

December 23, 2011

Submitted electronically via www.ifrs.org

International Accounting Standards Board
30 Cannon Street,
London EC4M 6XH
United Kingdom

Dear Sirs,

Re: Investment Entities (ED/2011/4)

This letter is the response of the Canadian Accounting Standards Board (AcSB) to the International Accounting Standards Board's (IASB) Exposure Draft, "Investment Entities," issued in August 2011.

The AcSB is Canada's national accounting standard setting body, which has adopted a strategy of importing IFRSs into Canada for publicly accountable enterprises, without modification or interpretation. The AcSB consists of members from a variety of backgrounds, including preparers, advisors, academics and financial statement users. Additional information about the AcSB can be found at www.acsbcanada.org.

The AcSB consulted with a broad spectrum of Canadian preparers, practitioners, regulators and users, including members of the AcSB's User Advisory Council. The views expressed in this letter take into account comments and perspectives raised by these stakeholders and AcSB

members. However, they do not necessarily represent a common view of the AcSB, its committees or staff. Views of the AcSB are developed only through due process.

The AcSB appreciates the opportunity to provide comments on the Exposure Draft and would like to thank the IASB and the FASB staff for joining in various roundtable discussions we held and responding to Canadian stakeholders' questions.

Meeting investors' needs

We commend the IASB for considering the preference of financial statement users and other stakeholders for fair value information about controlled investees of investment entities rather than consolidated information about those investees. We think that providing guidance in IFRSs that responds to the information needs of investment entities' stakeholders will open the door for a number of European and Asian jurisdictions to adopt IFRSs for investment fund reporting. The issuance of the Exposure Draft "Investment Entities" is an excellent example of the merits and the success of the IASB's due process.

Support the proposals

The AcSB supports strongly the IASB's proposals that there is a class of entities (investment entities) that should report investments in controlled investees at fair value through profit or loss, rather than consolidate them. Based on our experience in Canada and affirmed through extensive discussions over the last few years, the fair value of controlled investments provides the most relevant information to the users of investment entities' financial statements. Fair value reporting is more useful to investors in investment entities than consolidated financial statements because fair value information enables users to assess the investing performance of entities and to decide whether to buy, hold or sell ownership interests based on changes in their exit value.

Develop converged proposals

The AcSB urges the IASB and the FASB to work together to develop high-quality accounting guidance for investment entities that can be applied globally. In particular, we encourage the Boards to reach converged and consistent answers for upstream and downstream accounting within related groups of entities.

We are not convinced that the best accounting is to require a parent of an investment entity that is not itself an investment entity to consolidate all of its controlled entities. We are concerned that a standard is being developed based on whether it might be abused rather than being developed to provide the most useful information for investors.

We recommend strongly that the Boards require investment entities that hold a controlling interest in another investment entity, e.g. in a fund-of-funds structure, to report controlling interests in other investment entities at fair value in order to account for controlling interests in a consistent manner that reflects the investment entity's purpose and management approach.

Issuing high-quality accounting guidance for investment entities would increase the likelihood that the financially significant, global investment funds industry in jurisdictions which require or permit the use of IFRSs would move to IFRSs instead of continuing to apply a local set of accounting standards.

Clarify the proposals

During our consultations and analysis of the proposals, we identified some aspects of the investment entity criteria that should be clarified and enhanced to address practical concerns.

We think that the criteria should be revised for the following key points:

- *Business purpose* – The criterion and supporting guidance on business purpose should be strengthened by placing more emphasis on the need for exit strategies to realize capital appreciation and business purpose to earn investment income, and a demonstrated adherence to those strategies.
- *Nature of investment activity* – The provision of financial guarantees or collateral to investees of the investment entity or other entities related to the investment entity is an activity other than investing because the investment entity's exposure to risk would be greater than what is reported in the fair value of its investments and it would receive a financing benefit from placing additional capital at risk.
- *Unit ownership* – Ownership interests of a reporting entity that is not a legal entity should be included in this criterion to avoid contradicting the statement in criterion 2(f) that the entity

need not be a legal entity and to include all types of ownership interests that entitle a holder to an identifiable interest in the net assets of the investment entity.

Explanations of these key points and others, including some suggested revisions to the Exposure Draft proposals, are provided in the Appendix to this letter as part of the responses to the questions set out in the Exposure Draft.

