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February 15, 2012

Ms. Susan M. Cosper
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

File Reference No. 2011-200
Re: Proposed Accounting Standards Update, *Financial Services — Investment Companies (Topic 946): Amendments to the Scope, Measurement, and Disclosure Requirements*.

Dear Ms. Cosper:

Deloitte & Touche LLP is pleased to comment on the FASB's proposed Accounting Standards Update (ASU) *Financial Services — Investment Companies (Topic 946): Amendments to the Scope, Measurement, and Disclosure Requirements*. We support the efforts of the FASB and IASB (collectively, the "boards") to improve financial reporting for investment companies. We agree that it is vital to appropriately identify entities for which the measurement of investments at fair value provides the most relevant information to financial statement users. However, we believe that the boards should first establish a principle for determining which types of entities should be considered investment companies and then identify specific criteria that are in line with that principle.

We also believe that the exception to measurement of controlling interests in noninvestment company investees at fair value should extend to controlling interests in other investment companies and in investment property entities. Just as an investment company is prohibited from consolidating a noninvestment company, an investment company should not consolidate another investment company or an investment property entity. Rather than requiring consolidation, the boards should consider developing additional disclosure requirements that would make the financial position and operations of such controlled entities more transparent.

We agree with the proposed ASU's stipulation that a noninvestment company parent of an investment company should retain, upon consolidation, the specialized accounting of an investment company subsidiary. We believe that this would result in the provision of the most relevant information to investors in the parent. In addition, we think that it is appropriate to establish a clear principle and criteria at the investment company level that carries over to the consolidated financial statements of a noninvestment company parent rather than to prohibit the retention of investment company accounting or to impose barriers or restrictions that would result in differing accounting at the investment company and consolidated levels.

Finally, we are concerned that although the proposed ASU would generally align the scope of entities that qualify as investment companies with the scope of investment entities under the

IASB's exposure draft, there are a number of differences between the accounting requirements for entities that qualify as investment companies under the proposed ASU and the related requirements under the IASB's proposed guidance. For example, under U.S. GAAP, there are different requirements for determining the initial measurement of an investment company's investments. We recommend that the boards reconcile these differences before finalizing their proposals. We have attached Deloitte's comment letter on the IASB's investment entities exposure draft for your convenience. Our positions in the IASB letter are consistent with the positions in this letter.

Please also see the appendix below for our detailed responses to the proposed ASU's questions for respondents.

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We appreciate the opportunity to comment on the proposed ASU. If you have any questions concerning our comments, please contact Trevor Farber at (203) 563-2547.

Sincerely,

Deloitte & Touche LLP

cc: Robert Uhl, Deloitte & Touche LLP
Jim Schnurr, Deloitte & Touche LLP

Appendix
Deloitte & Touche LLP
Responses to Questions for Respondents

Question 1: The proposed amendments would require an entity to meet all six of the criteria in paragraph 946-10-15-2 to qualify as an investment company. Should an entity be required to meet all six criteria, and do the criteria appropriately identify those entities that should be within the scope of Topic 946 for investment companies? If not, what changes or additional criteria would you propose and why?

We do not believe that the proposed criteria are the best way of determining which entities would qualify as investment companies. Rather, we think that the boards should first establish a principle for which types of entities should be considered investment companies and then identify specific criteria that are in line with that principle. We suggest the following principle for identifying an investment company:

> An investment company pools investors' funds to provide the investors with professional investment management. The entity invests the proceeds only for capital appreciation, investment income (such as dividends or interest), or both, and provides the returns to its investors.

Further, we believe that the proposed ASU's criteria could be modified as follows to better support such a principle:

- *Nature of the investment activities* —The criteria in ASC 946-10-15-2(a) and 15-2(aa) (as amended by the proposed ASU) on "nature of the investment activities" and "express business purpose" could be combined and supplemented with a portion of the guidance in ASC 946-10-55-7 (as amended by the proposed ASU). Doing so would further clarify how these concepts interrelate. We suggest the following criterion:

  > An investment company has no substantive activities other than investing-related activities and provision of services related to those activities. The entity has made a commitment to its investors that such activities are its sole business purpose. Activities are considered to be other than investing activities if the entity or its affiliates obtain, or have the objective of obtaining, benefits from their investments that are not capital appreciation, investment income (such as dividends or interest), or both; are not available to other noninvestors; or are not normally attributable to ownership interests.

  We believe that the requirement that an investment company does not obtain, or have the objective of obtaining, returns from its investments that are not capital appreciation or investment income, or both differentiates an investment company from a conglomerate that acquires entities to obtain such benefits. We think that this concept should be included in both the criterion and the implementation guidance. Moreover, we believe that many of the boards' concerns about the abuse of the investment company principle would be alleviated if more emphasis were placed on the requirement that the investment company is not receiving such benefits.

- *Unit ownership* — Our concerns about this criterion and about the application guidance regarding unit ownership are further discussed in our response to Question 8.

- *Pooling of funds* — Our concerns about this criterion and about the application guidance regarding pooling of funds are further discussed in our response to Question 7.

- *Fair value management* — Our concerns about this criterion and about the application guidance regarding fair value management are further discussed in our response to Question 11.

We also have specific concerns and suggestions regarding the following application guidance:

- *ASC 946-10-55-4 to 55-6 on multiple investments* — We are concerned about the requirement that an entity must hold multiple investments to qualify as an investment company. An investment company may be formed to pool money to invest in a single entity for which the minimum investment is too great for each individual investor, the investment is unobtainable by single investors, or the investment could result in too great a concentration of risk for an individual investor. In these situations, the entity would be disqualified from being considered an investment company as a result of owning a single investment. The boards should consider whether this is consistent with the investment company principle.

  If the boards decide to retain the criterion that an investment company should have multiple investments, we agree with the proposed ASU's provision that an entity that holds a single investment should be allowed to qualify as an investment company when the entity (e.g., a blocker entity) was formed in conjunction with its parent investment company and that parent entity holds multiple investments. This concept is not included in the IASB's exposure draft.

- *ASC 946-10-55-10 on exit strategy* — ASC 946-10-55-10 (as amended by the proposed ASU) states that "[d]isposal of investments only during liquidation or to satisfy investor redemptions are not exit strategies." We are concerned that this statement would exclude limited-life entities from the scope of the proposed guidance. Partnership arrangements are often designed to have a limited life in which the investments will be disposed of when the entity is liquidated. We recommend that the Board amend this criterion so that (1) limited-life entities are not outside the scope of the proposed guidance and (2) disposal as a result of the liquidation at the end of the life of a limited-life entity would be considered in the evaluation of the express-business-purpose criterion.

  ASC 946-10-55-10 (as amended by the proposed ASU) also indicates that an investment company should have an exit strategy for how it plans to realize the capital appreciation of its investments. Accordingly, we believe that if an entity is holding debt securities until maturity, intending only to earn investment income, it would not need an exit strategy to meet the express-business-purpose criterion. Although we agree with the proposed ASU that an exit strategy would not be required for such investments, the IASB's exposure draft does not include this concept.

> We also recommend that the guidance include an example of an exit strategy based on the existence of "limits" (or on the investment's no longer meeting certain conditions), which is common with many investment companies. Examples of such situations might include a requirement to divest if an equity security is no longer included in an index or a situation in which a debt security no longer maintains an investment-grade credit rating.

