Association pour la participation des entreprises françaises à l'harmonisation comptable internationale

AFEP

ASSOCIATION FRANÇAISE DES ENTREPRISES PRIVÉES

IASB
30 Cannon Street
London EC4M 6XH
UK
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Paris, 22 December 2011

Re: ED/ 2011/4 Investment Entities

Dear Sir or Madam,

We welcome the opportunity to comment on the exposure draft "Investment Entities" published in August 2011 (the ED).

We broadly welcome the proposals stated in this exposure draft, as we believe that in the specific case of investment entities, fair value measurement is more relevant than the consolidation process.

However, we would like to express the following primary concerns with the proposals:

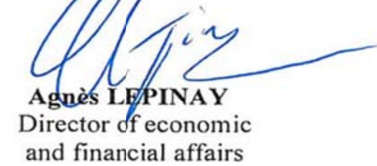
- An exemption from consolidation should also be granted at the group level to a non-investment parent of an investment entity when the arrangement between the parent and its investment entity subsidiary does not modify the business model of the subsidiary.

- We ask the Board to reconsider the transitional provisions, especially the mandatory effective date, which, in our view should be aligned with that of IFRS 10, IFRS 11, IFRS 12, IAS 27 and IAS 28 (the "consolidation package"). In this context, we respectfully call for a postponement of the transition date and fully of the whole consolidation package and fully support the recent EFRAG request to this effect.

Further comments are detailed in the appendix.

We remain at your disposal should you need further clarification or background information.

Yours faithfully,



Appendix – Answers to specific questions raised in the Invitation to comment

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, that should not consolidate controlled entities and instead measure them at fair value through profit or loss? Why or why not?

We agree that measurement at fair value is the best way to depict the Business model of entities referred to as investment entities. To consolidate their controlled investments on a line-by-line basis is meaningless and does not, in our view, represent their investment or management strategies. Finally, the percentage of interest in these controlled entities often varies over time, and applying the IAS 27 provisions (in particular regarding the group share in the profit or loss of the controlled entity), will not lead to useful information

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?

We agree with the proposed criteria to identify investment entities which overall capture well the characteristics of the Business model for which fair value is relevant.

We are nonetheless quite cautious about the reference to “investment income” in criterion 2(a) that could, in our view lead to an undesirable broadening of the range of entities which would meet that criterion. Moreover, if investments are made with the sole objective of obtaining investment income as described (interest, dividends, and rent), it will be unlikely that other criteria will be met (for example, that the performance is managed and evaluated on a fair value basis);

We believe that focus should be first on the Business model and in particular the existence of an exit strategy with some further criteria illustrating this Business model and the appropriate potential use of this exemption.

Finally, we believe that criterion 2(d) is very important as it will prevent some dedicated or almost-dedicated funds from being wrongly considered to be investment entities. Indeed, the underlying assets held by these funds are managed in the same way as other financial assets directly held by the parent of these funds. Therefore, in substance, these funds, which are set up for different practical purposes (such as, for tax reasons, cross-holdings within the group…), cannot be considered as separate autonomous businesses. We therefore agree with the inclusion of this among the criteria in the ED.

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?

We agree that providing such services to itself should not disqualify the entity from being an investment entity, since these services are closely related to its investment activities and thus are consistent with the Business model.

We also agree that when the entity provides such services to third parties and the services represent a significant part of its activity, the entity cannot be considered to be an investment entity.

Paragraph B2 is insufficient in that it states that an entity could still meet the substantive activities requirement, even if it has a "substantive" service activity, but it provides no guidance on when and how this would be the case.

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?

If the asset manager of a dedicated fund is an agent of the single investor, the entity should not be eligible to qualify as an investment entity for the reasons detailed in our response to question 2 in relation to paragraph 2(d) of the ED

However, situations where the fund manager is not an agent of the single investor should be rare in practice.

(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?

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?

In our view, there is a problem of consistency between the drafting of the measurement guidance of paragraphs 6 and 7 of the ED (which do not mention IAS 40 at all) and the explanatory text to this question, which states that paragraph B17 of the ED "requires that the fair value model of IAS 40 be used by an entity that qualifies as an investment entity".

Our reading is that B17 provides guidance to be used in relation to the criteria of paragraph 2 in the determination of whether an entity can qualify as an investment entity. It does not provide explicit measurement guidance for entities which do qualify as investment entities.

We agree that fair value measurement for investment properties is one of the valid criteria for qualifying as an investment entity.

Even though investment properties held by some real estate funds are held primarily for the collection of rental income, they are also managed on a fair value basis with a view to a potential future sale. Some may therefore interpret B17 to mean that those investment properties should always be valued at fair value, with no option to use the cost model available in IAS 40.

Our understanding of the intention of B17 is rather that a real estate entity holding properties both to earn rentals and for capital appreciation can still choose either the fair value model or the cost model as permitted by IAS 40. If our understanding is correct, then order to avoid any erroneous interpretation, the future standard should specify that IAS 40 should be applied first, with its existing free choice between fair value and amortised cost and then only those entities that have elected for the fair value model of IAS 40, could be eligible for qualification as an investment entity.