Need input from investment fund stakeholders

We understand that many jurisdictions in Europe and Asia do not require investment funds to apply IFRSs today and do not require investment funds to prepare consolidated financial statements. We are concerned that these investment entities will not respond to the Exposure Draft as they do not believe that it has an effect on them. As part of evaluating the input received on the Exposure Draft, we think that the IASB should ensure that users, preparers and advisors involved in investment fund reporting from those jurisdictions are encouraged to participate and provide their views on the appropriateness of these proposals.

We would be pleased to elaborate on our comments in more detail if you require. If so, please contact me, Peter Martin, Director, Accounting Standards at +1 416 204-3276 (email peter.martin@cica.ca), Rebecca Villmann, Principal, Accounting Standards at +1 416 204-3464 (email rebecca.villmann@cica.ca) or Nicky Lahner, Principal, Accounting Standards at +1 416 204-3348 (email nicky.lahner@cica.ca).

Yours truly,



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APPENDIX

Comments of the Canadian Accounting Standards Board on the IASB's Exposure Draft, "Investment Entities," issued in August 2011

Exclusion of investment entities from consolidation

Question 1: 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?

1. Yes. We agree strongly with the proposal that there is a class of entities, commonly thought of as an investment entity in nature, that should not consolidate controlled entities and instead should measure them at fair value through profit or loss. We agree with the IASB's rationale for why investment entities should not consolidate controlled entities.
2. Investment entities in Canada currently use fair value reporting in accordance with the principle-based requirements of Accounting Guideline AcG-18 *Investment Companies*. The resulting reporting has served investors well and we are not aware of any concerns about abuse or misuse of the investment company guidance in Canada.
3. The AcSB and Canadian stakeholders think fair value reporting is the most useful and only relevant financial information about controlled investees owned by investment entities, for the following reasons:
 - a. Investors in investment entities focus on assessing the exit value of an ownership interest to decide whether to invest, hold or sell. Accordingly, financial statements that report investments held and the performance of investments on a fair value basis provide investors with the financial information they most want.
 - b. The proposal reflects how investment entities are managed and enables users to evaluate management's performance based on the information that managers use, i.e., the proposal provides information that enables users to evaluate how efficiently and effectively the entity's management has discharged its responsibilities to use the entity's resources (the "stewardship" aspect of the objective of financial reporting).

- c. The investment objective of an investment entity is to maximize the investment returns it can receive from each investment regardless of the ownership interest held, i.e., whether it holds 2%, 30% or more than 50% of an investee's equity.
 - d. An investment entity's sole purpose is to maximize the investment income from holding investments and the exit value of its investments.
 - e. Consolidated financial statements would provide a combined position of all of the underlying assets and liabilities of the operating entities in which an investment entity has an indirect controlling interest. In the view of investors that we have consulted, information about the consolidated assets and liabilities of the operating entities would not assist them in evaluating the investing choices made by professional investment managers, nor the changes in value of their investment.
 - f. Relevant information that investors need to make decisions is the foremost qualitative characteristic of useful financial statement information, per Chapter 3 *Qualitative characteristics of useful financial information* of the IASB's *Conceptual Framework for Financial Reporting*.
4. The alternative views in the Investment Entities Exposure Draft held by some stakeholders or jurisdictions are based on the IASB's March 2010 Exposure Draft, "Conceptual Framework for Financial Reporting: The Reporting Entity". That Exposure Draft proposed that an entity should present consolidated financial statements when it controls one or more entities, as follows:

"If one entity controls another entity, the cash flows and other benefits flowing from the controlling entity to its equity investors, lenders and other creditors often depend significantly on the cash flows and other benefits obtained from the entities it controls, which in turn depend on those entities' activities *and the controlling entity's direction of those activities*. Accordingly, if an entity that controls one or more entities prepares financial reports, it should present consolidated financial statements. Consolidated financial statements are *most likely to provide useful information* to the greatest number of users." (paragraph RE8, emphasis added)