Question 2: The definition of an investment company in the proposed amendments includes entities that are regulated under the SEC's Investment Company Act of 1940. Are you aware of any entities that are investment companies under U.S. regulatory requirements that would not meet all of the proposed criteria in paragraph 946-10-15-2? If so, please identify those types of entities and which of the criteria they would not meet.

We agree that entities regulated under the SEC's Investment Company Act of 1940 (i.e., registered investment companies) should be within the scope of the proposed guidance, regardless of whether they meet the six criteria in the proposed ASU. SEC Regulation S-X, Rule 6-03(d),[1] requires registered investment companies to measure all of their investments at fair value. Because both the proposed ASU and SEC Regulation S-X require fair value measurement for investments held by registered investment companies, to include these companies within the scope of ASC 946 would conform the U.S. GAAP and SEC measurement requirements for these entities.

Question 3: The proposed amendments would remove the scope exception in Topic 946 for real estate investment trusts. Instead, a real estate investment trust that meets the criteria to be an investment property entity under the proposed Update on investment property entities would be excluded from the scope of Topic 946. Do you agree that the scope exception in Topic 946 for real estate investment trusts should be removed? In addition, do the amendments in the proposed Updates on investment companies and investment property entities appropriately identify the population of real estate entities that should be investment companies and investment property entities?

We agree that the scope exception for real estate investment trusts (REITs) should be removed and concur with the statement in paragraph BC11 of the proposed ASU that "an entity's election as a real estate investment trust should not affect whether the entity is an investment company." Because the exception is based on the tax requirements in the United States, it would need to be removed before the boards can issue a converged definition of an investment company.

However, we have concerns regarding whether this proposal and the proposed ASU on investment property entities will appropriately identify the population of real estate entities that should be investment companies. As noted in our February 15, 2012, comment letter on the Board's investment property entities exposure draft (File Reference No. 2011-210), we do not believe that another entity-based financial reporting model specific to entities that invest in a particular asset class (real estate) is warranted. We therefore do not believe that the concept of an investment property entity should be introduced; rather, we think that these real estate entities should be evaluated to determine whether they are investment companies. Real estate entities that meet the definition of an investment company should apply the measurement, presentation, and disclosure requirements in ASC 946.

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[1] SEC Regulation S-X, Rule 6-03(d), "Valuation of Assets."

We are also concerned that the fair value management criteria will not be applied consistently to certain types of real estate entities. For example, we would expect mortgage REITs to be investment companies as a result of the removal of the REIT scope exception. However, some mortgage REITs may assert that they do not meet the fair value management criteria proposed in ASC 946-10-15-2 because (1) they are in the business of holding loans until maturity to collect principal and interest or (2) they are not in the business of buying and selling securities. This may cause a lack of comparability between similar entities given that some mortgage REITs would meet the investment company criteria and others would not. See our other concerns related to the fair value management criterion in our response to Question 11.

Question 4: The proposed amendments would require an entity to reassess whether it is as an investment company if there is a change in the purpose and design of the entity. Is this proposed requirement appropriate and operational? If not, why?

Although we agree that an entity should reassess whether it is an investment company, the boards should ensure that the final criteria for qualifying as an investment company do not result in entities' fluctuating between qualifying as an investment company in one period and not qualifying in the next period, or vice versa.

Question 5: An entity may be an investment company when it performs activities that support its investing activities. As a result, a real estate fund or real estate investment trust (that is not an investment property entity) could be an investment company if the entity (directly or indirectly through an agent) manages only its own properties. However, the entity would be precluded from being an investment company if the other activities were considered more than supporting the entity's investment activities (for example, construction). Is this requirement operational, and could it be consistently applied?

Our recommended principle for an investment company is that its sole business purpose is to conduct investing activities. However, an investment company typically performs other activities that support its investing activities. Therefore, we agree that these other activities, when provided either directly by the investment company or through one of its investees, should not preclude the investment company from meeting the criterion. We also agree with the guidance in paragraph BC14 of the proposed ASU, which states that the determination of whether the entity's other activities would preclude an entity's qualification as an investment company should be based on facts and circumstances. When an investment company controls an investee that provides these other activities, consolidation of that investee is appropriate.

However, we recommend that the boards clarify whether these other activities would include financing-related activities. Certain investment company structures use leverage financing in which the borrowing is facilitated through a separate legal entity controlled by the investment company. If the boards believe that the financing-related activities are consistent with activities that support the entity's investing activities, the financial reporting of the investment company would reflect the use of leverage financing when executed through a subsidiary controlled by the investment company.

An investment company may also provide investment-related services to other entities (e.g., custody of assets or recordkeeping services). We do not believe this should preclude the entity from being deemed an investment company if either of the following criteria is met:

- The services are provided only to other related investment companies.

- The services provided to other parties are limited to a nonsubstantive level, where the entity's sole substantive business purpose can still be deemed to be holding investments for capital appreciation, investment income (such as dividends or interest), or both.

Question 6: The proposed implementation guidance includes examples of relationships or activities that would indicate that an entity obtains or has the objective of obtaining returns from its investments that are not capital appreciation or investment income. Do you agree with these examples? If not, how would you modify the examples while still addressing the Board's concerns identified in paragraphs BC15 and BC16?

We agree with the examples of relationships and activities that would indicate that an entity obtains returns from its investments that are not capital appreciation or investment income. However, some may question whether entities should consider the significance of the relationship or activities when making this assessment. Thus, we believe that further implementation guidance on the application of these relationships and activities would be beneficial.

Question 7: To be an investment company, the proposed amendments would require an entity to have investors that are not related to the entity's parent (if there is a parent) and those investors, in aggregate, must hold a significant ownership interest in the entity. Is this criterion appropriate? If not, why?

One of the fundamental characteristics of an investment company is that external investors pool their funds to obtain professional investment management services. In addition, having significant external ownership interests is an important safeguard against potential abuses to avoid consolidation. However, we have some concerns regarding the requirement that the entity must have investors that are unrelated to the parent (if there is a parent) and that those investors in the aggregate must hold a significant ownership interest in the entity.

Single-investor structures (or multiple-investor structures in which the investors are related parties) are often created by investment managers on behalf of, for example, a pension plan. The fact that the investment company only has a single investor (or multiple related investors) that is a pension plan has no bearing on the financial reporting needs of this investor. That is, the investor needs fair value information even though it may be the only investor in the fund. The boards should consider expanding the criteria to allow for a single investor in such circumstances.

In addition, the boards should consider that certain investment company structures (e.g., an employee side-by-side fund) consist of capital primarily from management or employees of the investment company's parent (the investment manager). These structures co-invest in other investment companies alongside the capital invested by external investors. The investment manager will often be considered the parent of the employee side-by-side fund because the investment manager has decision-making authority over, and economic exposure to, the entity and there are no substantive kickout rights. We believe that these structures are in line with the principle of an investment company because, even though there may not be external investors in the specific legal entity that are unrelated to the parent, the entity is investing along with an entity that otherwise comprises external investor capital. The boards should consider whether such investment company structures should be exempted from the pooling-of-funds criterion. This could be achieved either by amending the requirement to exclude employees from the related-party group used to evaluate this criterion or by amending the criterion to include affiliates of the parent rather than related parties.

