Federation of European Accountants
Fédération des Experts comptables Européens

Ms. Françoise Flores
Chair
Technical Expert Group
EFRAG
Square de Meeûs 35
B-1000 BRUXELLES

E-mail: commentletters@efrag.org

5 January 2012

Ref.: ACC/PRJ/TSI/IDS

Dear Ms. Flores,

Re: FEE Comments on EFRAG's Draft Comment Letter on the IASB Exposure Draft *Investment Entities*

(1) FEE (the Federation of European Accountants) is pleased to comment on EFRAG draft comment letter on the IASB Exposure Draft Investment Entities (the "ED").

(2) On balance, we agree with the IASB's proposal for an exception to the consolidation principle on the basis that the measurement of investees controlled by an investment entity at fair value produces more decision useful information than consolidation.

(3) We believe that if an investment controlled by an investment entity is held for capital appreciation, investment income or both only and the investor has a stated exit strategy for the investment or strategies for generating long-term investment income - that investment should be measured at fair value through profit or loss.

(4) We believe that the exception to the consolidation principle should be limited to those entities for which measurement at fair value through profit and loss provide more decision useful information than consolidated financial information.

(5) While we agree that clear criteria are needed to identify where it is appropriate to exempt investments from consolidation, we would recommend that the IASB could consider a more principle-based definition with a focus on the business model (holding investments solely for capital appreciation, investment income, or both) and the relevance of fair value over consolidation.

(6) The criteria could mainly be developed from paragraph 2(a) (nature of the investment activity) in conjunction with criteria from 2(b) (business purpose) together a more explicit reference to the exit strategy. Criteria 2(c) (unit ownership) and 2(d) (pooling of funds) seem to be less essential and could potentially be eliminated.

(7) On balance, we do not support the proposal that the parent of an investment company would need to consolidate the investments that are controlled by an investment entity subsidiary, if it does not qualify itself as an investment company according to the ED.

(8) Once it is established that fair value is the appropriate measurement basis at the investment entity subsidiary level, this accounting should be "rolled up" to the consolidated financial statements of the upper level parent. This would reflect the fact that part of the activities of the upper level parent involves a different business model which is to hold the investments of an investment entity for capital appreciation, investment income or both.

(9) We agree with the concept of having a disclosure objective for investment entities requiring information about the nature and the financial effect of the investment activities. However, the level of detailed narrative may result in excessive disclosures as developed in our detailed response.

(10) We agree with EFRAG that transition requirements proposed in this ED should be consistent with those in IFRS 10 Consolidated Financial Statements. We are supportive of full retrospective application of the new requirements unless impractical or the costs outweigh the benefits.

Our responses to Appendix of the EFRAG draft comment letter including responses to questions in the Invitation to comment section of ED are contained in the Appendix to this letter.

For further information on this letter, please contact Tibor Siska, Project Manager, at FEE Secretariat on +32 2 285 40 74 or via email at tibor.siska@fee.be.

Yours sincerely,

Philip Johnson
President

Appendix

Question 1 – Exclusion of investment entities from consolidation

Do you agree that there is a class of entities, commonly thought of as an investment entity in nature should not consolidate controlled entities and instead measure them at fair value through profit or loss? Why or why not?

Question to constituents

9 Do you believe that rather than applying the exclusion from consolidation at an entity level, individual investments should be excluded from consolidation if they are managed to maximise income or capital gains? If so, please explain why.

10 If you believe the exclusion should be applied at the level of individual investments, which criteria do you believe such investments should meet to qualify for the exclusion in order to make the exception robust?

Note to constituents

11 The wording of the remainder of this draft comment letter is predicated on the assumption that the exception is to be applied at the entity level.

(11) On balance, we agree with the IASB's proposal for an exception to the consolidation principle on the basis that the measurement at fair value of investees controlled by an investment entity produces more decision useful information than consolidation.

(12) Investors, which are typically the primary users of the financial statement of investment entities, make decisions based upon the fair value of investments. Consolidating investments in controlled entities would not provide the necessary information that the users of the financial statements of investment entities need. More useful information to assess the performance of the investments in the context of their business model is provided by measuring such investments at fair value through profit or loss.

(13) For example, mutual fund holders view their holdings as a direct investment in the underlying assets as opposed to an investment in the investment manager.

(14) This exception to the consolidation principle is acceptable provided there is a clear definition of what are the characteristics of an investment company. In that respect, the criteria proposed in the ED could be improved, as described further below.

(15) The investments held by investment entities are typically held on a short-term basis or for a longer-term basis with a documented exit plan. The objectives of an investment entity are to maximise the return on its investments for its unitholders through capital appreciation realised upon exit and returns through interest and dividends. Accordingly, we believe that more emphasis should be given to the need for a documented exit strategy in respect of the investments that are held solely for capital appreciation, investment income, or both and should and therefore it should be explicitly mentioned in the criteria for investment entities.