5. The last sentence of paragraph RE8 implies that the Boards considered that there are some situations in which consolidated financial statements would not provide useful information to the greatest number of users. No criteria or factors are provided in the Reporting Entity Exposure Draft to identify when other types of financial statements are acceptable, other than identifying parent-only and combined financial statements as other types of financial statements. Although the alternative views in the Investment Entities Exposure Draft agree with the rationale explained in paragraph RE8 in the Reporting Entity Exposure Draft, the alternative views do not acknowledge that there may be situations when other types of financial statements are acceptable. We think that investment entities is one of those situations because most users of investment entities' financial statements think that consolidated financial statements will not provide the most useful or relevant information.
6. Control is an important concept but the AcSB does not think that it should trump all other considerations in assessing the utility of different possible bases of financial reporting. The alternative views simply assert a belief that consolidation with supplementary disclosure of fair value better serves the needs of investors than reporting all controlled investees at fair value. No explanation is provided or evidence cited to support that belief. Our experience is otherwise.
7. The alternative views point out that a controlling interest is not the same as a non-controlling interest. That is true, but not a compelling argument for preferring consolidation over fair value. The difference in the investment entity's activities and the nature of the various interests that an investment entity has in its investees can be best reflected in the fair value of those interests.
8. Although an investment entity is typically a passive investor that does not exercise its power to direct the actions of its investees, this is not always the case. The level of involvement of the investment entity in the activities of the investee is irrelevant as to how the investment entity evaluates the performance of its investments. The key characteristic is that the investment entity evaluates the outcome of the operating decisions made by the investees primarily by the effect of those decisions on the fair value of its investments in the investees. Based on that analysis, the investment entity decides to hold or sell its

investment holdings. The asset that it controls and hence evaluates is the investment in the investee as a whole rather than the individual assets (and liabilities) of the investee.

9. The Boards need to decide on the appropriate unit of account and the appropriate measurement basis for that unit of account. We think that for entities meeting the criteria to be classified as an “investment entity”, the most appropriate unit of account is the investor’s net investment in an investee, and the most appropriate measurement basis is fair value. We think that this logic applies to all of the investment entity’s investments – whether they are subsidiaries, associates, joint ventures or portfolio investments.

Criteria for determining when an entity is an investment entity (paragraphs 2 and B1–B17)

Question 2: 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?

10. Yes. The AcSB agrees that the criteria in the 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. We urge the IASB and the FASB to work together to revise the criteria so that the guidance for investment entities issued by the Boards has the same investment entity criteria (in paragraph 2), except for the inclusion of an investment company regulated under the Investment Company Act of 1940. We think that the IASB should not provide an automatic qualification based on regulatory reporting requirements because of the wide variation in what constitutes an “investment fund” in the many jurisdictions that apply IFRSs.
11. We recommend that some aspects of the IASB’s proposed criteria be clarified and enhanced to address practical concerns identified through consultations with Canadian stakeholders, as set out below.

Demonstrate its business purpose

12. The AcSB recommends that an entity should be required to demonstrate how it is fulfilling its business purpose of “investing for capital appreciation, investment income (such as

dividends or interest), or both” (paragraph 2(b)). A key indicator is that an entity has realized capital appreciation and investment income and that it has plans to continue to do so. Therefore, we think that the criterion and supporting guidance on business purpose should be strengthened by placing more emphasis on the need for exit strategies to realize capital appreciation and the business purpose to earn investment income, and a demonstrated adherence to those strategies. To validate that it is carrying out its business plan, an entity should be able to demonstrate that some, but not necessarily all, of the following have occurred:

- a. It has received investment income.
 - b. It has generated realized and unrealized capital appreciation from investments.
 - c. It has taken actions to prepare an investment for sale, e.g. the entity may direct, or make arrangements for, the investee to issue an initial public offering or private placement of equity securities.
 - d. It has taken actions to address investments that are not performing or to maximize the investment returns.
13. The extent of evidence an investment entity can provide to demonstrate that it is carrying out its business plan may vary depending on its stage of operation, as less evidence may be available when an entity is newly formed. Overall, an entity’s plans and actions to sell its investments or otherwise realize their value are why the fair value of its investments is the most relevant information to users of its financial statements.
14. We think that focusing on an entity demonstrating its business purpose will help to address concerns raised by Canadian stakeholders about the need for the proposals to state whether or not an entity could be involved in the day-to-day operations of an investee.
15. We are of the view that an entity may qualify as an investment entity in the circumstances in which, as an investor, it actively exercises its power to control the investee by directing, or taking part in directing, the relevant activities of the investee. In our view, the critical differentiating features of an investment entity are that:

- a. Its objective in exercising its control is to maximize its variable returns in the form of dividends, interest and capital appreciation;
 - b. It conducts no other activities and receives no other benefits with respect to its investment; and
 - c. It has an articulated business and exit strategy for its investment and has demonstrated adherence to those strategies.
16. We think that these differentiating features apply whether the investment entity's investments are in the form of controlled subsidiaries, associates, joint ventures and portfolio investments. Therefore, we recommend that the IASB acknowledge in the basis for conclusions to the final standard that it considered and rejected a criterion based on the level of involvement of the investment entity in the activities of its investees.

