes will be made to the UGT as a result of this proposed Update.