



4 January 2012

Mr Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Hans

AOSSG comments on Exposure Draft ED/2011/4 *Investment Entities*

The Asian-Oceanian Standard-Setters Group (AOSSG) is pleased to provide comments on the Exposure Draft ED/2011/4 *Investment Entities* (the ED). In formulating its views, the AOSSG sought the views of its constituents within each jurisdiction.

The AOSSG currently has 25 member standard-setters from the Asian-Oceanian region: Australia, Brunei, Cambodia, China, Dubai, Hong Kong, India, Indonesia, Iraq, Japan, Kazakhstan, Korea, Macao, Malaysia, Mongolia, Nepal, New Zealand, Pakistan, Philippines, Saudi Arabia, Singapore, Sri Lanka, Thailand, Uzbekistan and Vietnam.

The AOSSG seeks to promote the adoption of IFRSs as well as foster the capacity of domestic standard setting in the region to contribute to the work of the IASB.

To the extent feasible, this submission to the IASB reflects in broad terms the collective views of the AOSSG members. Other views that are consistent or otherwise with the overall AOSSG comments are also provided within this submission. Individual member standard-setters may also choose to make separate submissions that are consistent or otherwise with aspects of this submission. The intention of the AOSSG is to enhance the input to the IASB from the Asian-Oceanian region and not to prevent the IASB from receiving the variety of views that individual member standard-setters may hold.

This submission has been circulated to all AOSSG members for their comment after having been initially developed through the AOSSG's Consolidation Working Group. The AOSSG has not received any substantive contrary views from our constituents.

The majority of the AOSSG members strongly support the IASB's proposal to provide an exception from consolidation for entities controlled by an investment entity on the basis that the measurement of these controlled entities at fair value provides more relevant and decision-useful information to users of the financial statements of the investment entity.

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However, a minority of AOSSG members have expressed strong support for the principle of consolidation on the basis of control and accordingly oppose the introduction of the consolidation exception. These AOSSG members share the alternative views expressed by the three IASB members on the ED.

In respect of the criteria for investment entities, some AOSSG members take the view that an entity with a single investor (e.g. a sovereign fund) should be eligible to qualify as an investment entity and be able to avail itself of the consolidation exception, as there is no conceptual reason why such an entity could not be an investment entity if all the other criteria proposed in the ED are met. That said, a few members within this group appreciate the difficulties involved in attempting to establish a set of sufficiently objective criteria to scope in these entities whilst minimising the potential abuses which the IASB is concerned with and they are on balance, willing to accept that some ‘legitimate’ investment entities may be excluded from the scope of the consolidation exception.

The majority of the AOSSG members do not agree that the non-investment entity parent of an investment entity should be required to consolidate controlled entities held via the investment entity. These AOSSG members consider that if it is argued that consolidation at the subsidiary level does not provide decision-useful information to users, it is difficult to conceive that consolidation at the parent level would do so. Some AOSSG members, however, are concerned that extending the consolidation exception to non-investment entity parents might permit groups to insert investment entities within their structures with the sole aim of avoiding consolidation of certain assets and liabilities. As such, these AOSSG members are more inclined to support the IASB’s proposal that non-investment entity parents should not be able to avail themselves of the consolidation exception so as to minimise structuring opportunities.

Our views are explained in more detail below.

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 and loss? Why and why not?

The majority of the AOSSG members agree that investment entities should measure controlled entities at fair value through profit and loss as this would better align financial reporting with the business model of investment entities, thereby resulting in more relevant and decision-useful financial information. These AOSSG members consider that reporting controlling and non-controlling interests on more than one basis (i.e. consolidation and fair value respectively) hinders comparability within the financial statements of an investment entity given that these investments are held by the investment entity for one sole objective, which is that of capital appreciation and/or investment income.

That said, within this group of AOSSG members that supports the consolidation exception, a minority subscribe to the view that consolidation, rather than fair value, is the appropriate accounting treatment in respect of entities that “actively” manage controlled entities notwithstanding that this is carried out with the intention to secure or maximise investment income and/or capital appreciation. For instance, entities controlled by private equity and venture capital funds are often classical subsidiaries managed actively by the funds for the purpose of generating higher returns that facilitate the distribution of current income as well as capital appreciation (e.g. the fund may appoint the controlled entity’s key management personnel/board of directors or help to restructure the controlled entity’s operations). These AOSSG members therefore urge the IASB to consider more fully the implications of the different arrangements practised by these funds and whether the proposed consolidation exception is appropriate for some of these funds.