Question 8: The proposed unit-ownership criterion would require an entity to have ownership interests in the form of equity or partnership interests to be an investment company. The entity would consider only those interests in determining whether it meets the proposed pooling-of-funds criterion. Therefore, a securitization vehicle, such as a collateralized debt obligation, may not qualify as an investment company under the proposed amendments because it may not meet the unit-ownership or the pooling-of-funds criterion. The entity would not consider interests held by its debt holders when evaluating these criteria to be an investment company. For entities that do not have substantive equity interests (for example, those considered variable interest entities under Subtopic 810-10), should the unit-ownership and pooling-of-funds criteria to be an investment company consider interests held by debt holders? Please explain.

We believe that the criterion in ASC 946-10-15-2(b) ("unit ownership") should be modified to reflect the fact that not all entities have shares outstanding or partnership interests. For example, certain actively managed collateralized loan obligations (CLOs) or collateralized debt obligations (CDOs) may provide beneficiaries with a proportionate share of net assets but not through either shares or partnership units. These types of entities pool funds from numerous investors (debt holders of various classes, including classes that bear the risks and rewards of owning the residual class) and operate in a manner similar to other types of leveraged investment companies. These entities may be required to classify their residual interests as a liability and accordingly have no equity outstanding in their financial statements.

Illustration 13 in SOP 07-1[2] indicates that CLOs would be considered investment companies even though they do not have a significant equity investment. In addition, the current practice is generally to account for CLOs and CDOs as investment companies in accordance with ASC 946.

To address the concern that an investment company should aggregate a significant portion of its capital from outside investors to prevent the abuse of the investment company principle, we believe that this criterion should include equity and debt interests, provided that those interests participate in both the risks and rewards of ownership. We believe that, rather than applying a technical classification approach to whether those interests are considered financial liabilities or equity instruments, the investment company should focus on whether the investor's interest represents rights to the net assets of the entity.

Question 9: Certain entities may meet all of the other criteria to be an investment company but have only a single investor (for example, a pension plan). The amendments in FASB's proposed Update on investment property entities provides that if the parent of an entity is required to measure its investments at fair value under U.S. GAAP or the parent entity is a not-for-profit entity under Topic 958 that measures its investments at fair value, the entity would not need to meet the unit-ownership and pooling-of-funds criteria to be an investment property entity. Considering the Board's concerns identified in paragraph BC24, should the criteria in this proposed Update be amended to address situations in which the entity has a single investor?

As noted in our response to Question 7, we do not believe that having a single investor should necessarily preclude an entity from being an investment company. We appreciate the Board's concerns in paragraph BC24 of the proposed ASU and note that this concern is common in

[2] AICPA Statement of Position 07-1, *Clarification of the Scope of the Audit and Accounting Guide* Investment Companies *and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies*.

situations in which the entity or its affiliates are performing significant research and development activities. To avoid recognition of the research and development expense, these activities might be undertaken by an investee of an investment company subsidiary within the group that is measuring its investments at fair value.

However, the proposed guidance in ASC 946-10-55-7 lists activities that would preclude an entity from meeting the nature-of-the-investment-activities criterion, including that "[t]he entity or its affiliates acquire, use, exchange, or exploit the processes, intangible assets, or technology of the investee or its affiliates." In addition, as noted in our response to Question 1, the nature-of-business-activities and express-business-purpose criteria in ASC 946-10-15-2(a) and 15-2(aa) could be combined and supplemented with a portion of the guidance in ASC 946-10-55-7 (added by the proposed ASU). We believe that this proposed change would mitigate the concerns outlined in paragraph BC24.

Question 10: The unit-ownership and pooling-of-funds criteria in the proposed amendments do not consider the nature of the entity's investors for evaluating if an entity is an investment company. That is, the criteria do not differentiate between passive investors and other types of investors. Do you agree that the nature of the investors should not be considered in evaluating the unit-ownership and pooling-of-funds criteria?

We acknowledge that paragraph 22 of SOP 07-1 introduced the concept of passive investors versus other types of investors. This paragraph states:

> Substantial ownership by passive investors, as opposed to substantial ownership by principal investors who determine the strategic direction or run the day-to-day operations of the entity, in an entity with the express business purpose of investing for current income, capital appreciation, or both provides evidence that supports that express business purpose. The more substantial the ownership by passive investors, the greater the evidence supporting the express business purpose.

However, we are concerned about the focus on the nature of the investors in the evaluation of the unit-ownership and pooling-of-funds criteria. If an entity has a single "passive" investor, it may be difficult to argue that the investor does not have the ability to direct the investment manager to take certain actions. The accounting outcome should be the same regardless of whether the investor is actively involved or hires a third-party investment manager to perform the activities of the investment company.

Question 11: The proposed amendments would require that substantially all of an investment company's investments are managed, and their performance evaluated, on a fair value basis. Do you agree with this proposal? If not, why? Is this proposed amendment operational and could it be consistently applied? If not, why?

It is unclear how this criterion should be evaluated because fair value is defined in U.S. GAAP for financial reporting, but not necessarily for management purposes. Performance may be managed on a basis close to fair value but excluding certain factors such as liquidity, credit risk, or a control premium if these are not deemed significant to the investment. For example, if an investment in a controlled entity is purchased primarily for investment income (e.g. an interest owned by a fixed-income fund), fair value may not be the primary measurement attribute used to make decisions about the financial performance of the investment. In this case, fair value may be a measurement attribute considered by management, but yield (income) or credit may be the primary measurement attribute. However, both credit and yield affect the fair value of the

investment and are key components used in determining fair value. It is therefore unclear whether the entity would meet the fair value management criterion. In addition, investors may be able to redeem their investments on the basis of the net asset value (calculated by using fair value) of the entity, in which case the fair value of the underlying investments would be important to these investors.

In this respect, the Basis for Conclusions in the FASB's proposed ASU is inconsistent with the IASB's exposure draft, since the proposed ASU indicates that when evaluating the fair value management criterion, an entity should consider "how it transacts with its investors." The proposed ASU also states that "money market funds, which currently report their investments at amortized cost, would be considered to be managing their investments on a fair value basis." (However, some might argue that money market funds are managed on a yield basis rather than at fair value.) Because the IASB's exposure draft does not include similar language, entities could reach different conclusions under U.S. GAAP than they do under IFRSs.

Taking into account the above, we believe the boards should consider providing guidance on how purely an entity needs to apply the concept of fair value in managing and evaluating investments to meet the fair value management criterion. As described in our response to Question 3, we are concerned that if the boards do not clarify how this criterion should be applied, it will not be applied consistently to certain types of entities (e.g., REITs).

Question 12: The proposed amendments would retain the requirement that an investment company should not consolidate or apply the equity method for an interest in an operating company unless the operating entity provides services to the investment company. However, the proposed amendments would require an investment company to consolidate controlling financial interests in another investment company in a fund-of-funds structure. An investment company would not consolidate controlling financial interests in a master-feeder structure. Do you agree with this proposed requirement for fund-of-funds structures? If not, what method of accounting should be applied and why? Should a feeder fund also consolidate a controlling financial interest in a master fund? Please explain.