(16) The concept of whether there are exceptions to general principles because fair value is more relevant is not unique to controlled investments of investment entities.

(17) IAS 28 already provides a measurement exemption for investments in associates and joint ventures held by venture capital organisations, mutual funds, unit trusts and similar entities including investment-linked insurance funds. These entities can elect to measure its investments at fair value through profit and loss at the entity level. Therefore, the exception proposed in this ED is not entirely new. It is an extension of the recognised fact that fair value measurement is a more relevant measurement basis for investments held by entities meeting specific criteria such that the exemption is extended to controlled investees and is made mandatory.

Question 2 – Criteria for determining whether an entity is an investment entity (paragraphs 2 and B1-17)

Do you agree that the criteria in this exposure draft are appropriate to identify entities that should be required to measure their investments in controlled entities at fair value through profit or loss? If not, what alternative criteria would you propose, and why are those criteria more appropriate?

(18) We believe that even though the proposal constitutes an exception to the consolidation principle and in that sense represents a rule, the definition of an investment company could be improved by putting emphasis that use of the exception should be limited to those entities for which measurement at fair value through profit and loss provides more decision useful information than consolidated financial information. Accordingly, it is important that the population of companies to which the exception would apply is appropriately circumscribed.

(19) We agree that clear criteria are needed to identify where it is appropriate to exempt investments from consolidation. Therefore, we would recommend that a more principle-based approach should be adopted. This would emphasise both the business purpose of the reporting entity and the way information is provided internally and externally in order to assess the investment company's performance. In terms of business purpose, the standard should clearly state that the exemption from consolidation should only apply to investments that are held solely for capital appreciation, investment income, or both.

(20) Accordingly, criteria upon which the exemption from consolidation could be built should mainly be developed from paragraph 2(a) (nature of the investment activity) in conjunction with criteria from 2(b) (business purpose) including an explicit reference to potential exit strategy as an additional criterion.

(21) As mentioned before, we agree with EFRAG that the exit strategy is a key aspect in identifying an investment entity and therefore it should be more prominently emphasised. The investment entity's business plan should not only outline how it will identify appropriate investments but also provide potential exit strategies enabling to realise its capital appreciation or investment strategies that generate long-term investment income. Therefore, the Board should explicitly refer to the existence of a potential exit plan in the criteria and not only described in the application guidance.

(22) Where the investments are held for capital appreciation, investment income or both and the investor has a documented exit strategy for the investment or strategies for generating long-term investment income, the investments are likely to be managed, and their performance evaluated, at fair value through profit or loss. Therefore, the

manner in which the business is conducted is also important criteria and accordingly criterion 2(e) (fair value management) should be reinforced.

(23) In addition, we recommend that the Board also consider other criteria that might be relevant (based on the definition of investment companies in old Canadian GAAP):

a. The enterprise does not obtain, or have not the objective of obtaining, benefits from its investments that are not normal benefits attributable to an ownership interest (such as dividends). Such benefits might include, for example, access to processes, intangible assets or technology of the investee; guarantees provided by an investee to benefit the investor,

b. The enterprise or its affiliates are not involved in the day-to-day management of investees, affiliates of investees, or other investment assets. That requirement may be met, however, if management of the enterprise or its affiliates is represented on the boards of directors of investees or affiliates of investees, or provides limited assistance to management of investees or affiliates of investees for a short period.

(24) On the other hand, the criteria 2(c) (unit of ownership) and 2(d) (pooling of funds), seem less essential and could potentially be eliminated.

(25) We also note that the exposure draft states that an entity 'can be, but does not need to be' a legal entity. However, we are unclear as to whether this opens up the possibility of an individual legal entity, measuring the investments of, for example, one business unit at fair value through profit or loss while those of another are consolidated. We encourage the Board to provide more clarity in this area.

(26) We also agree with EFRAG that the reference to "investment" should be clarified. Investment means not only investments in investees that the investment entity controls but for instance, investment properties and financial assets as well.

Question to constituents

16 The ED sets detailed criteria that an entity must meet in order to qualify as an investment entity, which has given rise to the question whether all of the criteria are necessary. In particular, the need for the criteria in paragraphs 2(a) and 2(d) of the ED and the requirement to have an exit strategy were challenged in the course of EFRAG TEG discussions. Do you believe that all the criteria proposed in the ED are necessary in order to define an investment entity or do you believe that not all of the criteria mentioned above need to be met? If so, please explain and provide examples.

17 Do you believe that the criteria in the ED would prevent entities from applying the exception even though you consider them to be investment entities?