Provision of financial guarantees

17. The AcSB thinks that the IASB should revise the guidance concerning guarantees to clarify that providing financial guarantees or collateral to other entities within the group are activities that demonstrate that an entity is investing other than for capital appreciation or investment income (paragraph B6(f)). We think that providing guarantees should not be permitted for the following reasons:
- a. Stakeholders explained, as part of their rationale for why investment entity guidance is needed, that “there is *no recourse* to the investment entity for the investee's debt, even if a controlling interest is held.” (paragraph BC3, emphasis added). Many investors we consulted agreed with this position.
 - b. The entity's exposure to risk would be greater than what is reported in the fair value of the investment.
 - c. The entity could be unable to exit the investment unilaterally, or could be required to fulfill its guarantee after exiting the investment or for an amount greater than the entity's share of the investee's liability, based on its ownership interest.

- d. The provision of a guarantee or other credit support by an investor is a financing activity rather than an investing activity because the investor will receive a benefit from placing additional capital at risk.
18. Therefore, we recommend that the IASB change the application guidance in paragraph B6(f) so as to identify that the following activities demonstrate that an entity is investing other than for capital appreciation or investment income:

“The entity provides financing guarantees or assets to serve as collateral for borrowing arrangements of its investees, or investees of the entity provide financing guarantees or assets to serve as collateral for borrowing arrangements of the entity or other investees of the entity. (However, an entity is able to use the investments in its investees as collateral of any of its borrowings and an investee is able to use its assets as collateral for any of its borrowings.)”

19. We also recommend that the IASB not use the word “affiliate” in the proposed guidance because this is a term that is defined in law in some jurisdictions and has a variety of different meanings in practice. The use of this term will likely create confusion. As well, we think that the proposed definition of an affiliate is not clear because one could read it to include the entity or a qualifying investment entity.

Unit ownership criterion

20. The AcSB recommends that the description of, and application guidance for, the unit ownership criterion (paragraph 2(c)) be revised to be the “ownership interest” criterion and include ownership interests of an entity that is not a legal entity. A revision is needed in order to include all types of ownership interests that entitle a holder to an identifiable interest in the net assets of the investment entity. Otherwise, the unit ownership criterion appears to contradict the statement in criterion 2(f) that the entity need not be a legal entity because the explanation and examples provided only reflect ownership units in legal entities.

21. Therefore, we recommend that the IASB revise paragraph B12 as follows:

“The definition of an investment entity requires that investors have acquired ownership interests ~~units~~, such as shares, ~~or~~ partnership interests, or other legal or contractual rights of a similar nature, in the investment entity. Each ~~unit~~ of ownership interest represents a specifically identifiable interest portion of ~~in~~ the net assets of the investment entity.”

Holding debt instruments

22. The AcSB recommends that the guidance explaining the nature of investment activity and business purpose criteria (paragraph 2(a) and (b)) should include holding debt instruments to earn interest income as a qualifying investing activity. Although interest is identified as investment income, the requirement that an entity have an exit plan to demonstrate that its business purpose is to earn capital appreciation can be difficult to meet for a debt instrument. Often, an entity holds a bond or loan to maturity as a strategy to diversify its investment portfolio. Thus, the exit strategy for the bond or loan is to receive the return of its capital, rather than capital appreciation. The guidance on exit strategies should be revised as follows:

“An entity’s express business purpose is also evidenced through its investment plans. For example, when an investment entity’s purpose is to earn capital appreciation, it should have an exit strategy documenting how ~~the entity~~ it plans to realise capital appreciation of its investments. ...” (paragraph B9 of the Exposure Draft, revisions shown in markup)

“...For investments in debt securities, examples of exit strategies include selling the debt in a private placement, ~~or~~ converting the debt to equity securities and subsequently selling those equity securities, or holding the debt securities to maturity. ...” (paragraph B11 of the Exposure Draft, revisions shown in markup)