Furthermore, one AOSSG member within this group is concerned about the rule-based approach of the proposal and believes that the IASB should clearly define the principle on when fair value measurement provides more relevant and decision-useful information to users as opposed to consolidation by focusing on the nature of investments and establish appropriate criteria in line with this principle.

A minority of AOSSG members strongly oppose the introduction of any exception to the principle of consolidation under any circumstances as they believe that the concept of control is fundamental to determining the boundaries of a reporting entity and the preparation and presentation of financial statements and that financial reporting requirements should be principle-based and contain few, if any, exceptions. These AOSSG members are of the view that the ED is a backwards step from the consolidation model in IFRS 10 and would result in the presentation of financial statements by investment entities that are less relevant and less representationally faithful than would be the case if controlled entities were consolidated. These members also consider that the proposal to prescribe specific accounting treatment for certain types of entities is not consistent with the IASB’s long standing practice of transaction-based standard setting. Furthermore, they are concerned that the criteria for determining whether an entity is an investment entity as set out in the ED are highly subjective and open to abuse and that the ED could lead to increased use of off balance sheet accounting and structuring opportunities. In this regard, these AOSSG members strongly shared the alternative views expressed by the three IASB members on the ED.

One AOSSG member recommends that the IASB consider giving an option to investment entities to either elect to consolidate controlled investments (with disclosure of fair value information) or to measure their controlled entities at fair value through profit and loss.

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?

The majority of the AOSSG members broadly agree with the investment entity criteria set out in the ED.

However, in respect of the criterion on “pooling of funds”, some AOSSG members do not agree with the requirement that an investment entity must have unrelated investors that in aggregate hold a significant ownership interest in the entity. Please refer to our comments to Question 4 for further details.

Another associated concern relating to the “pooling of funds” criterion is that paragraph B16 of the ED specifically requires an entity with a single investor to be formed “in conjunction” with the formation of the single investor that is itself an investment entity in order to meet the definition of an investment entity. Some AOSSG members, however, are of the view that as long as there is pooling of funds at a higher level in the investment structure, the timing of formation of the entities is irrelevant. These AOSSG members therefore request the IASB to clarify the rationale for the requirement in B16 and/or to modify the requirement in B16 accordingly.

In addition, some AOSSG members consider that a key feature of an investment entity is the existence of exit strategies for investments held by the entity for purposes of capital appreciation, particularly in the case of an investment entity that actively manages its controlled entities. These AOSSG members therefore recommend that this requirement be explicitly incorporated as one of the criteria for investment entities within paragraph 2 of the ED. One AOSSG member further recommends that the IASB clarify if long-term exit strategies or extensions of initial documented timeframes for exit strategies would preclude an entity from meeting the “business purpose” criterion.

One AOSSG member suggests that the syntax for paragraphs 2(c) and B12 of the ED be tightened so that it is clear that ownership refers to beneficial ownership as opposed to merely legal ownership. This will avoid any unintended consequences whereby a structure (such as a trust) that confers a proportion of share of net assets on the beneficial (but not the legal) owners would be deemed as not meeting the investment entity criteria.

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 and why not?

The majority of the AOSSG members agree that an entity that provides services that relate to its own investment activities either directly or indirectly through an investee should still be eligible to qualify as an investment entity.

In respect of an entity that provides services that relate to the investment activities of other entities, these AOSSG members do not think that the entity should qualify as an investment entity unless the provision of such services is not substantive.

To prevent diversity in application, one AOSSG member requests the IASB to provide further clarification or guidance on the scenarios on what constitutes “substantive”.

Some of those AOSSG members that do not support the proposed consolidation exception consider that an entity should not qualify as an investment entity if it provides services that relate to its own investment activities and/or the investment activities of other entities, in the interest of limiting the extent to which entities would not prepare consolidated financial statements.

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.**

Some AOSSG members take the view that an entity with a single investor, such as a sovereign fund, should be eligible to qualify as an investment entity. These AOSSG members are not able to isolate any conceptual rationale for excluding a single investor entity from the definition of an investment entity if all the other criteria proposed in the ED are met. Whilst these AOSSG members agree that the more extensive the pooling of funds to avail the owners of professional investment management, the greater the evidence that the entity is investing for investment income and/or capital appreciation, they believe that this should be an indicator rather than a criterion for the identification of an investment entity.