We agree that an operating entity that provides services to an investment company should be consolidated, since these services can be distinguished from investments held for capital appreciation, investment income, or both. However, we disagree that, in a fund-of-funds structure, an investment company should consolidate a controlling financial interest in another investment company. ASC 810-10-10-1 states, in part:

> The purpose of consolidated financial statements is to present, **primarily for the benefit of the owners and creditors of the parent,** the results of operations and the financial position of a parent and all its subsidiaries as if the consolidated group were a single economic entity. [Emphasis added]

We believe that there are many reasons for an investment company to invest in another investment company. In some situations, the purpose of the investment is to diversify the portfolio of the investment company parent. In such cases, as with investments in noninvestment companies, the purpose of the investment is to generate a return on the basis of the performance of the investee entity. The owners of the parent investment company (the individual investors) are concerned with the performance of their investments rather than the performance of the consolidated group. Accordingly, if the subsidiary investment company is consolidated and the noncontrolling shareholders' interests are included, the financial statements would not be useful

to the parent entity's investors. The financial statements could be further distorted if the parent is required to consolidate a controlling financial interest in a controlled investment company and that interest represents an insignificant portion of the investor investment company's total assets.

A controlled investment company is sometimes formed in conjunction with its investor investment company to, for example, legally isolate certain investments that will be held by the controlled investment company. We agree that consolidation would make the controlled investment company's operations more transparent. However, we do not believe that there is a conceptual basis for requiring consolidation in these situations but not requiring consolidation when an investment company has a controlling financial interest in an unrelated investment company to diversify its portfolio. We are also concerned that if consolidation were only required for controlling interests in certain types of investment company subsidiaries, there would be diversity in practice regarding when consolidation is appropriate. We believe that rather than requiring consolidation, the boards should require additional disclosures that increase the transparency of the underlying operations of controlled investment companies.

We also note the following operational concerns with this proposed requirement:

- An investment company's percentage of ownership in an open-ended investment company could continually change as a result of redemptions and issuances of ownership interests by the controlled investment company. Under the proposed guidance, the investor investment company would be required to consolidate and deconsolidate its controlling interest in its investee investment company, resulting in financial information that is not useful to investors. In addition, it would be onerous for preparers and auditors to monitor the issuances and redemptions of ownership interests by the investee investment company.

- The assessment of which auditing firm is the principal auditor, as required by AU Section 543,[3] could be affected. Specifically, if an investee investment company is audited by a different independent auditor and represents a significant portion of the consolidated entity's operations, the auditor of the consolidated entity must determine whether its own participation is sufficient to enable it to serve as the principal auditor and to report as such in the consolidated financial statements. We are concerned that if there are fluctuations in the investor investment company's ownership percentage, the independent auditing firm may not meet the principal-auditor requirements.

- Similarly, the proposed requirement may result in violations of the auditor independence rules, as outlined by the SEC and AICPA. An accounting firm may have relationships with or provide services for an investment company that would not be allowed if the investment company was an audit client. Independence issues may arise when, as a result of fluctuations in the investor investment company's ownership percentage, an investee investment company that is not independent of the auditing firm must be consolidated and the consolidated financial statements have to be opined on by the independent auditor.

- In some situations, an investment company may invest in an investment company that is managed by a different investment management entity. Although the investor investment

[3] AICPA *Professional Standards*, AU Section 543, "Part of Audit Performed by Other Independent Auditors."

> company has a controlling financial interest in the investee investment company, it may not be able to obtain the information required to prepare consolidated financial statements in a timely manner or at all, particularly if the investee investment company is in a foreign jurisdiction.

We do agree that an investment company should not consolidate a controlling financial interest in a master-feeder structure. The current presentation and disclosure requirements related to a master-feeder structure adequately address the needs of users. We recommend that the Board emphasize this requirement by incorporating the following statement from paragraph BC37 of the proposed ASU into the final standard:

> [A] feeder fund should not be required to consolidate controlling financial interests in its master fund because the current presentation and disclosure requirements for master-feeder structures, such as including the master fund's financial statements as part of the feeder fund's financial statements, address concerns regarding transparency into the underlying investments and obligations of the master fund.

The Board may want to define a master-feeder structure in the implementation guidance, especially if the consolidation requirements for master-feeder structures are different from those for fund-of-fund structures in the final ASU.

Question 13: The proposed amendments would require an investment company to consolidate a controlling financial interest in an investment property entity. Should an investment company be subject to the consolidation requirements for controlling financial interests in an investment property entity? If not, what method of accounting should be applied and why?

Similarly to our response to Question 12, we do not believe that an investment company should consolidate a controlling interest in an investment property entity. Fair value measurement is the most relevant measurement attribute for an investment company's interest in an investment property entity. To ensure that investors receive similar information for both directly held properties and properties held through an investment property entity subsidiary, we suggest that the boards require additional disclosures to the extent that the investment in the investment property entity is material in relation to the investment company parent's net assets.

Question 14: The proposed amendments would prohibit an investment company from applying the equity method of accounting in Topic 323 to interests in other investment companies and investment property entities. Rather, such interests would be measured at fair value. Do you agree with this proposal? If not, why?

We agree that the equity method, as prescribed in ASC 323, should not be applied to an investment company's interest in another investment company or an investment property entity. We believe that reporting changes in the fair value of those investments is more meaningful for investors than presenting the equity in earnings of the investees.

Question 15: An investment company with a controlling financial interest in a less-than-wholly-owned investment company subsidiary or an investment property entity subsidiary would exclude in its financial highlights amounts attributable to the noncontrolling interest. Do you agree that the amounts attributable to the noncontrolling interest should be excluded from the calculation of the financial highlights? If not, why?

We agree that amounts attributable to a noncontrolling interest should be excluded from the financial highlights of an investment company parent. We believe that users are only concerned with financial highlights that pertain to their investments in the entity (i.e., the investment company parent's interest only).

Question 16: If an investment company consolidates an investment property entity, the proposed amendments require the investment company to disclose an additional expense ratio that excludes the effects of consolidating its investment property entity subsidiaries from the calculation. Do you agree? If not, why?

Although we disagree that an investment company should consolidate an investment property entity, if the Board decides to retain this requirement, we agree that an investment company that consolidates an investment property entity should disclose an additional expense ratio that excludes the effects of this consolidation.

Question 17: Do you agree with the additional proposed disclosures for an investment company? If not, which disclosures do you disagree with, and why? Would you require any additional disclosures and why?

We generally agree with the disclosure requirements, except as follows:

- We believe that the requirement to disclose restrictions on the ability of investees to transfer funds to the investment company could be onerous to apply, and we question whether it is beneficial for investors.

- Regarding the proposed requirement to disclose financial support, we believe the guidance should be revised to clarify that a new investment at the discretion of the investment company is not considered "financial support."

See also our responses to Questions 12 and 13 regarding additional disclosures we recommend for interests in other investment companies and investment property entities.

However, we disagree with the presentation requirement in ASC 946-360-45-1, under which an investment company would present rental revenue and rental operating expenses from real estate properties separately in its statement of changes in net assets. For all other investments, the investment company is only required to provide its net investment income (either dividends or income) in its statement of changes in net assets. We therefore question why the presentation requirements for real estate investments are different.

Question 18: The proposed amendments would retain the current requirement in U.S. GAAP that a noninvestment company parent should retain the specialized accounting of an investment company subsidiary in consolidation. Do you agree that this requirement should be retained? If not, why?