Single investor

23. The AcSB recommends that the pooling of funds criterion (paragraph 2(d)) include a practical provision to address situations in which an entity may, for a short period, have a single investor. For example, when a fund is being launched, during its life and when it is being wound down, an investment entity can at times have one investor even though its business purpose and marketing strategy is, or was, based on unrelated investors holding a significant ownership interest in the entity. The practical guidance could be similar to the guidance that does not require an entity to hold multiple investments throughout its existence (paragraph B5 of the Exposure Draft). It could be drafted as follows:

“Although the investment entity must have investors that are unrelated to the parent (if any), and in aggregate hold a significant ownership interest in the entity, an investment entity is not required to have investors that hold a significant ownership interest in the entity at all times throughout its existence. For example, an entity is not precluded from being an investment entity in the following situations, provided it meets the other criteria of an investment entity:

- (a) The entity’s initial offering period has not expired.
- (b) The entity has not yet sold interests to investors to replace ownership interests that were redeemed.
- (c) The entity is in the process of liquidation.”

‘Nature of the investment activity’ (paragraphs 2(a) and B1–B6)

Question 3: 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?

24. Yes to option (a). The AcSB agrees that an entity should still be eligible to qualify as an investment entity when it provides (or holds an investment in an entity that provides) services that relate to its own investing activities.

25. No to option (b). We think that an entity that provides services that relate to the investment activities of entities other than the reporting entity itself is conducting business activities with the objective of earning returns other than from capital appreciation or investment income. Therefore, such an entity should not qualify as an investment entity.

‘Pooling of funds’ (paragraphs 2(d) and B14–B16)

Question 4 (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?

26. Yes. The AcSB agrees that an entity with a single investor unrelated to the fund manager should be eligible to qualify as an investment entity when the entity with a single investor was established for legal, regulatory, tax or other business reason or when the investor is a government-related entity. See our response to question 4(b) for our rationale and examples of possible structures.
27. Also, see the recommendation in our response to question 2 to include a practical provision to address situations in which an entity may, for a short period, have a single investor.

Question 4 (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.

Entity established for legal, regulatory, tax or other business reason

28. The AcSB thinks that an entity with a single investor that is formed for legal, regulatory, tax or other business reasons should not be precluded from meeting the definition of an investment entity provided that the entity and its single investor, together, meet all of the criteria to be an investment entity. For example, an investment entity may incorporate a subsidiary entity to purchase an investment that consists of a business or group of assets in order to limit the entity’s legal liability for the investment. We think that an entity with a single investor, that is itself an investment entity, should be formed in conjunction with, but not necessarily at the same time as, the investment entity.
29. The AcSB understands that the guidance in paragraph B16 was intended to permit the use of “pass through entities” when an entity is set up for legal, regulatory, tax or other

business reasons. As drafted, the paragraph is not clear whether it was written to address two-tier structures in which there is an intermediate investment entity parent that is directly owned by an ultimate parent and whether the ultimate parent could still meet the definition of an investment entity.

30. The paragraph also requires that the intermediate entity was “formed in conjunction with the formation of” the ultimate parent in the structure. The AcSB questions how this paragraph should be applied because it could result in some entities and structures not qualifying as an investment entity because of a minor technicality. We think that “formed in conjunction with the formation of” the ultimate parent should mean that the entities were set up together or formed to be part of a combined structure and therefore should not necessarily mean that the entities had to be formed at the same time.
31. Therefore, we recommend that the IASB clarify paragraph B16 as follows:

“An entity ~~with that is controlled by~~ a single investor may be formed (for legal, regulatory, tax or other business reasons) in conjunction with ~~the formation of the~~ that single investor as its parent entity. In some cases, the ~~single investor parent~~ entity may have its own investors that are unrelated ~~to the single investor entity’s parent (if any)~~ and that, in aggregate, hold a significant ownership interest in the ~~single investor parent~~ entity. Provided that the entity and its parent entity, when considered together, meets all the ~~other~~ criteria for an investment entity, having a single investor ~~that is itself an investment entity,~~ and that was formed ~~in conjunction with the entity to be part of a combined structure for legal, regulatory, tax or other business reasons,~~ would not preclude the entity from meeting the definition of an investment entity.”

Government-related entities

32. Paragraph B14 requires investors that are related to the parent to be treated as a single investor for the purposes of applying the pooling of funds criterion. Different government agencies or government bodies could invest in an investment fund. The investment fund would not be eligible to qualify as an investment entity because these government-related

entities are considered to be related to the parent and would therefore be treated as a single investor.

