



Department of Treasury and Finance

Contact: Veronique Row
 Phone: 02 6215 2104
 Our Ref: RMS11/07420

1 Treasury Place
 GPO Box 4379QQ
 Melbourne Victoria 3001
 Telephone: (03) 9651 5111
 Facsimile: (03) 9651 5298
 DX 210759

Mr Kevin Stevenson
 Chairman
 Australian Accounting Standards Board
 PO Box 204
 COLLINS ST WEST VIC 8007

Our Ref:

Dear Mr ^{Kevin}Stevenson

ED 220 Investment Entities

The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) welcomes the opportunity to provide comments to the Australian Accounting Standards Board (AASB) on the International Accounting Standards Board (IASB) Exposure Draft: *Investment Entities*.

HoTARAC has broad concerns that the proposals in the ED are 'rules-based' rather than principles-based and lack a robust conceptual underpinning. HoTARAC is also concerned with the nature of criteria for determining an investment entity, which are subjective and could lead to inconsistent outcomes and management manipulation.

The majority of HoTARAC members share the concerns raised by the AASB in its preface to the ED. In particular, the HoTARAC majority does not consider the ED establishes a sound conceptual basis for the industry-specific departure from the consolidation principle. We consider there should be a single set of requirements and guidance for consolidation. As noted in the ED's Alternative Views paragraph AV3, the IASB proposed to make explicit that the concept of control is central to the concept of a 'reporting entity' in its *Conceptual Framework* project. The HoTARAC majority believes that, if proposals in the ED were to be implemented, it would undermine the work done on, and the validity of, the *Conceptual Framework* project.

From HoTARAC's understanding, the IASB's rationale for the ED (as noted in Basis for Conclusions' paragraphs BC3-BC5) is that the information resulting from the ED would better serve user-needs. HoTARAC acknowledges the tension between user-needs and conceptual reasoning, but a HoTARAC majority is of the view that both characteristics can be reasonably attained with appropriate additional disclosures (see HoTARAC's proposed alternate approach in its detailed response).

Additionally, the HoTARAC majority disagrees with the following proposals:

- The application of differential treatments for controlled investments if the controlling entity is an investment entity with a parent that is not an investment entity.
- That more useful information is provided to users by presenting all investments held by an investment entity on a fair value basis, regardless of whether the investment entity has a controlling interest. In HoTARAC's view a controlling interest fundamentally alters the nature of an investment in that the controlling entity has the capacity to influence financial policies that in turn impact on returns.
- That the requirements of the ED are mandatory if an entity meets the investment entity criteria.
- The removal of the exemption option in IAS 28 *Investments in Associates and Joint Ventures* (as amended in 2011) for non-investment entities of IAS 28 (see response to IASB question 9 for further information).

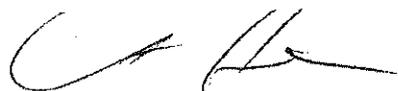
A minority of HoTARAC members, while acknowledging the desirability of a consistent approach to the reporting of controlled entities, agree that there are a class of entities whose primary aim is to achieve capital appreciation and/or investment income and for whom the ability to control the entity is a secondary consideration. The minority of HoTARAC members strongly recommend that if the proposals proceed, the justification be in terms of the business model approach used in IFRS 9 *Financial Instruments*, rather than the control principles of IFRS 10.

HoTARAC has also noted a significant number of inconsistencies and incorrect references in the ED.

HoTARAC's detailed comments, responses to the AASB Specific Matters for Comment and the IASB questions in the exposure draft are attached.

If you have any queries regarding HoTARAC's comments, please contact Veronique Row from the Australian Department of Finance and Deregulation on (02) 6215 2104.

Yours sincerely



Grant Hehir
CHAIR
HEADS OF TREASURIES ACCOUNTING AND REPORTING ADVISORY
COMMITTEE

20 November 2011

Encl

HoTARAC Response to AASB ED 220 *Investment Entities*

AASB Specific Matters for Comment

The AASB would particularly value comments on the following:

1. if the IASB's proposals proceed, whether you agree with the AASB's proposal not to provide relief for Tier 2 entities from the proposed disclosure requirements in paragraphs 9 – 10 and B18 – B20 of this Exposure Draft;

HoTARAC agrees with the AASB's proposal not to provide relief. HoTARAC does not consider entities potentially qualifying as investment entities as Tier 2 as they would probably require a greater level of public accountability. However, HoTARAC would recommend the AASB provide justification for its position, on the basis of its application of the Tier 2 Disclosure Principles, as it has for other topics.

2. whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:

(a) not-for-profit entities; and

(b) public sector entities;

HoTARAC is not aware of any regulatory issues for public sector entities. HoTARAC cannot comment on other NFP entities.

3. whether, overall, the proposals would result in financial statements that would be useful to users;

The broad view of HoTARAC is that the proposals would not result in financial statements that would be useful to users. However, the alternative approach proposed by HoTARAC would go towards meeting some users' needs.

HoTARAC question the conceptual underpinning of different classifications of entities applying different accounting treatments to common sets of facts (this is developed further in HoTARAC responses to the IASB's questions). HoTARAC broadly endorses the significant concerns raised by the AASB in its 'request for comments' cover to the IASB ED, and supports the views expressed in paragraph AV2 on the fundamental importance of the concept of control.

HoTARAC is also concerned with:

- the move towards a 'rules-based' (rather than principles-based) standard;
- the application of judgement to compliance with these rules; and
- the potential this has for manipulation to achieve a desired result by financial statements' preparers.

4. whether the proposals are in the best interests of the Australian economy; and

HoTARAC has no comment.

5. unless already provided in response to specific matters for comment 1 – 4 above:

(a) the types of entities that might be impacted by the proposals; and

(b) the costs and benefits of the proposals, whether from a user or preparer perspective, whether quantitative (financial or non-financial) or qualitative.

(a)

Paragraphs B12 and B13 would appear to exclude most public sector entities apart from some Corporations Act companies and investment vehicles under the proposals.

(b)

Most public sector entities are ultimately consolidated into Whole-of-Government (WoG) financial statements, which, as the WoG would not be considered an investment entity, would be required to consolidate all entities directly or indirectly controlled. Therefore, there would be no overall benefits of the proposals for consolidated government entities. This is also inconsistent with the IASB's view in paragraph BC20, that "... in most cases, investment entities would have investment entity parents".

In these circumstances, the proposed requirement will result in additional costs, where an investment entity subsidiary will be required to account for its controlled investees at fair value through profit or loss in addition to those same entities (investees) being consolidated by the non-investment-entity parent.

Editorial Matter

HoTARAC notes that on the top of page iv of the AASB's 'request for comments' cover to the IASB ED, the incorrect AAS number has been used for 'Life Insurance Contracts'. This should be AASB 1038.

HoTARAC Response to IASB ED 2011/4 *Investment Entities*

General comments

HoTARAC appreciate the IASB returning to a '120-day' comment period.

HoTARAC observes that the IASB have only recently released IFRS 10 and IFRS 12 (and the other related standards), yet the ED appears to be substantiated by commentary received previously in response to ED 10 *Consolidated Financial Statements* (December 2008). Amending these new standards, before their effective mandatory date, appears to be contrary to the notion that standards are best practice at the time of publication.

Given the substantial changes to the consolidation principle introduced under the ED and the departure from the principal based approach to accounting standard development, HoTARAC would also expect the policy changes introduced under the ED to be supported by more substantive evidence than responses to the 2008 Exposure Draft.

HoTARAC has broad concern that the proposals are 'rules-based' rather than principles-based and the overall lack of a robust conceptual underpinning.

The majority of HoTARAC members strongly disagree with the proposed industry-specific departure from the consolidation principle; an entity should be consolidated where the control principles are met, unless a sound conceptual basis is established for departing from this principle.

The majority of HoTARAC does not consider there to be conceptual justification or rationale for the proposed change. Accordingly, and consistent with HoTARAC's response to ED 10, there should be a consistent control principle for consolidation for all entities.

The majority of HoTARAC questions the rationale behind the different application of the ED to entities within a consolidated entity where the parent is not an investment entity. Apart from the conceptual inconsistency mentioned above, there are practical issues raised by the proposal as per Mr Yamada's comment (refer AV13). As the proposed application of the ED is mandatory (paragraph 6 of the ED states the investment entity 'shall not consolidate the entities it controls'), investment entities that have a non-investment parent will effectively be subject to increased disclosures and costs. Firstly, to apply the requirements of the ED, and secondly, to apply conventional consolidation techniques when preparing statements for the consolidating entity.

