



## Proposed Improvements to Criteria for Investment Company Accounting and Proposed Accounting Guidance for Investment Property Entities

The FASB is proposing improvements to the accounting guidance for investment companies and also proposing new accounting guidance for entities focused on investing in real estate properties. These proposals recognize the views of many investors that fair value measurement is most relevant for investments held by entities that are in the business of pooling funds and providing professional investment management services.

### Why Is the FASB Issuing These Exposure Drafts?

#### Investment Companies

The concept of an investment company is not a new concept in the United States. Under long-standing U.S. Generally Accepted Accounting Principles (GAAP), an investment company measures all of its investments at fair value, even if the entity holds a controlling financial interest in an investee. The investment company proposal would improve the criteria to be an investment company to more appropriately reflect the characteristics of an investment company. These improvements to the criteria would capture the appropriate population of entities for which fair value is the most appropriate measurement attribute for their investments.

The investment companies project is a joint effort between the FASB and

the International Accounting Standards Board (IASB) to converge financial reporting by investment companies by developing consistent criteria for determining whether an entity is an investment company. The concept of an investment company would be new to International Financial Reporting Standards (IFRS). Therefore, the proposal would improve 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 IFRS.

#### Investment Property Entities

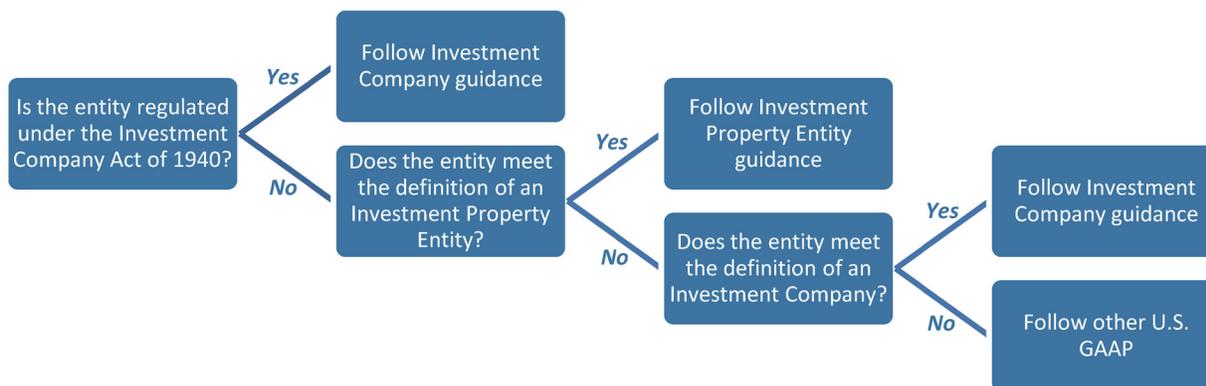
Currently, an entity that invests in real estate properties but is not an investment company is required to measure its real estate properties at cost. However, some of those entities measure their real estate properties at fair value because they are controlled by pension plans that are required to measure their investments at fair value or the development of industry accounting practices allows them to measure real estate investments at fair value. The proposal would require all entities that meet the criteria to be investment property entities to follow the proposed accounting guidance resulting in consistent application of U.S. GAAP across all real estate entities that have similar business operations.