33. The AcSB recommends that government-related entities not be considered related when applying the pooling of funds criterion, provided that the entity meets all of the other criteria to be an investment entity. We think that the same definitions and approach used in IAS 24 *Related Party Disclosures* for government-related entities (IAS 24 paragraph 25) should apply in the investment entity guidance. As well, additional disclosures, similar to IAS 24 paragraph 26, could be required in order to provide users of the entity's financial statements with information about the different government-related entities investing in the entity and the extent of their holdings.

Measurement guidance (paragraphs 6 and 7)

Question 5: 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?

34. Yes. The AcSB agrees that an investment entity that holds investment properties should be required to apply the fair value model in IAS 40 and that any financial assets should be measured at fair value in accordance with IFRS 9, IAS 39 or the proposed standard on investment entities. We think that investment entities should measure all investments at fair value on a consistent basis because fair value provides more relevant information to users of investment entities' financial statements.

Fund-of-funds

35. The AcSB agrees with the IASB's proposal to require all controlling interests held in another entity be reported at fair value. Overall, the Canadian preparers, accounting practitioners and regulators we consulted support strongly investment entities with a fund-of-funds structure reporting controlling interests in other funds at fair value. The following reasons support this view:

- a. *Apply consistent rationale* – If an investment entity’s purpose and management approach is the same for a controlling interest in another fund and a controlling interest in an operating entity, the method of reporting those investments should be the same. If transparency is a concern, then it should also be a concern about controlling interests in investees that are not funds. The fair value of a controlling interest reflects the price that would be received to sell the investment based on its net assets, thus, the fair value of the investee’s liabilities are considered. We think that the disclosures required by IFRS 7 *Financial Instruments: Disclosures*, IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and the Exposure Draft would provide transparency about the risks of investments and commitments or guarantees to provide additional funding (also see the response to question 7).
- b. *Avoid obscuring the investments managed by the top fund* – For investment entities (i.e., the top funds) that invest in an extensive number of investees, having to consolidate a controlled fund would result in reporting the investments owned by the controlled fund. As a result, the number of investments reported would multiply. Such reporting could make it difficult to evaluate the material investment positions held by the top fund and its investment performance. Disclosures, including disclosures about credit and liquidity risk, provide users information to assess an investment entity’s economic exposures.
- c. *Practical concerns* – The ownership in another fund often changes daily. It can be very difficult to determine when one investment entity controls another, to obtain the financial information about a controlled fund’s investments and to prepare consolidated financial statements (i.e., report investments held by the controlled fund in its parent’s financial statements).

Practical expedient for determining net asset value

36. When developing IFRS 13 *Fair Value Measurement*, the IASB considered the need to provide a practical expedient for an investment entity to use a measure of fair value in specific circumstances to report net asset value without adjustment. The IASB did not provide such a practical expedient in IFRS 13 because IFRSs did not permit an investment

entity to report controlled investees at fair value at that time. The AcSB recommends that the IASB reconsider the issue and provide a practical expedient similar that included in US GAAP, Topic 946 *Financial Services—Investment Companies*, in finalizing its investment entity guidance.

Accounting in the consolidated financial statements of a non-investment entity parent (paragraph 8)

Question 6: 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?

37. The AcSB does not support the IASB’s proposal that a parent of an investment entity that is not itself an investment entity be required to consolidate all its controlled entities because the Boards have not reached a common conclusion. Stakeholders we consulted think that this proposed requirement for non-investment parent would only affect a few entities in Canada. For some of these entities, the effect would be significant compared to current practice.
38. Listed below are points and concerns that the AcSB considered when discussing the proposed approach in the Exposure Draft.

Developing a standard to prevent abuse

39. We are concerned that this part of the standard is being developed based on whether permitting fair value measurement in the non-investment entity’s consolidated financial statements could be abused, rather than on whether the proposals will result in providing decision useful information for financial statement users, i.e., information that is relevant, representationally faithful and verifiable. The potential for inappropriate application of guidance by a few entities should not affect how standards are developed for a large group of entities that would apply the standard with rigor. To address concerns that a standard could be applied inappropriately, we think the guidance should be written clearly.