(27) As indicated above, the IASB could consider a more principle-based definition with a focus on the business model and the relevance of fair value over consolidation. Criteria could mainly be developed from paragraph 2(a) (nature of the investment activity) in conjunction with criteria from 2(b) (business purpose) together a more explicit reference to the exit strategy. Criteria 2(c) (unit ownership) and 2(d) (pooling of funds) seem to be less essential and could potentially be eliminated.

Question 3 – 'Nature of the investment entity' (paragraphs 2(a) and B1-B6)

Should an entity still be eligible to qualify as an investment entity if it provides (or holds an investment in an entity that provides) services that relate to:

(a) its own investment activities?

(b) the investment activities of entities other than the reporting entity?

Why or why not?

(28) We believe that an entity that provides (or holds an investment in an entity that provides) investment services to entities other than the reporting entity should not be excluded from the scope of this ED for that reason. We also believe that when an investment entity controls an investee that provides investment related services, consolidation of that investee is appropriate.

(29) Indeed, we do not believe that providing services relating to the investment activities of entities would preclude an entity from being deemed to be an investment entity if either

a. The services are provided only to other related investment entities; or

b. The services provided to other parties are limited to a level at which the entity's sole substantive business purpose can still be deemed to be holding investments for capital appreciation, investment income or both.

Question 4 – 'Pooling of funds' (paragraph 2(d) and B14-B16)

(a) Should an entity with a single investor unrelated to the fund manager be eligible to qualify as an investment entity? Why or why not?

(b) If yes, please describe any structures/examples that in your view should meet this criterion and how would you propose to address the concerns raised by the Board in paragraph BC16?

(30) We agree with the fact that an investment entity should have significant ownership comprised of a party unrelated to the investment entity. This seems to be essential since one of the fundamental criteria of being an investment entity is that external investors evaluate the performance of the entity on a fair value basis.

(31) There is merit to excluding wholly-owned subsidiaries from the scope due to limit abuse (a parent would not be able to segregate certain subsidiary in a separate entity for the sole purpose of avoiding consolidation). However, it is not clear why there needs to be multiple outside investors. It maybe again to ensure that there is substantive outside investors (if there is only one, it would be easier to limit the influence) – however the requirements of IFRS 10 to consider "de facto agents" would appear to ensure that the single third party investor would be substantive (if it is not, its interest would be added to that of the parent), similarly the requirement to consider call options would help in ensuring that in substance the entity with a singly third party investor is not like a wholly owned subsidiary.

(32) Consequently, we believe the exemption from consolidating controlled entities should be available where the definition of an investment entity is met even if there is only one investor which is unrelated to the fund manager.

Question 5 – Measurement guidance (paragraphs 6 and 7)

Do you agree that investment entities that hold investment properties should be required to apply the fair value model in IAS 40, and do you agree that the measurement guidance otherwise proposed in the exposure draft need apply to financial assets, as defined in IFRS 9 and IAS 39 *Financial Instruments: Recognition and Measurement*? Why or why not?

(33) We agree with the requirement that an investment entity should measure all investment properties at fair value since this is consistent with the basis for the exception from consolidation and that is that fair value information is the most relevant basis of measurement to users of the financial statements of investment entities.

(34) We do not agree that the fair value measurement should be limited to financial assets and investment properties in the scope of IAS 40. An investment entity may hold investments in other forms of assets (e.g. works of art). We believe that of the assets held by an investment property (except those held for use in supporting operations) should be measured at fair value.

Question 6 – Accounting in the consolidated financial statements of a non-investment parent (paragraph 8)
Do you agree that the parent of an investment entity that is not itself an investment entity should be required to consolidate all of its controlled entities including those it holds through subsidiaries that are investment entities? If not, why not and how would you propose to address the Board's concerns?

(35) On balance, we do not support the proposal that the parent of an investment company would need to consolidate the investments that are controlled by an investment entity subsidiary. In our view the exception established for an investment entity should 'roll up' into its parent's own consolidated financial statements and investments should continue to be carried at fair value through profit or loss rather than consolidated.

(36) Once it is established that fair value is the appropriate measurement basis at the investment entity subsidiary level, "rolling up" this accounting to the consolidated financial statements of the upper level parent would reflect the fact that part of the activities of the upper level parent involves a different business model which is to hold the investments of an investment entity for capital appreciation, investment income or both.

(37) We understand the concerns about the possibilities for abuse and potential accounting inconsistencies arising, for instance when the controlled investee owns shares of its ultimate parent (fair value accounting by the controlled investment entity for its investments would not allow for proper elimination of own capital and therefore the group would have a stronger equity base when preparing consolidated financial statements).

(38) In our view, the accounting consistency can be overcome by further guidance or disclosure requirements. Concerns about the possibility for abuse can be addressed by robust and appropriate set of criteria for the application of fair value accounting at an investment subsidiary level and by disclosing transactions between the investment entity and other members of its consolidated group.