We agree that a noninvestment company parent should retain the specialized accounting of an investment company subsidiary when it consolidates that subsidiary. This is consistent with ASC 810-10-25-15 (originally issued as EITF Issue 85-12[4]) and current practice. We agree that the

[4] EITF Issue No. 85-12, "Retention of Specialized Accounting for Investments in Consolidation."

retention of specialized accounting would improve users' visibility into the investments held by the investment company subsidiary.

Question 19: An entity that no longer meets the criteria to be an investment company would apply the proposed amendments as a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption by calculating the carrying amounts of its investees as though it had always accounted for its investments in conformity with other applicable U.S. GAAP, unless it is not practicable. If not practicable, the entity would apply the proposed amendments as of the beginning of the period of adoption. Do you agree with this proposal? If not, why?

We agree with the proposed ASU's transition method for an entity that no longer qualifies as an investment company. Moreover, we agree that an entity should be permitted to apply the proposed guidance as of the beginning of the period of adoption to the extent that it is not practical to apply the proposed ASU as a cumulative-effect adjustment to retained earnings.

Question 20: How much time would be necessary to implement the proposed amendments?

We recommend that the boards reach out to preparers, asking them to estimate how much time they would need to implement the proposed amendments. As a general observation, we believe that 18 months between the final standard's issuance and effective date would be enough time.

Question 21: The proposed amendments would prohibit early adoption. Should early adoption be permitted? If yes, why?

Because of the potential reduction in comparability, we believe that early adoption of the proposed guidance should not be permitted. We also agree with the Board's own basis for prohibiting early adoption, as addressed in paragraph BC49 of the proposed ASU.

Question 22: The proposed amendments would apply to both public and nonpublic entities. Should the proposed amendments apply to nonpublic entities? If not, how should the proposed amendments differ for nonpublic entities and why?

We agree that the proposed guidance should apply to both public and nonpublic entities. The boards should consider providing additional transition time for nonpublic entities (e.g., delaying the effective date for nonpublic entities by one year).

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Mr Hans Hoogervorst
Chairman
International Accounting Standards Board
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5 January 2012

Dear Mr Hoogervorst,

Exposure Draft ED 2011/4 – Investment Entities

Deloitte Touche Tohmatsu Limited is pleased to respond to the International Accounting Standards Board's (the IASB's) Exposure Draft on Investment Entities ('the exposure draft').

We support the Board's efforts to improve financial reporting as we agree that there are entities for which the measurement of investments in controlled subsidiaries at fair value provides the most relevant information to financial statement users and the most faithful representation of the relationship between the entity and its investees. However, to identify the types of entities for which this is the case, our preference would be firstly to establish a principle of which types of entities should be considered investment entities and then to identify specific criteria necessary to satisfy that principle. We further believe that for these entities it is appropriate to measure all of their investments at fair value, rather than the approach in the exposure draft, which only requires fair value measurement for certain types of investments held by such entities.

We also agree with the exposure draft that the exception to measurement of controlling interests at fair value should extend to controlling interests in other investment entities. Similar to the requirement that an investment entity should not consolidate a non-investment entity, we agree that an investment entity should not consolidate another investment entity. We believe that rather than consolidation, the Board should develop additional disclosure requirements that provide transparency into the financial position and operations of a subsidiary investment entity.

We do, however, disagree with the exposure draft's proposal that a non-investment entity parent of an investment entity should consolidate all entities it controls through its consolidated investment entity subsidiary. We do not believe that this would result in the most relevant information being provided to investors in the parent. We believe that it is appropriate to establish a clear principle and criteria at the investment entity level that carries-over to the consolidated financial statements of a non-investment entity parent, rather than to prohibit the retention of investment entity accounting, or to impose barriers

or restrictions that would result in differing accounting at the investment entity and consolidated levels.

Finally, we are concerned that although this exposure draft would generally align the scope of entities that qualify as investment entities with the scope of investment companies under the Financial Accounting Standards Board's (FASB's) proposals, there are a number of differences between the proposed accounting requirements for entities that qualify as investment entities under the exposure draft and the FASB's proposed guidance. For example, U.S. GAAP has different requirements for determining the initial measurement of an investment entity's investments. We recommend that the Boards reconcile these differences before finalising their exposure drafts.

Our detailed responses to the questions in the invitation to comment are included in the Appendix to this letter.

If you have any questions concerning our comments, please contact Veronica Poole or Andrew Spooner in London at +44 (0)20 7007 0884 or +44 (0)20 7007 0204 respectively.

Yours sincerely,

Veronica Poole
Global Managing Director
IFRS Technical

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

Yes.

We support the Board's proposal to exempt consolidation for certain investment vehicles and to instead require measurement of investments in controlled entities at fair value through profit or loss. We support the proposal for a number of reasons as summarised below.

For certain entities measurement of investments at fair value provides the most relevant information to financial statement users and is the most faithful representation of the relationship between the entity and its investee. For entities such as mutual funds, investment trusts or partnerships and other similar entities, future net cash inflows primarily occur as a result of disposal of the investment rather than through management of the underlying assets and operations of the investee. The prospect of those future cash inflows can more readily be assessed by reference to the fair value of investments than by presentation of an investee's individual assets, liabilities and performance. For this reason, accounting for controlled investees at fair value provides more meaningful information than consolidation.

In addition, fair value is a more relevant measurement attribute as both management and investors typically make decisions based upon the fair value of investments. In many cases, the unit capital (or similar in-substance ownership interests) of an investment entity is puttable back to an investment entity at fair value. Accordingly, this necessitates frequent determination of that value as it is the basis on which investors make their decisions on whether to hold or divest of their ownership interest in an investment entity.

Measurement at fair value through profit or loss also ensures a consistent measurement basis for holdings in various ownership positions irrespective of the size of the holding. For investment entities this is meaningful as the size of the holding may differ but the investment strategy may be the same. For instance, an investment fund may hold 51% of the ordinary shares of one investee while holding 21% of the ordinary shares of another investee but have the same investment strategy. Applying a consistent policy for measuring its investments is preferable to consolidating some and not others when the objectives of holding both the investments are identical and investors demand the same fair value information for both investments.

We are aware that the proposals are an exception to the consolidation principle, but we see this as a positive and reasonable extension of the concept already existing in IAS 28, which we support, for investments held by venture capital organizations, mutual funds, unit trusts and similar entities. The extension to non-consolidation of controlled entities subject to meeting specified criteria is welcome. However, as made clear in our response to other questions below we believe the criteria could be improved.

Question 2 - Criteria for determining when an entity is an investment entity
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 Board's reasons for requiring an exception from consolidation but we do not believe the proposed criteria are the best way of expressing the types of entities that should be subject to the exception. Our preference would be firstly to establish a principle of which types of entities should be considered investment entities and then secondly identify specific criteria necessary to satisfy that principle. We suggest the following principle for identifying an investment entity:

> "An investment entity pools investors' funds to provide the investors with professional investment management. The entity invests the proceeds only for capital appreciation, investment income (such as dividends or interest) or both, and provides the returns to its investors."