As part of the FASB and IASB's joint project on accounting for leases,

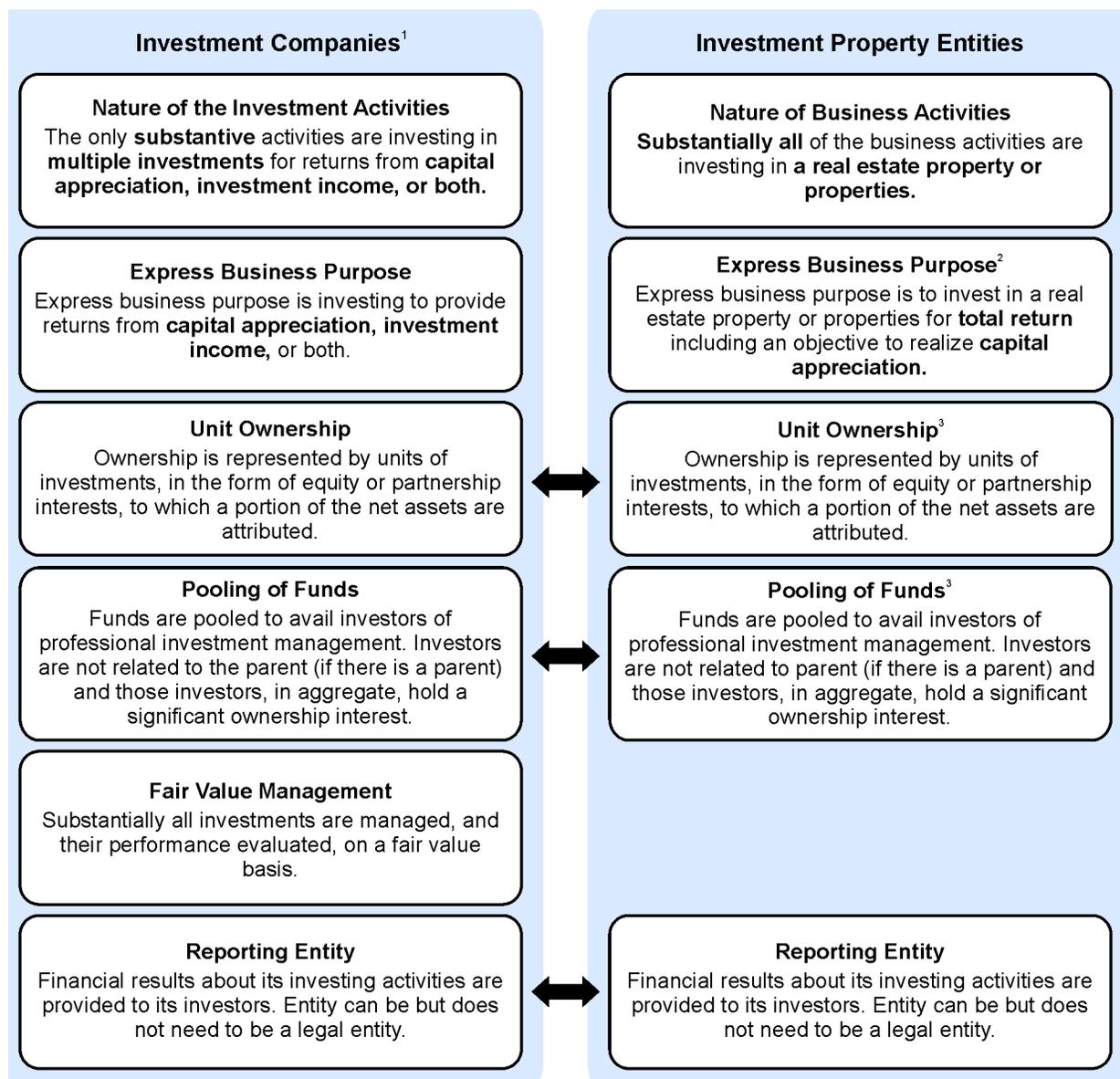
the IASB decided that a lessor of an investment property would not be required to apply the proposed lessor accounting requirements if the lessor elects the fair value model for its investment properties under IFRS. This proposal is a result of the FASB's efforts to align the scope of entities that would apply the proposed lessor accounting model under U.S. GAAP and IFRS. In response to consistent investor input, the FASB decided to prescribe the circumstances when fair value would be required, rather than introduce an optional accounting practice into U.S. GAAP.