Furthermore, these AOSSG members do not share the concern raised by the IASB in paragraph BC16 of the Basis for Conclusions that an investment entity could be inserted into a larger corporate structure to achieve off balance sheet accounting for some assets notwithstanding the fact that the parent could own almost all of that investment entity. They believe that the requirements set out in paragraph B6 of the ED will ensure that any modification to the activities of an investment entity by its parent for purposes of obtaining benefits other than investment income and/or capital appreciation would disqualify the entity from meeting the definition of an investment entity and from using the consolidation exception.

However, a few AOSSG members within this group appreciate the difficulties involved in attempting to establish a set of sufficiently objective criteria to scope in single investor entities whilst minimising the abuses which the IASB is concerned with given that structures may be set up differently in myriad forms in different jurisdictions. Consequently, they are willing to accept that some “legitimate” investment entities may be excluded from the scope of the consolidation exception.

Those AOSSG members that do not support the proposed consolidation exception consider that an entity that has a single investor unrelated to the fund manager should not qualify as an investment entity, in the interest of limiting the extent to which entities would not prepare consolidated financial statements.

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?

The majority of the AOSSG members agree that investment entities that hold investment properties should be required to apply the fair value model in IAS 40.

Some AOSSG members consider that the measurement guidance proposed should not be restricted only to financial assets as defined in IFRS 9 or IAS 39, as investment entities may invest in non-financial assets such as wine or art pieces for capital appreciation. They believe that the measurement guidance should be extended to these assets as well.

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?

The majority of the AOSSG members do not agree that the non-investment entity parent of an investment entity should be required to consolidate controlled entities held via the investment entity.

These AOSSG members consider that the accounting treatment, whether at the subsidiary or parent level, should be driven primarily by the decision-usefulness of information presented to users. If it is argued that consolidation at the subsidiary level does not provide decision-useful information, these AOSSG members are not persuaded that consolidation at the parent level would do so.

In addition, given the business model of investment entities, acquisition and disposal of investments, including controlled entities, are likely to be fairly frequent. This will result in frequent consolidation and deconsolidation of the controlled entities by the non-investment entity parent which would impair the decision-usefulness of the parent's consolidated financial statements.

Furthermore, these AOSSG members observe that the proposal for a non-investment entity to consolidate controlled entities held via its investment entity subsidiary contradicts another proposal in the ED which requires the non-investment entity to retain the fair value accounting applied by its investment entity subsidiary to associates and joint ventures in its consolidated financial statements. They therefore question the rationale for the accounting asymmetry.

Whilst these AOSSG members appreciate the IASB's concerns on the potential accounting inconsistencies and possibilities for abuse as set out in paragraph BC20 of the Basis for Conclusions (e.g. where the non-investment entity parent issues its equity to an investee of its investment entity subsidiary), they believe these concerns could be better addressed by prescribing specific accounting guidance or by refining the investment entity criteria. These AOSSG members also do not concur with the IASB's observation in BC20 that "in most cases, investment entities would have investment entity parents".

To this end, these AOSSG members note that the FASB's Exposure Draft on *Investment Companies* would require a non-investment entity to retain the accounting applied by its investment entity subsidiary in its consolidated financial statements.

These AOSSG members therefore urge the IASB to extend the consolidation exception to non-investment entity parents.

Some AOSSG members, however, are more concerned with the potential for abuse even though they recognise the merits of the arguments set out above. In particular, these AOSSG members are concerned that extending the consolidation exception to non-investment entity parents might permit groups to insert investment entities within their structures with the sole aim of avoiding consolidation of certain assets and liabilities. Mindful of the role that non-consolidation of certain banking assets and liabilities played in the financial crisis, they are more inclined to take a limiting position on the consolidation exception by agreeing that non-investment entity parents should not be availed of the consolidation exception.

Those AOSSG members that do not support the proposed consolidation exception consider that, if the IASB were to proceed with an exception, it should be as limited as possible. Accordingly, they support the IASB's proposal to require a non-investment entity parent to consolidate all of its controlled entities, including those held via its investment entity subsidiaries.