We believe that the specific criteria proposed in the exposure draft could be modified to better support such a principle as follows:

Nature of the investment activity - The criteria in paragraphs 2(a) and 2(b) ('nature of the investment activity' and 'business purpose') could be combined and supplemented with a portion of the guidance in paragraph B6 of the exposure draft. Doing so would help to further clarify how these concepts interrelate. We suggest the following criterion:

> "An investment entity has no substantive activities other than investing-related activities and provision of services related to those activities. The entity has made a commitment to its investors that such activities are its sole business purpose. Activities are considered to be other than investing activities if the entity or its affiliates 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."

We believe the requirement that an investment entity does not obtain, or have the objective of obtaining, benefits from its investments that are not capital appreciation or investment income differentiates an investment entity from a conglomerate that acquires entities for the purpose of obtaining such benefits. This concept should be included in the criterion rather than only in the implementation guidance. We also believe that many of the Board's concerns related to the abuse of the investment entity principle (and the Board's decision to not retain the fair value measurement in consolidation) would be alleviated, if more emphasis were placed on the requirement that the investment entity is not receiving such benefits.

Unit Ownership - We believe that the criterion in paragraph 2(c) ('unit ownership') should be modified to reflect the fact that not all entities have shares outstanding or partnership interests. For example, certain actively managed collateralised loan obligations (CLOs) or collateralised debt obligations (CDOs) may provide beneficiaries with a proportionate share of net assets but not through either shares or partnership units. These types of entities pool funds from numerous investors (debt holders of various classes, including classes that bear the risks and rewards from owning the residual class) and operate in a manner similar to other types of leveraged investment entities. In addition, some investment entities issue residual interests that may be required to be

classified as a liability in accordance with IAS 32 and accordingly have no equity outstanding in their financial statements (for example, ownership units in limited life funds which are mandatorily redeemable upon termination of the fund). To address the concern that an investment entity should aggregate a significant portion of its capital from outside investors in order to prevent the abuse of the investment entity principle, we believe that this criterion should include equity and debt interests, provided those interests participate in both the risks and rewards of ownership. Rather than following a technical classification approach consistent with IAS 32 of whether those interests are considered financial liabilities or equity instruments, we believe that the focus should be placed on whether the investor's interest represents rights to the net assets of the entity.

Pooling of Funds - Our concerns around this criterion and application guidance regarding pooling of funds are further discussed in our response to Question 4.

Fair Value Management – The basis for the accounting by an investment entity for its investments in controlled entities at fair value through profit or loss is that fair value is a more appropriate measurement attribute than consolidation. Therefore, fair value management is an essential criterion in establishing the appropriate parameters of an investment entity. However, it is unclear as to how this criterion should be evaluated as fair value is a concept defined for financial reporting but not necessarily for management and performance evaluation of investments. Performance may be managed on a basis close to fair value but excluding certain factors such as liquidity, credit risk or a control premium if these are not deemed significant to the investment. For example, if an investment in a controlled entity is purchased primarily for investment income (for example an interest in a fixed income fund), fair value may not be the primary measurement attribute used to make decisions about the financial performance of the investment. In this case, fair value may be a measurement attribute considered by management of the entity, but yield (income) or credit may be the primary measurement attribute. However, both credit and yield affect the fair value of the investment and are key components used in determining fair value. In addition, investors may be able to redeem their investments based on the net asset value (calculated using fair value) of the entity and therefore fair value of the underlying investments is important to the investors.

The basis for conclusions in the IASB's and FASB's exposure drafts contain inconsistencies in this respect, as the FASB's exposure draft provides that when evaluating this criterion, the entity should consider "how it transacts with its investors". The FASB's exposure draft also states that "money market funds, which currently report their investments at amortized cost, would be considered to be managing their investments on a fair value basis." The IASB's exposure draft does not include similar language. Accordingly, it is unclear as to whether cash management funds, including money market funds (for which some could argue the "primary measurement attribute" is yield rather than fair value) would qualify as investment entities.

There are also remaining differences between the fair value measurement guidance in IFRSs and in U.S. GAAP. Most notably, ASC Topic 820 (as referenced in IFRS 13.BC238) provides a practical expedient permitting use of an unadjusted net asset value as fair value in specific circumstances. Careful analysis of this and other differences is needed to assess how this affects the application of the fair value management criterion and any unintended differences between IFRSs and U.S. GAAP which may result.
Taking into account the above, we believe the Board should consider providing guidance on how purely the concept of fair value needs to be applied in managing and evaluating investments for this criterion to be satisfied.

Reporting Entity – We believe that the criterion in paragraph 2(f) incorrectly references the disclosure requirements, rather than implementation guidance on how to apply the reporting entity criterion. We suggest including implementation guidance that states:

> "An entity can be but does not need to be a legal entity to be an investment entity. The economic substance of the entity, rather than its legal form, should be evaluated to determine whether the entity is a reporting entity that provides investors with periodic financial results about its investing activities."

With respect to the application guidance supporting the specific criteria, we have certain concerns or request additional clarification in order to ensure the principle of an investment entity is appropriately supported.

- **Paragraph B3: Collateral associated with an investment** – We question the requirement that if the purpose of acquiring an investment is to obtain the underlying collateral and the underlying collateral is not related to the entity's investment objectives, this would preclude the entity from being an investment entity. There may be occasions where an investment entity acquires collateral that is unrelated to their investment objectives, but the entity may decide to retain the collateral for the long term. Accordingly, they may change their investment strategy. It is not apparent why this change in investment strategy subsequent to the possession of the collateral should disqualify the entity from being an investment entity. In addition, we request additional clarity over what is meant by "the rights that a third party may have over the collateral" when determining whether collateral is held temporarily.

- **Paragraph B4-B5: Multiple investments** – We are concerned with the requirement that an investment entity must hold multiple investments to qualify as an investment entity. An investment entity may be formed to pool money to invest in a single entity for which the minimum investment is too great for each individual investor, the investment is unobtainable by single investors or where the investment could result in too great a concentration of risk for an individual investor. In these situations, the entity would be disqualified from being considered an investment entity as a result of owning a single investment. The Board should consider whether this is consistent with the principle. In addition, the Board should permit an entity to qualify as an investment entity if it holds a single investment, when the entity (for example, a blocker entity) was formed in conjunction with its parent investment entity and that parent entity holds multiple investments. In a Master-Feeder structure, the master and feeder funds may often be formed at different times even when the structure is planned in advance. We suggest that the Board clarify that this should not preclude a Feeder fund from being considered an investment entity formed in conjunction with a Master fund.

- **Paragraphs B9-B11: Exit strategy** – The Board should clarify whether holding an investment that pays a return over a fixed life to maturity would qualify as a potential exit strategy. The application guidance regarding exit strategies in the exposure draft only refers to realisation of capital appreciation of investments. However, the investment activities of many investment entities will include investing in fixed income instruments whose exit strategy will be earning a yield over the life of the instrument and recovering the initial investment upon maturity. We recommend that this scenario be specifically addressed in the application guidance as its omission could lead to an inference that holding to maturity is not a permissible exit strategy. We also recommend that the list of

examples in paragraph B11 include an example of an exit strategy based on the existence of 'limits' that are common in many investment entities such as a requirement to divest should certain criteria no longer be met (for example, an equity security is no longer included in an index or a debt security no longer maintains an investment grade credit rating).

Question 3 - 'Nature of the investment activity'
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?