#### Determining Which Accounting Guidance to Apply

The criteria to be an investment company and investment property entity are similar. An entity that is regulated under the Securities and Exchange Commission's (SEC) Investment Company Act of 1940 would be required to follow investment company accounting guidance. All other entities would first determine whether they are investment property entities. An entity that is not an investment property entity would then determine whether it is an investment company. Entities that do not meet either definition would follow other applicable U.S. GAAP. The decision tree below depicts the assessment to determine which accounting guidance to apply.



## Criteria to Be an Investment Company or an Investment Property Entity



### Notes:

1. An entity that is regulated under the SEC's Investment Company Act of 1940 would be an investment company, regardless of whether it meets all six of the investment company criteria.
2. Real estate properties held by an entity for either of the following purposes do not meet this criterion:
  - (a) The entity's own use in the production or supply of goods or services or for administrative purposes
  - (b) Development for sale in the ordinary course of business upon completion.
3. A subsidiary entity whose parent entity is required to account for its investments at fair value in accordance with U.S. GAAP or whose parent entity is a not-for-profit entity that measures its investments at fair value is not subject to the unit-ownership and pooling-of-funds criteria.

## Essential Elements of the Investment Companies Exposure Draft

In addition to the changes to the definition of an investment company and providing comprehensive implementation guidance for assessing whether an entity is an investment company, the Exposure Draft requires that an investment company:

- Consolidate controlling financial interests in another investment company and an investment property entity in a fund-of-funds structure. The Exposure Draft amends financial statement and financial highlights presentation requirements for consolidation of less-than-wholly-owned entities.
- Measure investments in which it is able to exercise significant influence at fair value unless the investee is an operating entity that provides services to the investment company.
- Provide additional disclosures regarding financial support provided to any of its investees and any significant restrictions on an investee's ability to transfer funds to the investment company.
- Present separately and provide disclosures relating to rental revenue and rental expenses on real estate properties held directly or indirectly through a consolidated subsidiary.

The Exposure Draft would also require that a parent entity with an investment company subsidiary retain the specialized investment company accounting guidance in consolidation, regardless of whether the parent entity is an investment company itself.

## Essential Elements of the Investment Property Entities Exposure Draft

In addition to providing comprehensive guidance for assessing whether an entity is an investment property entity, the Exposure Draft requires that an investment property entity:

- Measure all investment properties at fair value with all changes in fair value recognized in net income. Initial measurement would be transaction price, including transaction costs.
- Measure real estate properties other than investment properties in accordance with other U.S. GAAP.
- Recognize rental revenue arising from a lease of an investment property when it is received or receivable.
- Consolidate controlling financial interests in another investment property entity, an investment company, and an operating entity that provides services to the investment property entity.
- Measure investments in which it is able to exercise significant influence at fair value with changes in fair value recognized in net income unless the investee is an operating entity that provides services to the investment property entity.
- Measure interests in which it does not have a controlling financial interest and is not able to exercise significant influence in accordance with other U.S. GAAP.
- Present separately and provide disclosures relating to rental revenue and rental expenses on investment properties.

The Exposure Draft would also require that a parent entity with an investment property entity subsidiary retain the specialized investment property entity accounting guidance in consolidation, regardless of whether the parent entity is an investment property entity itself.

## Next Steps

After the comment period closes, the FASB will analyze feedback received through comment letters, public roundtables, and information gathered through other outreach activities. The FASB will redeliberate the proposed requirements at public meetings before issuing a final Accounting Standards Update. Feedback received on the investment companies proposal will be redeliberated jointly with the IASB.

## Comment Deadline

The comment period on both proposals ends on January 5, 2012.

The IASB issued its proposal, *Investment Entities*, on August 25, 2011. Comments on the IASB's Exposure Draft are also requested by January 5, 2012.

## Effective Date

The effective dates will be determined after the FASB considers the feedback received on both proposals.

Early adoption would be prohibited under both proposals.

**For more information—and to register for our live webcast on November 28—  
please visit the FASB's website at [www.fasb.org](http://www.fasb.org).**

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