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Sir David Tweedie
International Accounting Standards Board
30 Cannon Street
London
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Dear Sir David,

PROPOSED AMENDMENT TO IAS 28 - ACCOUNTING FOR INVESTMENTS IN ASSOCIATES

The British Venture Capital Association is pleased to comment on Question 1 of the above Exposure Draft issued by the International Accounting Standards Board. Our comments are set out in the Appendix to this letter.

If you have any questions concerning our comments, please contact the undersigned on 0207 025 2960.

Yours sincerely

John Mackie

John Mackie
Chief Executive

BVCA

BRITISH VENTURE CAPITAL ASSOCIATION
PROPOSED AMENDMENT TO
IAS 28, ACCOUNTING FOR INVESTMENTS IN ASSOCIATES

Question I: Do you agree that IAS 28 and IAS 31, Financial Reporting of Interests in Joint Ventures, should not apply to investments that otherwise would be associates or joint ventures held by venture capital organisations, mutual funds, unit trusts and similar entities if these investments are measured at lair value in accordance with IAS 39, Financial Instruments: Recognition and Measurement, when such measurement is well-established practice in those industries?

We strongly believe that investments held by venture capital organisations, mutual funds, unit trusts and other similar entities should not be required to be reported using equity accounting. We support the arguments in A4 of the basis for conclusions that use of the equity or proportional consolidation methods for such investments produces information that is not relevant to the investors and other primary users of these accounts.

We believe that the use of the equity and proportional consolidation methods are not appropriate where the reporting entity's primary activity is investing capital in other companies for the purpose of generating profit from the ultimate resale of that investment at a future point. By contrast, the equity accounting and proportional consolidation methods are appropriate where the investors' primary business is not that of making investments that are intended to be held for a short to medium term period. The key difference between the two investment approaches is that venture capital organisations, mutual funds, unit trusts and other similar entities seek to generate a capital return on their investment from the future resale of their stake. Other companies normally make their investment with the expectation of complementing their other primary business activities such that the benefit they hope to achieve from their investment will be the result of their direct and strategic ongoing involvement in the company's activities rather than the future sale of the investment.

In the United Kingdom, the difficulty that equity accounting possesses in providing relevant financial information in respect of investment funds and similar organisations is dealt with very effectively by the provisions contained in paragraphs 49 and 50 of Financial Reporting Standard 9. Such organisations ". . . should include all investments that are held as part of their investment portfolio in the same way (ie at cost or market value), even those over which the investor has significant influence......". We believe that this concept of "investments held as part of an investment portfolio" is the key to determining an appropriate accounting policy that will provide the most relevant information to the users of these accounts.

We are concerned that the scope exemption in paragraph I, from the requirement to report under IAS 28 and IAS 31, only applies where specifically *fair value* accounting under IAS 39 is applied. In IAS 32.5 fair value is defined as 'the amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arms length transaction'. As it is currently worded, the revised IAS 28 is likely to create problems for reporters where they are unable to identify a suitable measure of fair value to satisfy the requirements of IAS 39.

The current version of IAS 39.70 states that there is a presumption that fair value can be reliably determined for most financial assets but that this presumption can be overcome for an investment in an equity instrument that does not have a quoted market price in an active market and for which other methods of reasonably estimating fair value are clearly inappropriate or unworkable. IAS 39.95 states that a measure of fair value can be considered to be reliable if (a) the variability of the range of reasonable fair value estimates is not significant or (b) if the probabilities of the various estimates within the range can be reasonably assessed and used in estimating fair value. This point is included in paragraph 101 of the exposure draft of IAS 39 and is expanded in paragraph 102 such that ‘if the range of reasonable fair value estimates is significant and the probabilities of the various estimates cannot be reasonably assessed, an entity is precluded from measuring the instrument at fair value. IAS 39 IGC Q&A 70-2 states that if the fair value of an unquoted equity instrument cannot be reliably measured, the instrument should be measured at cost after deduction for impairment. Since IAS 39 clearly envisages circumstances where fair value will not be reliably determinable, it would appear inconsistent for the accounting treatment to default to equity accounting where the investment is held as part of an investment portfolio.

The BVCA has produced valuation guidelines for its members, which discuss the various valuation techniques appropriate for different types of investments. For example, in our guidelines we recommend that early stage investments should normally be valued at cost less impairment unless third party valuations are available. For development stage investments we suggest using either cost less impairment, third party valuation, an earnings multiple or net assets depending on the exercise of judgment and circumstance. For other investments at different stages of maturity, similar possible valuation techniques are available requiring the exercise of judgment regarding the selection of an appropriate method. These are all methodologies for deriving fair value in appropriate circumstances. However, it is clear that for venture capital organisations with unquoted equity investments, there will inevitably be instances where it is not possible to obtain or compute a reliable measure of fair value, for example due to the lack of a track record or recent financial information, as well as the difficulty in making reliable estimates where the nature of business comprises discovery, innovation or development activities.

Finally, with regard to the proposed wording of the scope exemption in paragraph I , the final sentence states that “When such investments are measured at fair value, changes in fair value are included in profit or loss in the period of change.” We are concerned that this precludes venture capital and similar organisations from treating assets that are “available for sale” in accordance with paragraph 103 (b) of the Exposure Draft of Revised IAS39 where gains and losses (other than impairment losses) should be recognised directly in equity. The implication of the proposed wording is that all such assets are all assumed to be “trading assets” for the purpose of IAS 39. We would not wish to impose a definition (one way or the other) on these assets, but rather allow the assets to be treated fully in accordance with IAS 39, whether they are “trading assets” or “available for sale”.

Our Conclusion is that investments in associates held as part of an investment portfolio by venture capital and similar organisations should be recognised in the same way as other portfolio investments, at cost or at market value. In the absence of a reliable measure of fair value, BVCA

companies should also be able to recognise investments at cost less impairment in line with the wider measurement provisions of IAS 39 rather than having to report using equity accounting or the proportional consolidation method as the amendment to the standard appears to suggest. We therefore suggest that the scope exemption in paragraph I should be amended to delete ‘at fair value’ and to remove the requirement to report changes in fair value in profit or loss, such that qualifying investments fall under the broader measurement and reporting requirements of IAS 39.