



Response to IASB Exposure Draft: Investment Entities

5 JANUARY 2012

INTRODUCTION

The Institute's Accounting Standards Committee has considered the above exposure draft and I am pleased to forward its comments to the IASB.

The Institute is the first incorporated professional accountancy body in the world. The Institute's Charter requires the Accounting Standards Committee to act primarily in the public interest, and our responses to consultations are therefore intended to place the general public interest first. Our Charter also requires us to represent our members' views and protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

Our key comments and responses to the questions in the invitation to comment are set out below.

Any enquiries should be addressed to Amy Hutchinson, Assistant Director, Accounting and Auditing and Secretary to the Accounting Standards Committee.

KEY COMMENTS

We understand the IASB's reasons for proposing this exposure draft, and agree that for 'investment entities' users often find fair value information on controlled investments more useful than information on a consolidated basis. As 'decision-usefulness' is one of the key objectives of financial reporting, this is a persuasive argument. However, we have a number of concerns, both in relation to the specific proposals and the implications for financial reporting more widely:

- Financial reporting should be principles-based and exceptions from these principles should be extremely rare.
- Creating a departure from the principle of consolidation risks creating a precedent for further departures from the conceptual framework to be sought.
- If 'decision-usefulness' is considered to be capable of overriding the key principles of the conceptual framework, there is a risk to the overall quality and credibility of IFRS. If new requirements and departures from principles are justified purely because the resulting information is 'decision-useful', financial reporting will become internally inconsistent, less comparable and more voluminous.
- The proposals in this exposure draft are rules-based and we doubt whether they will be workable. They provide structuring opportunities and will result in similar investments being accounted for differently depending on which side of the rules an entity falls.
- We believe the proposals should be based on the nature of the investment i.e. the purpose for which an investment is held, rather than on the type of investor, and should be principles-based. This is in line with the measurement of financial instruments which is based on business purpose.

RESPONSES TO SPECIFIC QUESTIONS

Question 1

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

Response:

We do agree that when an entity holds controlled investments purely for capital appreciation and investment income, the most relevant information for users is fair value information, rather than for these entities to be consolidated. This would mean that all investments would be reported on the same basis, regardless of whether or not these are controlled. We understand that users of the financial statements of such entities would prefer to see fair value information, and would find this information more decision-useful than information on a consolidated basis. Since the objective of financial reporting is to provide information that 'is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity', we agree with the reason for proposing this exemption.

However, we also believe that the argument presented by the three board members in the alternative view is very strong and is conceptually sound. ICAS strongly supports principles-based standards and believes that exceptions to principles should be extremely rare. We share the concern stated in the alternative view that a great deal of strain will be placed on the definition of an investment entity due to the fact that it is rules-based. Furthermore, the creation of one exception such as this has the potential to put the IASB under pressure to create further exceptions from other elements of the conceptual framework. Therefore, if the IASB is to continue with this proposal, we believe that further work is required to ensure that the exception is principles-based so that it achieves its aim without comprising the integrity of the conceptual framework.

The criteria for assessing which controlled investments should be measured at fair value through profit or loss should be principles-based, as the current proposals are rules-based and are drafted from an anti-abuse perspective, which is not conducive to high-quality financial reporting. We believe that the principle on which the exemption should be based should be related to an entity's business model, or management intent, which is in line with the measurement of financial instruments under IFRS 9. Therefore the determination should be based on the nature and purpose of investment as opposed to the nature of the investing entity. We do not support industry-specific financial reporting as we believe the general framework for financial reporting should be applicable to all types of entities. Industry-specific standards provide structuring opportunities and reduce comparability.

We believe that the best solution to this issue is to identify a principles-based approach, based on the business purpose of the investment. This will ensure that the exception is workable, since it will not be a case of entities attempting to fit into a narrow set of criteria. We also believe it is vitally important that the IASB considers these proposals in the context of the conceptual framework, and in particular, consider the implications for the reporting entity exposure draft. It is crucial that there is a conceptually sound basis for these proposals.

Question 2

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?

Response:

As stated above, we do not support the criteria proposed in the exposure draft. We do not support industry-specific accounting and do not believe that the current proposals will work in practice. The definition of an investment entity is very narrow which will lead to entities deliberating structuring operations so as to take advantage of the exemption. Many entities which would hope to benefit from these proposals will not in fact do so, which will result in different entities holding similar controlled investments accounting for them differently. We agree with the alternative view that the definition will come under pressure and that significant resource will be required to ensure that it is applied correctly. As we propose above, the exception should be based on the nature and purpose of the investment and should be expressed as a high-level principle with more detailed examples or indicators to support the principle.

Question 3

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?

Response:

We do not have any comments on this point, based on our response to Question 2.

Question 4

- (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 you would propose to address the concerns raised by the Board in paragraph BC16.

Response:

We do not have any comments on this point, based on our response to Question 2.

Question 5

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 only to financial assets, as defined in IFRS 9 and IAS 39 Financial Instruments: Recognition and Measurement? Why or why not?

Response:

We are not in favour of specific rules for certain types of entity, but in general, the fair value model will provide more relevant information about investment properties.

Question 6

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?

Response:

We do not agree that a non-investment parent of an investment entity should be required to consolidate all controlled entities including those held through subsidiaries that are investment entities. This contradicts our view that the exemption should be based on the business purpose of an investment rather than the type of investing entity. This proposal is driven from an anti-abuse perspective and we believe the fact that this provision is considered necessary only serves to demonstrate the problems associated with the IASB's proposed approach.

Question 7

(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?

Response:

We agree with the overall structure of the disclosure requirements in the exposure draft. There is a high-level principle within the main body of the standard, with examples of how this principle might be met provided in the application guidance. We support this principles-based approach which we believe will result in more meaningful, focussed disclosures.

Question 8

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?

Response:

The transition requirements for these proposals should be consistent with those in IFRS 10 Consolidated Financial Statements i.e. there should be retrospective application. However, account should be taken of the outcome of the IASB's current proposals on the transition guidance in IFRS 10.

Question 9

(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?

Response:

We believe that the exemption in IAS 28 should accord with this exemption.