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Mr Hans Hoogervorst
Chairman
International Accounting Standards Board
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Email: commentletters@ifrs.org

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.