A minority of HoTARAC members, while acknowledging the desirability of a consistent approach to the reporting of controlled entities, agreed that there were a class of entities whose primary aim is to achieve capital appreciation and/or investment income and for whom the ability to control the entity is a secondary consideration. The minority of HoTARAC members viewed a requirement to consolidate investees for this class of entities as potentially giving rise to significant inefficiencies, particularly where the entity's holdings can change significantly from time to time for reasons unrelated to controlling the activities of the investee. The minority of HoTARAC members strongly recommend that if the proposals proceed the justification be distanced from the concept of control under IFRS 10 and an approach based on business models, similar to the approach taken in IFRS 9 *Financial Instruments*, be used.

HoTARAC would like the IASB to be aware that there are a substantial number of editorial matters relating to the ED, including inconsistencies and incorrect references, which have been addressed at the end of this response.

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?

The majority of HoTARAC strongly disagrees with the proposal.

The majority of HoTARAC members believe that entities that meet the definition of ‘control’ should be consolidated. In the HoTARAC majority’s view the Board’s Basis for Conclusions do not establish a strong enough conceptual case for departure from this principle. BC3-BC5, as discussed further below, are solely based on users’ needs rather than reasoning from a conceptual basis. HoTARAC acknowledges the tension between users’ need and conceptual reasoning but the HoTARAC majority is of the view that both characteristics can be reasonably attained with appropriate additional disclosures (see HoTARAC’s proposed Alternative Approach in the Other Comments section of this response).

The majority of HoTARAC members agree with the alternative views articulated in paragraphs AV1 to AV13, particularly the view of paragraph AV2 that control is fundamental to the preparation and presentation of financial statements.

With regard to the rationale set out in the Basis for Conclusions, a majority of HoTARAC members have the following comments:

- HoTARAC agrees with paragraph BC2, which provides a snapshot of the project’s history, and refers to the Board having “always sought to avoid requirements that are industry-specific, focusing instead on the nature of transactions, rather than on the nature of the entities involved”. The ED represents a departure from that objective.
- HoTARAC notes that subsidiaries are ultimately consolidated if there is a non-investment-entity parent, compromising the credibility of the arguments for the departure and also resulting in inconsistent treatment, reducing users’ ability to compare entities’ financial position. Contrary to paragraph BC20, HoTARAC would like the IASB to be aware that, in the public sector, it is likely that the ultimate parent would be a non-investment entity. The argument of paragraph BC3, that the fair value of the investment is the most useful information to users, is therefore questionable (this is further discussed in the response to question 6).
- HoTARAC disagrees with the arguments of BC4 that consolidating controlled entities will reduce comparability in the financial statements between controlled and non-controlled investments. When the investor has a controlling interest the nature of the investment is fundamentally different as the investor controls the financial policies underpinning those returns. This is consistent with the view expressed in AV7.

- HoTARAC recognises the importance of fair values information to investors articulated in paragraph BC5. However, HoTARAC does not believe this constitutes sufficient justification for the change. Alternative options, such as additional disclosure as suggested in paragraph AV5, would be more appropriate rather than changing a core principle of financial reporting.

HoTARAC is concerned with the subjective nature of the criteria, in particular paragraph B5(b) allows an entity to be classified an investment entity where “the entity has not yet identified suitable investments and therefore has not yet executed its investment plan to acquire multiple investments”. This could easily result in inconsistencies and management manipulation given the subjective nature of the criteria (this point is also raised in the response to question 2).

HoTARAC Minority View

As noted above, a HoTARAC minority were sympathetic to the objectives the proposals seek to achieve. The minority agreed that there were a class of entities whose primary aim is to achieve capital appreciation and/or investment income and for whom the ability to control the entity is a secondary consideration. The minority consider that the relative stakes these ‘investment entities’ hold in other entities will change from time to time for reasons such as fund additions and withdrawals and portfolio rebalancing in line with investment objectives. Accordingly, the ‘investment entity’ will form a different relationships to its investments compared to situations where the primary objective is control of the activities of the investee.

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

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?

HoTARAC disagrees with the criteria.

