ICAEW

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Chair
European Financial Reporting Advisory Group
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Chère Mme Flores

ED/2011/4 *Investment Entities*

MAJOR POINTS

1. ICAEW welcomes the opportunity to comment on EFRAG's draft comment letter, published in September 2011, on the International Accounting Standards Board Exposure Draft ED/2011/4 *Investment Entities.* Our responses to the main issues highlighted by EFRAG are set out below. A draft of our response to the IASB, which has not yet been finalised, is attached to this letter.

2. Like EFRAG, we welcome the IASB's proposals and are supportive of their proposals to introduce an exemption from the requirements of IFRS 10 *Consolidated Financial Statements* for investment entities.

3. However, like EFRAG we have some concerns about certain aspects of the proposals.

    a. Like EFRAG, we are not in favour of requiring a parent, which is not an investment entity itself, to consolidate the controlled entities that it holds through subsidiaries that are investment entities. In our view the exceptions available to the investment entity should 'roll up' into its parent's own consolidated financial statements regardless of whether that parent is an investment entity or not. If fair values provide users with the most useful information about investments held for capital appreciation, investment income or both at an investment company level, it seems incongruous to suggest that they do not provide the most useful information in the context of a group whose parent company is not an investment entity.

    b. Unlike EFRAG, we believe that the definition of an investment entity should be reconsidered. We recommend that a more principles-based approach is adopted with the exemption from consolidation being made available to investments held by venture capital organisations, mutual funds, unit trusts and similar entities including investment-linked insurance funds. We believe that the criteria as drafted are too restrictive and that if the board is to retain them then some simplifications would be beneficial.

    c. Wheras EFRAG calls on the IASB to carry out an impact assessment to better understand the practical implications of any amendments to IAS 28, we simply disagree with the proposed removal of the exemption that is currently available to certain entities under that standard. We see no reason to remove the option to measure associates and joint ventures at fair value through profit or loss from non-investment entities.

4. Our detailed comments to the specific questions raised by EFRAG are set out below.

RESPONSES TO SPECIFIC QUESTIONS RAISED BY EFRAG

EFRAG question 1
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.

5. From a theoretical perspective, some may argue that how an investment is measured should be based on the nature of the investment rather than on the nature of the investor ie, that in all instances those investments held for capital appreciation, investment income or both should be measured at fair value through profit or loss while those investments acquired for wider business purposes should be consolidated. We have some sympathy for this viewpoint.

6. However, we feel that introducing an exemption at a transaction level rather than an entity level would present structuring opportunities. We therefore pragmatically agree that it is necessary to limit the exemption to investment entities.

EFRAG question 2
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?

7. Not applicable.

EFRAG question 3
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.

8. We are not convinced by the board's decision to 'use US GAAP as the basis for developing criteria' for determining whether an entity meets the definition of an investment entity or not. This has resulted in detailed criteria being included in the proposals. While we agree that clear criteria are needed, we would recommend that a more principles-based approach is adopted. with the exemption from consolidation being made available to investments held by venture capital organisations, mutual funds, unit trusts and similar entities including investment-linked insurance funds (to borrow the wording from paragraph 1 of the current version of IAS 28).

9. We believe that the criteria as drafted are too restrictive and that if the board is to retain them then some simplifications would be beneficial. The attached draft response to the IASB sets out our views on each of the individual criteria.

10. We note that EFRAG believe that having an exit strategy is a key aspect in identifying and investment entity. We agree that this is an important criterion and should be given greater prominence. However, the definition of an investment entity requires investments to be held for capital appreciation, investment income or both. This suggests that an exit strategy is not always necessary eg, where an investment is held for investment income. We suggest that any additional criteria should refer to an exit strategy for the investment **or** strategies for generating long-term investment income.

EFRAG question 4
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?

11. Yes. Again please see the attached draft response to the IASB for more details of our concerns about the restrictive nature of the criteria in the exposure draft.

Please contact me should you wish to discuss any of the points raised in this letter or the attached draft response.

Yours sincerely

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