The future standard should then specify that investment properties held by a qualifying investment entity should be accounted for using the fair value model of IAS 40.

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?

No, we do not agree. If fair value measurement provides the most useful information at the investment entity level, it is also relevant at the group level. Groups today have mixed business models, and financial reporting should highlight this fact, instead of eliminating it.

Furthermore, we do not understand concerns expressed in paragraphs BC 20:

- First, we do not share the Board's stated view that in most cases investment entities have investment entity parents. Financial institutions and Insurance companies s are quite a good illustration of groups that often include entities that could qualify as investment entities, whereas the entity's parents will not.

  Thus, it is neither true, nor appropriate to conclude that "in most cases the investment entity accounting would be available when needed".

- On the contrary, the circumstances mentioned (that is, where a non-investment entity parent issues its equity to an investee of its investment entity subsidiary) are quite rare in our experience and should therefore not prevent the establishment of a robust principle-based standard. Perhaps the Board should try to address this narrow and very specific issue, rather than to risk weakening the whole standard.

  We agree with EFRAG's analysis of the conditions set in paragraph B6 of the ED and the consequence derived from this assessment, i.e. that any arrangement between the parent and its investment entity subsidiary that modifies the nature of the investment activity would disqualify the entity from using the consolidation exception.

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?

First, we believe that the scope of the disclosures must be specified. It should be made clear, that as long as fair value measurement cannot be retained for the consolidated statements, the additional disclosures are required only for the investment entity's own reporting, and not for the notes to the consolidated financial statements.

Furthermore, it should also be made clear in paragraph 9 and 10 that the additional information required is only about entities controlled by the investment entity, not all of similar investments.

Finally, we fully share the point raised by EFRAG, that it would be more efficient if the IASB, as a standard setter, were to carry out the task of identifying the duplication of disclosures between this ED and IFRS 7, IFRS 12, IFRS 13 and other IFRSs, rather than multiplying the effort by requiring each and every investment entity to do this, as stated in paragraph B 17 of the ED.

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?

While we welcome the IASB's concern to reduce complexity, we believe that in this specific case, the relevance of the information and therefore consistency with IFRS 10 should prevail. Moreover, because of the specific criteria to be met in order to qualify as an investment entity, especially the "fair value criterion" in paragraph 2(e), we believe that the necessity to use hindsight would be limited. We think therefore that retrospective application should be required.

At last, but not the least, we strongly call for an alignment of the transition date of both IFRS 10 (and the other standards published in relation to the consolidation package) and this amendment and therefore ask for a postponement of the mandatory transition date for IFRS 10. Consistency between the consolidation package and this amendment is not the only valid reason to make such a suggestion. We would also point out the following main reasons:

- Although our members have been following closely the evolutions of these standards through the various stages of the due process, it is only once the IASB has definitively completed its decision-making process that they as a preparer entity can purposefully begin to understand, analyse and interpret the requirements of the individual standards and how the various standards in this set of consolidation standards relate to each other. The results of this work have to be confirmed with the entity's auditors to ensure that no fundamental disagreements of principle arise later in the process. The entity will then have to define how it will apply the principles to its own investments given the circumstances in which it operates.
- Once a common understanding of the principles and their application has been achieved, an entity must review the whole of its portfolio of interests in other entities, irrespective of the previous accounting requirements for those interests, and determine for each what the nature of the interest is under the new requirements. The conclusions must again be agreed with the auditors and, for those interests for which the new requirements impose a change of classification, historical data must be collected or estimated to allow the financial statements to be appropriately restated as if the new standards had been in place at the time of the transactions. Consolidating an investee which was not previously consolidated requires acquisition accounting as provided for by IFRS 3 Business Combinations. This necessitates the obtaining of historical information about, for example, fair values and management intent, and can be very time-consuming.

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?

Although we can understand the rationale behind this decision, we believe that the decision about such an amendment should not be made prior to the completion of an effect study. Alignment of definitions across standards may lead to significant changes in practice, and the Board should first be certain that financial reporting would be improved.

For this reason, the alternative proposed at (b) above may be more reasonable.

Other comments

- Newly setup entities

Paragraph B5 illustrates some situations when an entity may not fully meet all criteria at a point in time but not necessarily be precluded from being an investment entity. While we agree with all of these examples, we believe that one is missing. When a fund is newly created, it may not have a significant proportion of external investors. The investment entity may initially own all the ownership interest while awaiting the obtaining of performance data necessary for it to attract external investors. As the main objective remains the commercialization of interests in the investment entity, this temporary situation should not be a barrier to qualification.

- Collateral

Paragraph 7(b) requires that assets (and related liabilities) controlled as a result of defaults shall be accounted for in accordance with other applicable standards. We believe that it would be useful to add some application guidance to ensure that the appropriate accounting treatment is clear in respect of these assets and the interaction with the fair value measurement of the residual interest.

- Change in the status (paragraph 5 of the ED)

We question the proposed transitional accounting for an entity that becomes an investment entity under paragraph 5. In fact, we do not understand the rationale behind a restatement of opening retained earnings rather than an adjustment to the net income of the period.