These AOSSG members believe that, if the IASB introduces an exception based on the character of an entity, it should not allow that exception for an entity (a parent) that does not have the requisite characteristics. They believe that the structuring opportunities that would be available if the IASB were to allow the exception to flow up into a non-investment-entity group would undermine the credibility of IFRSs.

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?

The AOSSG is generally supportive of the proposed disclosure objective.

However, rather than leaving it to preparers to determine which disclosure requirements in IFRS 7, IFRS 12, IFRS 13 and the ED would result in duplication of disclosures (as stipulated in paragraph B20 of the ED), the AOSSG is of the view that the ED should clearly set out the disclosure requirements applicable to investment entities.

In addition, some AOSSG members are concerned that the long list of “examples” of additional disclosures in paragraph B19 of the ED may be taken as mandatory disclosure. As such, these AOSSG members recommend that the IASB streamline the list to those disclosures that are most decision-useful to users.

Those AOSSG members that do not support the proposed consolidation exception consider that if fair value information is considered particularly significant for a certain class of entity, then it should be required to be disclosed and not be a substitute for consolidation.

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?

Some AOSSG members disagree that the proposed requirements should be applied prospectively. These AOSSG members are of the view that the proposals should be applied retrospectively in accordance with IAS 8 so as to enhance the comparability and usefulness of the financial statements presented. In this regard, these AOSSG members do not share the IASB’s concern on the use of hindsight in determining the fair value of the investments since to qualify as an investment entity, an entity must necessarily manage its investments on a fair value basis in the first place.

Most AOSSG members that agree with the prospective application proposal believe that the same relief should be given to first-time adopters of IFRSs.

Question 9—Scope exclusion in IAS 28 (as amended in 2011)

- (a) Do you agree that IAS 28 should be amended so that the mandatory measurement exemption would apply only to investment entities as defined in the exposure draft? If not, why not?**
- (b) As an alternative, would you agree with an amendment to IAS 28 that would make the measurement exemption mandatory for investment entities as defined in the exposure**

draft and voluntary for other venture capital organisations, mutual funds, unit trusts and similar entities, including investment-linked insurance funds? Why or why not?

The majority of the AOSSG members appreciate the conceptual merits for the proposed amendment to IAS 28 as it would increase consistency within IFRSs.

However, some AOSSG members question if the proposed amendment would result in decision-useful information for venture capital organisations, mutual funds, unit trusts and similar entities including investment-linked insurance funds that do not qualify as investment entities under the ED. Accordingly, these AOSSG members urge the IASB to carry out further outreach to ascertain the implications of the proposed amendment.

Some AOSSG members are opposed to changing the measurement exemption of IAS 28 without the IASB first undertaking a thorough review of equity accounting, as they believe the proposals will lead to greater use of that method.

Other comment

One AOSSG member is concerned that the proposals in the ED could result in accounting for the form, rather than the substance, of some entities that hold investments via special purpose vehicles.

For example, a real estate investment trust (the trust) may hold investment properties (IPs) either directly or indirectly via special purpose vehicles (SPVs) for tax, legal, regulatory or other business reasons. In situations where SPVs are set up for the sole purpose of holding the IPs, the trust could be deemed not to meet the investment entity definition by virtue of the fact that the SPVs are not managed on a fair value basis since only the IPs held by the SPVs are managed on such a basis by the trust (the rest of the SPVs' assets and liabilities, e.g. bank loans obtained by the SPVs to finance the acquisition of the IPs, are not managed on a fair value basis by the trust). Conversely, if the trust holds the IPs directly, it would meet the investment entity definition.

As the SPVs are shell conduits, this AOSSG member is of the view that: (1) the structure of the trust is not relevant to the assessment of whether the trust meets the investment entity definition given that the fundamental objective of the trust, regardless of its structure, is to invest in the underlying IPs for investment income and/or capital appreciation; and (2) the trust should account for the assets, liabilities, revenue and expenses of the SPVs on a line-by-line basis rather than measure the SPVs at fair value. This would better reflect the underlying economic substance, rather than the form, of the trust.

Accordingly, this AOSSG member urges the Board to refine the ED proposals to ensure that they do not result in accounting for the form, rather than the substance, of entities that hold investments via special purpose entities such as real estate investment trusts.

The AOSSG is keen to play a key role in the development of a global set of high quality financial reporting standards and trusts that the IASB finds our comments helpful.

If you have any queries regarding any matters in this submission, please contact us.

Yours sincerely



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