Our recommended principle for an investment entity is that its sole business purpose is conducting investing activities. A critical element of conducting and managing investing activities is performing services in support of those activities. Therefore, we agree with the exposure draft's proposals that the provision of services, either directly by the investment entity or through an investee of the investment entity, should not preclude an investment entity from meeting the criterion if the entity has no other substantive activities other than investing activities. We also agree that when an investment entity controls an investee that provides investment related services, consolidation of that investee is appropriate.

We recommend that the Board clarify whether investment related services would include financing related activities. Certain investment entity structures utilise leverage financing where the borrowing is facilitated through a separate legal entity controlled by the investment entity. If the Board believes that the financing related activities are considered investment related services, the financial reporting of the investment entity should reflect the use of leverage financing when executed through a subsidiary controlled by the investment entity.

An investment entity may provide investment related services to other entities (for example, custody of assets or recordkeeping services). We do not believe this should preclude the entity from being deemed an investment entity if either:

- the services are provided only to other related investment entities; or
- the services provided to other parties are limited to a non-substantive level,

where the entity's sole substantive business purpose can still be deemed to be holding investments for capital appreciation, investment income (such as dividends or interest), or both.

Question 4 - 'Pooling of funds'
(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.

One of the fundamental characteristics of an investment entity is that external investors pool their funds to obtain professional investment management services. Additionally, having significant external ownership interests is an important safeguard to prevent potential abuses from attempting to structure around consolidation. However, we have concerns in certain situations with the requirement that the entity must have investors that

are unrelated to the parent (if there is a parent), and in aggregate those investors must hold a significant ownership interest in the entity.

Single investor structures (or multiple investor structures where the investors are related parties) are often created by investment managers on behalf of, for example, a pension or other retirement scheme or a decommissioning fund. The fact that the investment entity only has a single investor (or multiple related investors) that is a pension or similar fund has no bearing on the financial reporting needs of this investor. The investor requires fair value information regardless of the fact that it may be the only investor in the fund. The board should consider expanding the criteria to allow a single investor in such circumstances.

In addition, the Board should consider that certain investment entity structures (an employee side-by-side fund) comprise of capital primarily from management and/or employees of the investment entity's parent (the investment manager). These structures co-invest in other investment entities alongside the capital invested by external investors. The investment manager will often be determined to be the parent of the employee side-by-side fund as the investment manager has decision making authority over the entity, economic exposure to the entity and there are no substantive kick-out rights. We believe that these structures should meet the principle of an investment entity; even though there may not be external investors in this specific legal entity that are unrelated to the parent, it is investing along with an entity otherwise comprised of external investor capital. The Board should consider whether this could be achieved by either amending the requirement to exclude employees from the related party group used when evaluating this criterion or by amending the criterion to include affiliates of the parent rather than related parties.

We also have concerns over the application guidance which states that options to acquire another investor's interest held by the parent or its related parties should be combined and treated as if held by the parent for the purposes of assessing whether this criterion is met. 'The parent's related parties' could include the underlying investment entity itself, which may have a call option to acquire its own equity (for example, a right to acquire its investors' interests at fair value in the event that a required capital call is not met). We do not believe that such an arrangement should necessarily preclude qualification as an investment entity.

Question 5 - Measurement guidance

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?

We agree that investment entities that hold investment properties should be required to apply the fair value model in accordance with IAS 40 as this would be the most relevant information for users of the financial statements of an entity that manages its investments on a fair value basis and would address the concern noted in paragraph BC4 of the exposure draft over reporting investments on more than one basis. For the sake of clarity, we recommend that a consequential amendment be made to IAS 40 to reflect this requirement.

We do not, however, agree that the measurement guidance proposed in the exposure draft should be restricted to financial assets and investment property as an investment entity may hold investments in the form of other investment assets (for example, commodities). We believe that such assets should also be measured by an investment entity at fair value

through profit or loss and that a requirement to do so should be included within the main body of the IFRS rather than with Application Guidance, as is the case with the requirement on investment property in the exposure draft.

Question 6 - Accounting in the consolidated financial statements of a non-investment entity parent

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?

We do not agree with the proposal in the exposure draft that a non-investment entity parent of an investment entity should consolidate entities it controls through its consolidated investment entity subsidiaries. Rather, we believe that the investment entity accounting should be retained in the financial statements of a non-investment entity parent. If an appropriate clear principle and criteria are established at the investment entity level, they should carry-over to the consolidated financial statements of a non-investment entity parent. We support the proposed consequential amendment to IAS 28 to retain the accounting that an investment entity subsidiary applies for its associates or joint ventures, but do not understand the conceptual basis for then "unwinding" the fair value measurement for that investment entity's controlled investments. Further, we believe that IAS 28 should be amended to clarify that fair value measurement is retained for controlled investees of an investment entity associate or joint venture in the equity accounting by a non-investment entity.

We believe that the Board's concerns related to abuse of the investment entity principle by establishing an internal investment entity subsidiary to avoid recognising expenses are addressed by the requirements in paragraph B6 of the exposure draft. Specifically, if an internal investment entity subsidiary were investing to obtain, or had the objective of obtaining, either for itself or for other entities within the group, benefits from its investments that are neither capital appreciation nor investment income, the subsidiary would violate the requirement in paragraph B6 (which extends to benefits obtained by the entity's affiliates) and would therefore not qualify as an investment entity for the purposes of its individual financial statements. As indicated in our response to Question 2, we propose to include this requirement in the criteria to qualify as an investment entity, as we believe that this is a key distinction in identifying an investment entity.

We also understand that the Board is concerned that allowing a non-investment entity parent to retain the investment entity accounting in consolidation could result in a situation where a portion of an entity owned by a consolidated group is measured at fair value while another portion of the same entity is accounting for by consolidation, using the equity method or at cost. This could occur when the non-investment entity parent directly acquires an investment in an investee of its investment entity subsidiary. In the parent entity's consolidated financial statements, the investment held directly by the non-investment entity parent may, for example, be accounted for by the equity method while the investment held by the investment entity subsidiary would be measured at fair value if fair value measurement were retained in consolidation. However, we believe that this situation currently exists in practice. As acknowledged in paragraph BC21 of the basis of conclusions to IAS 28, the Board felt it appropriate to use the measurement exemption (i.e., fair value) for portions of an investment in an associate held through, for example, a venture capital organisation rather than accounting for the direct and indirect investments in such an entity as a single unit.

We note that the American Institute of CPAs (AICPA) attempted to address this concern with the issuance of SOP 07-1[1]. This SOP was subsequently deferred indefinitely due to implementation concerns, including tracking whether the consolidated group has similar investments to the consolidated investment entity. We also have concerns with the approach proposed in the SOP where barriers or restrictions are imposed that would result in differing accounting at the investment entity level versus the consolidated group level. We encourage the Board to perform additional outreach to determine the prevalence of this concern (the situation currently could exist under U.S. GAAP), rather than punitively prohibiting the carry-over of the fair value for controlled investments when consolidating an investment entity subsidiary.

In respect of the considerations noted in paragraph BC20 of the exposure draft, we acknowledge that an issue of equity to an investee of an investment entity subsidiary would increase the net equity position of the non-investment entity parent (albeit with a resulting dilution of the interests of other equity holders). However, this is also true of an issue of equity to an employee benefit plan. IAS 19(2011).143 addresses the issue through disclosure and we would consider a similar approach to be appropriate here.