(39) We suggest that the following criteria could be used to ensure that it is appropriate for the parent of an investment company to maintain in the parent's consolidated financial statements the accounting applied at the investment company's own financial statements:

a. The non-investment entity parent entity, or its affiliates, do not actively participate in the day-to-day management of an investee entity. However, the non-investment entity parent entity or its affiliates may be permitted to have representation on the board of directors and provide limited assistance to management of investee entities.

b. The non-investment entity parent, or its affiliates, do not obtain, or have the objective of obtaining, benefits from its investments that are not capital appreciation, investment income (such as dividends or interest), or both, are not available to other non-investors or are not normally attributable to ownership interests.

c. For a non-investment entity parent of an investment entity, the consolidated group (the parent company and its consolidated subsidiaries) follows established policies that effectively distinguish the nature and type of investments made by investment entities in the consolidated group from those made by non-investment entities. These policies address, at a minimum:
   (i) the degree of influence held by the investment entity and related parties over the investees;
   (ii) the extent to which investees are in the same line of business as the parent company or its related parties; and
   (iii) the level of ownership interest in the investment entity held by the consolidated group.

(40) We believe that these criteria (similar to those provided in US and Canadian GAAP) would be sufficient to address the concerns over potential abuse.

(41) In addition, we note that the Board is proposing that the parent of an investment entity would be required to measure the investment entity's investments in joint ventures and associates at fair value. We do not consider that there is a conceptual basis to require that the parent of an investment entity should apply a different treatment to the subsidiaries of an investment entity than to the investment entity's joint ventures or associates.

Question 7 – Disclosures (paragraph 9 and 10)

(a) Do you agree that it is appropriate to use this disclosure objective for investment entities rather than including additional specific disclosure requirements?

(b) Do you agree with the proposed application guidance on information that could satisfy the disclosure objective? If not, why not and what would you propose instead?

(42) We agree with the concept of having a disclosure objective for investment entities requiring information about the nature and the financial effect of the investment activities in which it engages rather than a detailed list of specific disclosures.

(43) However, we agree with EFRAG that the level of detailed narrative can lead to extensive disclosure requirements.

(44) It is not clear whether the disclosures of paragraph B19 are optional or mandatory. Certain preparers may feel obliged to include everything whereas others may see it as entirely optional and keep disclosure to minimum.

(45) We note that paragraph B20 states that 'an investment entity does not need to apply the disclosure requirements if other IFRSs require disclosures of the same information'. The Board should determine which disclosures are already required by other standards and avoid repetition of requirements that already exist elsewhere.

(46) Information suggested by the proposed application guidance will already be disclosed by investment entities, either as part of the business review in the narrative part of their financial statements or because other standards (such as IFRS 7,12 and 13).

Question 8 – Transition (paragraph C2)

Do you agree with applying the proposals prospectively and the related proposed transition requirements? If not, why not? What transition requirements would you propose instead and why?

(47) We agree with EFRAG that transition requirements proposed in this ED should be consistent with those in IFRS 10 Consolidated Financial Statements. We are supportive of full retrospective application of the new requirements unless impractical or the costs outweigh the benefits.

(48) Retrospective application should be relatively straightforward for investment entities that qualify for the use of this exception since they should be managing its investments on a fair value basis and should therefore have the relevant information readily available to restate comparative periods.

Avenue d'Auderghem 22-28 • B-1040 Brussels • Tel: +32 (0)2 285 40 85 • Fax: +32 (0)2 231 11 12 • secretariat@fee.be • www.fee.be

Question 9 – Scope exclusion in IAS 28 (as amended in 2011)

(a) Do you agree that IAS 28 should be amended so that the mandatory measurement exemption would apply only to investment entities as defined in the exposure draft? If not, why not?

(b) As an alternative, would you agree with an amendment to IAS 28 that would make the measurement exemption mandatory for investment entities as defined in the exposure draft and voluntary for other venture capital organisations, mutual funds, unit trusts and similar entities, including investment-linked insurance funds? Why or why not?

(49) We agree that investment entities should be required to measure associates and joint ventures at fair value through profit or loss, as this reflects their business model and is consistent with the proposed treatment for controlled entities.

(50) However, other entities, such as venture capital organisations, that currently are able to use fair value for associates and will not be captured by the definition of investment entities will no longer be able to use fair value accounting. Instead, they would be required to use the equity method to measure their investments in joint ventures and associates.

(51) We see no reason to remove the option to measure such investments at fair value through profit or loss from these non-investment entities. In our view, the option to fair value through profit or loss under IAS 28 should be retained unless the set of criteria for investment entities are defined in such a way to capture these other entities.