Canada's experience

40. In Canada, Accounting Guideline AcG-18 *Investment Companies* has been applied in a principle-based manner for many years. Consultations with regulators and other financial statement users over the years have demonstrated that AcG-18 has not resulted in the abuses said to have occurred in other jurisdictions. As part of developing the Exposure Draft, the AcSB appreciates that the IASB considered proposals based on, and similar to, the requirements in AcG-18 concerning when a parent company can report controlled investees of an investment company subsidiary at fair value in its consolidated financial statements.
41. The AcSB thinks that the examples of relationships and activities that are considered to be other than investing (in paragraph B6 of the Exposure Draft) identifies the activities considered to be abusive and will result in an entity engaging in those activities not qualifying as an investment entity. AcG-18 contained similar requirements based on the principles that the parent company or their related parties:
- a. “do not obtain, or have the objective of obtaining, benefits that are unavailable to unrelated non-investor enterprises and that are not normal benefits attributable to an ownership interest, such as dividends” (paragraph 10(c) of AcG-18); and
 - b. “follows established policies that effectively distinguish the nature and type of investments made by investment companies in the consolidated group from those made by non-investment companies” (paragraph 10(d) of AcG-18).
42. Therefore, the AcSB agrees with the statement in the Basis for Conclusions in the Exposure Draft that “if more useful information is provided by allowing the investment entity subsidiary to measure controlled investments at fair value it is likely that useful information would also be provided by retaining this accounting in the consolidated financial statements” (paragraph BC20).

Rationale for concerns

43. The Basis for Conclusions explains that the boards addressed the concern that a parent entity could take advantage of having an investment entity as one subsidiary in a group by precluding an entity or its affiliates from obtaining or having the objective of obtaining returns that are unavailable to unrelated investors (paragraph BC19 based on the guidance in paragraph B6 of the Exposure Draft). When considering whether a non-investment-entity parent of an investment entity should retain the fair value accounting of its investment entity subsidiary, the IASB expressed further concerns about potential accounting inconsistencies and possibilities for abuse in such structures and provided one example of such a situation. We think that the IASB should explain the types of abuses or inconsistencies that could occur to substantiate these concerns.
44. The example provided is how a consolidated group could have a stronger capital base because an investment entity subsidiary has invested in shares of the parent (in paragraph BC20). This concern is the same issue that was considered in the IASB's Exposure Draft "Insurance Contracts". In the insurance proposals, an insurer would be permitted to measure underlying assets of unit-linked contracts, including holdings of an insurer's own shares, at fair value. Therefore, we question why an insurer would be permitted to contravene the usual accounting for treasury shares required by IAS 32 *Financial Instruments: Presentation* (paragraphs 33 and 34) in accounting for unit-link contracts when other entities would not be able to obtain the same accounting in very similar circumstances. The IASB should be consistent with this approach and apply the same rationale to the investment entity proposals.
45. The AcSB encourages the IASB and the FASB to continue to work together to develop high-quality accounting guidance for investment entities that can be applied globally.

Disclosures (paragraphs 9 and 10)**Question 7(a): Do you agree that it is appropriate to use this disclosure objective for investment entities rather than including additional specific disclosure requirements?**

46. Yes. The AcSB agrees that it is appropriate to use the proposed disclosure objective for investment entities. Requiring entities to apply a disclosure objective will encourage them to apply their judgement to disclose information that is relevant to users and help to reduce disclosures that are less informative.

Question 7(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?

47. Yes. The AcSB agrees that the proposed application guidance is information that could satisfy the disclosures objective. In addition, the AcSB thinks that existing disclosure requirements, in particular in IFRS 7 *Financial Instruments: Disclosures* and IFRS 12 *Disclosures of Interests in Other Entities*, should provide sufficient information for users of financial statements to assess the extent of an investee's financial obligations and transparency about the investees' financial risks that are exposures of the investment entity. Thus, we do not think that additional disclosures are required.
48. Some members of the AcSB's User Advisory Council expressed concern about the difficulty of evaluating the economic exposures in fund-of-funds structures and the possible use of multi-level corporate structures to conceal the extent of an entity's exposures. The AcSB acknowledges their concerns. However, the AcSB thinks that, based on the view that there should be no recourse to an investment entity for investees' obligations, an investment entity only has the value of its investments at risk. This risk is reflected in the fair value of the investment entity. The existing disclosure requirements should result in disclosure about an investee's liquidity risk and the maximum exposure to credit risk. As a result, users will be informed about the economic exposures of the investment entity.
49. If an investment entity decided to put more capital at risk to fund an investee, paragraph 10 (b) and (c) in the Exposure Draft proposes that an investment entity should disclose financial support provided and current intentions to provide such support. The AcSB

acknowledges that users often want more information, but that the needs of users should be prioritized. Fair value is a relevant measure to be used for evaluating an investment entity's performance. In addition, the AcSB is not aware of any significant concerns with the existing practice in Canada of investment entities reporting on a fair value basis.

