THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

20 October 2008

Our ref: ICAEW Rep 123/08

Your ref:

John Stevens
Secretary, SORP Working Party
The Association of Investment Companies
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Dear Mr Stevens

STATEMENT OF RECOMMEND PRACTICE: FINANCIAL STATEMENTS OF INVESTMENT TRUST COMPANIES AND VENTURE CAPITAL TRUSTS

The Institute of Chartered Accountants in England and Wales (the ICAEW) is pleased to respond to your request for comments on your Exposure Draft SORP *Financial Statements of Investment Trust Companies and Venture Capital Trusts*.

The ICAEW's Financial Services Faculty was established in 2007 to become a world class centre for thought leadership on issues and challenges facing the financial services industry, acting in the public interest and free from vested interests. It draws together professionals from across the financial services industry and from the 25,000 ICAEW members specialising in the sector. This includes those working for regulated firms, in professional services firms, intermediaries, and regulators.

Please contact Iain Coke, Head of the Financial Services Faculty or me, should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

ICAEW Representation

ICAEW REP 123/08

EXPOSURE DRAFT SORP FINANCIAL STATEMENTS OF INVESTMENT TRUST COMPANIES AND VENTURE CAPITAL TRUSTS

Memorandum of comment submitted in October 2008 by The Institute of Chartered Accountants in England and Wales, in response to The Association of Investment Companies (AIC) Exposure Draft SORP *Financial Statements of Investment Trust Companies and Venture Capital Trusts* published in July 2008

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INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales welcomes the opportunity to comment on the Exposure Draft Statement of Recommended Practice (SORP) *Financial Statements of Investment Trust Companies and Venture Capital Trusts* published by The Association of Investment Companies.

WHO WE ARE

2. The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 130,000 members in more than 140 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 700,000 members worldwide.

3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The Institute ensures these skills are constantly developed, recognised and valued.

MAJOR POINTS

4. We welcome the revision of the SORP and agree there have been sufficient changes since it was first issued to merit an update. We note that the most controversial aspect discussed, the 'C' shares, has not actually been addressed in the body of the SORP, and that the SORP will need to be revised in the light of the feedback you receive. In addition to our responses to your specific questions, we comment on your change to disclosures about realised and unrealised profits.

RESPONSES TO SPECIFIC QUESTIONS

Q1: Do you agree that VCTs should be included within the scope of the SORP?

5. We agree that the scope of the SORP should be extended to include Venture Capital Trusts (VCTs) as this is likely to make it easier to compare VCTs financial statements with each other and with other businesses.

Q2: Do you agree that the investment related disclosures previously set out in the Listing Rules, but now removed, should become a requirement of the SORP?

6. We support the Financial Services Authority's move towards more principles-based regulation, which was a driver in the requirement for these disclosures being dropped from the Listing Rules. However, the information required at paragraphs 27 and 79 does not appear to be onerous to compile. Providing the AIC has evidence that the information provided is valued by readers of the financial statements, we are content that the SORP should instead require them.

Q3: Do you believe the 'C' shares should be classified as equity or a liability?

7. The definition of equity in Financial Reporting Standard (FRS) 25 is narrow and the 'C' shares, which have conventionally been treated as equity, do not in fact meet this definition. The reason for this is that a variable number of 'C' shares are exchanged for the existing shares into which they convert. Accordingly, we think that the 'C' shares do need to be classified as liability. We recognise that this is not an intuitive outcome and clear disclosures will be needed to help users interpret the information.

Q4: What are the implications of either classification and do you believe it is important to users which classification is adopted?

8. If the shares are classified as equity the use of the true and fair override would be required for all VCTs with this type of share; we do not think this is an appropriate use of the override nor one a SORP should be encouraging. If the 'C' shares are categorised as a liability, the implications for users is that the balance sheet in particular will look different. We believe that the reason for this change can be explained and that going forward it will not be an insuperable obstacle to users' understanding of the financial statements.

Q5: If you believe that 'C' shares should be classified as equity how can this be justified in accordance with accounting standards? (In particular how would you deal with the requirement set out in paragraph 16b of FRS 25?)

9. We do not think that classification of the 'C' shares as equity can be achieved in accordance with accounting standards, given the definition of equity in FRS 25.

Q6: Do you agree with the Association's view that if 'C' shares are classified as a liability it would not be appropriate to categorise them as at fair value through profit or loss?

10. We agree that it would not be appropriate to categorise them as at fair value through profit and loss. FRS 26 (9) defines these as liabilities which are held for trading, or designated as at fair value through profit on loss upon initial recognition. As the 'C' shares are neither held for trading nor meet the requirements for designating, this would not be the appropriate category.

Q7: If 'C' shares are classified as a liability how can the accounts best be presented to give useful and meaningful information to the user?

11. Working with interested parties, the AIC should develop its own proposals as to how the liability should best be shown in the accounts, including measurement issues. The Investment Management Committee's discussion of presentation was not definitive, but included the view that an amount for a 'C' share liability in the balance sheet could be supported by a note to the financial statements showing information similar to that already provided. We are aware that currently a columnar approach is used on the face of the financial statements which splits out amounts relating to 'C' and ordinary shareholders and think that the retention of a columnar approach where possible may still be useful, although clearly it will differ from that currently used.

Q8: If 'C' shares are classified as a liability and the accounts are presented in accordance with your response to Q7 above, do you believe that the accounts would give a true and fair view?

12. Companies Act does not demand compliance with accounting standards in requiring companies to give a true and fair view of their profit or loss and of their position at the end of the period in their financial statements. However, what constitutes a true and fair view will normally be assessed in the light of existing accounting standards. Accordingly, whilst there are valid arguments for regarding the shares as equity, they should nevertheless be classified as a liability because they do not meet the definition of equity given in FRS 25. Providing the financial statements disclose the particular nature of the 'liability', we consider the accounts could give a true and fair view.

DISCLOSURE CHANGE

In the light of our guidance in Technical Release 01/08, we welcome the change to no longer require disclosure of realised and unrealised profits (ED SORP paragraph 17). As our guidance indicates, these do not correspond exactly with distributable profits and the disclosures would not have provided useful information.

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