Finally, we do not necessarily believe that paragraph BC20 of the exposure draft is correct that in most cases investment entities would have investment entity parents. It is common for asset managers to sponsor investment entities, for banking groups to have an investment management division or for a group whose principal business is managing its own investments also to have a division offering investment or pension administration services to third parties.

Question 7 - Disclosure
(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?

We are supportive of the proposed disclosure objective in the exposure draft that an investment entity shall disclose information that enables financial statement users to evaluate the nature and financial effects of the investment entity's investment activities and agree that it is appropriate to use this disclosure objective rather than additional specific disclosure requirements. We are also generally supportive of the required disclosures related to any changes in an entity's status as an investment entity and whether the investment entity has provided, or intends to provide, any financial or other support to any controlled investees. However, we note that the requirement to disclose the nature and extent of any restrictions of transfer of funds between controlled investees and the investment entity appears largely to repeat the requirements of IFRS 12.13. It is unclear what benefit this information provides to investors in an investment entity (particularly one which intends to realise its investment through disposal).

We are also generally supportive of the application guidance on providing additional disclosures to help meet the disclosure objective. However, we do have some concerns with the application guidance as described further below.

- We believe that the reconciliation of total assets less total liabilities per share at the beginning and end of the period proposed in paragraph B19(a) and the

[1] Statement of Position 07–1 Clarification of the Scope of the Audit and Accounting Guide Investment Companies and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies

expense and income ratio disclosures proposed in paragraph B19(b) could be distorted by ownership interests which are themselves classified as liabilities (for example, ownership units in limited life funds which are mandatorily redeemable upon termination of the fund). We would therefore propose that such units be excluded from 'total liabilities' for the purposes of these disclosures.

- We agree that disclosure of the controlled investees of a subsidiary investment entity should be provided in the financial statements of its parent investment entity but we do not consider that this alone would provide sufficient transparency of the risks associated with both the underlying assets and any use of leverage by the subsidiary investment entity. As a result, we recommend that the Board expand the disclosure requirements for investment entity parents of another investment entity in paragraph B18 to provide specific details of investments held and any use of leverage by the subsidiary investment entity together with other key metrics such as expense ratios. We would also expect similar disclosures to be provided in the financial statements of a non-investment entity parent of an investment entity if, as we propose in Question 6, investment entity accounting is retained in those financial statements.

Question 8 - Transition

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?

We do not agree with the exposure draft's proposal to require prospective application. The Board notes in the basis for conclusions that prospective application was decided upon as retrospective application would be impracticable. However, one of the proposed criteria to qualify as an investment entity is that substantially all of the investments of the entity are managed, and their performance evaluated, on a fair value basis. Therefore, we would expect that in the majority of cases an investment entity would already have historical fair value information for their investees and that with suitable transitional provisions retrospective application would therefore be practicable. We also do not believe that comparative information would be meaningful if an investment entity is required to consolidate its investee in one period and measure its investment in that investee at fair value in the next when no substantive change in the relationship between the two has occurred.

Additionally, it seems illogical to require a different means of transition for the investment entities standard than is required by IFRS 10. Paragraph BC26 of the basis for conclusions in the exposure draft states that 'to propose retrospective application for investment entities would also be inconsistent with the tentative decisions taken by the Board for the overall consolidation standard'. However, the Board has subsequently required retrospective application, subject to certain specific exceptions, of IFRS 10.

We believe that the Board should consider transitional provisions in respect of the following.

- Consideration of the criteria to be considered an investment entity and accounting for any changes in status in previous periods could be onerous and would in many cases provide little informational value for users. We suggest that the Board consider a transitional provision similar to that included in IFRS 10.C3 (as proposed for amendment in ED/2011/7) to permit consideration of those criteria only at the date of initial application and subsequently.
- As part of any reconsideration of the fair value management criterion (as recommended in our response to Question 2), we suggest that the Board consider

how to address any difference in previous periods between the measure used for management purposes and fair value as defined by IFRS 13.

The Board should also consider how any transitional provisions should apply to investment entities adopting IFRSs for the first time. As no consequential amendment to IFRS 1 is proposed in the exposure draft, it appears that such an entity would be required to apply the requirements of the exposure draft from the date of transition to IFRSs. This would be inconsistent with the approach proposed in the exposure draft for existing IFRS reporters albeit not, as noted above, with the approach we favour for existing IFRS preparers. We believe that prospective application from the beginning of the current reporting period could be particularly burdensome for first-time adopters for the following reasons:

- if the entity measured its investments in controlled entities at fair value under its previous GAAP, it would be required to consolidate those entities at the date of transition only to revert back to fair value at the beginning of the first period reported upon under IFRSs; or
- if the entity consolidated its investments in controlled entities under its previous GAAP, it would be required to consider all of the requirements of IFRS 1, IFRS 10 and possibly IFRS 3 in respect of subsidiaries up until the beginning of the first period reported upon under IFRSs only to then switch to fair value.

For these reasons, we would support application from the date of transition for first-time adopters. However, as for existing IFRS preparers some transitional provisions may be necessary to address the issues noted above. We recommend that the Board reconsider first-time adoption issues as part of their redeliberations on the transitional provisions of the exposure draft and either make any necessary consequential amendments to IFRS 1 or state clearly in the basis of conclusions of any final IFRS the reasons why no such amendment was deemed to be required.

Finally, we believe that a clearer description of the mechanics of moving from consolidation of controlled entities to measurement at fair value is needed if prospective application is retained or, in any case, to cater for the circumstance of an entity becoming an investment entity. Specifically, we believe the provisions of paragraphs 5 and C2 are unclear in the following respects:

- those paragraphs refer to ‘any changes in the fair value of investees’ net assets previously recognised, and remaining in, accumulated other comprehensive income.’ Some entries to other comprehensive income (for example, revaluations of property, plant and equipment) are made on the basis of fair value, others (for example, retranslation of foreign operations) are not. We believe that it should be made clear that all entries to other comprehensive income are treated in the same way;
- the exposure draft is silent on whether, or how, any amounts accumulated in other comprehensive income are recycled to profit or loss; and
- the exposure draft is silent on the treatment of any non-controlling interest in the controlled entity on transition from consolidation to measurement at fair value.

We recommend that the mechanics of transition be explained more clearly and suggest that an illustrative example might be of assistance in achieving clarity.

Question 9 - Scope exclusion in IAS 28

(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?

We agree with the alternative presented to make the measurement exemption mandatory for investment entities and voluntary for other entities currently permitted by IAS 28 to use fair value.

In order to achieve consistency with the treatment required for controlled entities it should be mandatory for investment entities to measure their investments in associates and joint ventures at fair value and, as stated in our response to Question 5, other forms of investments (for example, commodities) should also be measured at fair value.

We do not, however, believe that this treatment should be limited to that narrow group of entities as we believe that measurement at fair value could provide as faithful a representation as equity accounting for investees over which those entities currently identified in IAS 28 have significant influence or joint control. We also note that measurement of such investments at fair value by the entities currently permitted to do so by IAS 28 provides useful information to investors and, as far as we are aware, has not resulted in significant abuse.