Incorporate disclosures by reference

50. The AcSB also recommends that, similar to IFRS 7 paragraph B6, an investment entity should be able to “incorporate by cross-reference from the financial statements to some other statement, information that is available to users of the financial statements on the same terms as the financial statements and at the same time” in order to meet the disclosure objective. Including additional information provided in other reports to meet regulatory requirements by reference in the financial statements would help to minimize duplicative reporting requirements and reduce the cost for and effort of preparers.

Transition (paragraph C2)

Question 8: 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?

51. Yes. The AcSB agrees with the proposed transition requirements for entities that are applying IFRSs.

Consistent application by first-time adopters

52. The AcSB thinks that a first-time adopter that is a qualifying investment entity should be able to measure its controlled investees at fair value at the date of transition and throughout all periods presented in its first IFRS financial statements. Financial information in the comparative period and the first IFRS reporting period should be presented on a consistent basis in order to provide the most relevant information to users of the investment entity's financial statements.
53. Although IFRS 1 *First-time Adoption of International Financial Reporting Standards* requires that a first-time adopter not apply transitional provisions in another standard, we

think that there is uncertainty as to whether a qualifying investment entity could report its controlled investments at fair value in the comparative period in its first IFRS financial statements. There is uncertainty because IFRS 1 restricts an entity's ability to revise estimates and requires fair value of assets to be determined at the entity's date of transition to IFRSs when an entity is required, or elects, to measure assets at fair value.

54. An entity will not have used hindsight to determine the fair value of its controlled investments when it has previously reported controlled investees at fair value in accordance with its previous accounting framework or determines the fair value at the required date. Therefore, the AcSB recommends that IFRS 1 be amended to clarify that a first-time adopter should apply the investment entity amendment from the date of transition to IFRSs when the fair value of investments have been determined at that date.

First-time adopter should apply IFRS 13 from date of adoption

55. IFRS 13 *Fair Value Measurement* amended IFRS 1 to require an entity adopting IFRSs in 2013 to determine a fair value in accordance with the new standard from the date of transition. We think that an investment entity should be provided with the same time to implement the new guidance as entities that are currently applying IFRSs, especially given the number of fair values investment entities may need to determine.
56. In addition, an investment entity that has previously reported controlled investees at fair value in accordance with its previous accounting framework could be required to revise the fair value of investments and per-share information previously reported to financial statement users. Such restatements could create confusion because ownership interests in the investment entities will have been issued and redeemed based on those previously reported values.
57. The AcSB recommends that IFRS 1 be amended to provide a one-year relief to a qualifying investment entity adopting IFRSs in 2013 by not requiring it to apply IFRS 13 from the date of transition in its first set of IFRS financial statements.

Scope exclusion in IAS 28 (as amended in 2011)

Question 9 (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?

58. No. The AcSB does not agree that IAS 28 should be amended to require that only a qualifying investment entity measure investments in associates and joint ventures at fair value. We think that some venture capital organizations, unit trusts and other similar entities may not qualify as investment entities as defined in the Exposure Draft. These types of entities should continue to be permitted to measure investments in associates and joint ventures at fair value when the fair value of those investments will provide more useful information to its financial statements users.

Question 9 (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?

59. Yes. The AcSB agrees that IAS 28 should be amended to require a qualifying investment entity to measure investments in associates and joint ventures at fair value because the fair value of investments provides the most relevant information to users of investment entities' financial information. As well, we think an investment entity should measure all of its investments on a consistent basis.

60. As explained in our response to question 9(a), the AcSB thinks that some venture capital organizations, unit trusts and other similar entities should be permitted to measure investments in associates and joint ventures at fair value. Therefore, we recommend that the scope exemption from applying the equity method should not be removed for these types of entities (i.e., paragraph 18 of IAS 28 (as amended in 2011) or paragraph 1 of IAS 28 (as revised in 2003)).