HoTARAC agrees with the concern of paragraph AV11 that the criteria are highly subjective. This could foreseeably result in inconsistencies and management manipulation, hence at best reducing comparability between entities (when comparability is one of the reasons for the ED’s proposals) and at worse misleading users of financial statements’ information. One of the characteristic of high quality standards is, in HoTARAC’s view, that similar transactions are reflected the same for all entities. Accordingly, to provide specific exemptions from the control concept without a strong conceptual basis would result in reducing the quality of standards issued by the IASB.

In HoTARAC’s view, another characteristic of high quality standards is that consensus between preparers and auditors on interpreting the standard is achieved without lengthy deliberation. The high level of subjectivity introduced in this proposal is likely to result in different interpretations.

The following are examples of subjectivity that may be introduced by ED's proposals:

- The terms 'substantive' and 'substantially all' are used in paragraph 2(a) and (e) respectively without being defined. Paragraph BC10 acknowledges issues surrounding the consistency of terminology interpretations in US GAAP; HoTARAC is not convinced this issue can be resolved through the use of the term 'substantive' rather than 'primary'. Two slightly different investment-type entities could be required to follow differing accounting requirements depending on interpretation of the terms used. HoTARAC views the evidence requirements of paragraphs B8, B10 and B11 as too subjective and easy to manipulate. HoTARAC believes evidence should be restricted to primary evidence such as the entity's constitution, charter and business plans where such evidence is available. The use of less subjective, concrete evidence would corroborate the business purpose and remove some of the opportunities for manipulation.
- BC7 states that 'it is essential to define carefully the appropriate population of entities that are required to use the exception'. HoTARAC does not believe that this has been achieved due to the subjective nature of the criteria as discussed above.

HoTARAC notes the inconsistency between paragraph 2(e) which states 'substantially all of the investments ... on a fair value basis' and its accompanying guidance paragraph B17 which states 'all controlled investments ... on a fair value basis'. Notwithstanding the above, HoTARAC generally agrees with paragraph B9 on the need for an investment entity to have an exit strategy from its investments and an explicit commitment to its investors of the specified purpose of the entity.

Question 3 – 'Nature of the investment activity' (paragraphs 2(a) and B1–B6)

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?

HoTARAC does not agree that an entity should be eligible to meet the criteria for an investment entity under either question 3(a) or (b).

Criterion paragraph 2(a) of the ED limits investment entities to those whose only substantive activities are the investing in multiple investments for capital appreciation, investment income or both. An entity would only meet this criterion where its service relating to investment activities are not substantive.

Question 4 – ‘Pooling of funds’ (paragraphs 2(d) and B14–B16)

(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.

HoTARAC does not believe an entity with a single investor unrelated to the fund manager should be eligible to qualify as an investment entity.

HoTARAC agrees with paragraph BC16 that treating an entity with a single investor as an investment entity opens the door for potential manipulation, which is a general concern with the proposals in the ED.

HoTARAC notes that this position would have consequences for dealing with a pooling of related investors treated as one single investor, being that in this circumstance, the entity would not meet the investment entity criteria.

HoTARAC notes that it is likely that in the instance of a single investor, this investor would control the entity. If the investor is a reporting entity that is not classified as an investment entity, it would be required to consolidate its investment in the potential ‘investment entity’ and its subsidiaries. This illustrates the inconsistency of the proposals.

Question 5 – Measurement guidance (paragraphs 6 and 7)

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?

HoTARAC agrees that investment properties should be accounted for in accordance with IAS 40’s fair value model for consistency, and that there is no reason to depart from this standard. However, HoTARAC notes that the cost model under IAS 16 *Property, Plant and Equipment* may be applicable under certain circumstances. In these circumstances, under criterion paragraph 2(e) of the ED, HoTARAC understands that these investment entities should be consolidated by the parent entity.

HoTARAC agrees that the measurement guidance other than investment properties would only apply to financial assets.

HoTARAC notes that IFRS 13 *Fair Value Measurement*, applicable from 1 January 2013, will replace the fair value methods and assumptions of IAS 40.

Question 6 – Accounting in the consolidated financial statements of a non-investment entity parent (paragraph 8)

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?

HoTARAC broadly agrees.

As noted in the comments above, the majority of HoTARAC believes that entities that satisfy the definition of 'control' should be consolidated, regardless of whether or not the parent is an investment entity.

However, the majority of HoTARAC disagrees with the inconsistent application of accounting treatments at various stages of the consolidation process where there is more than one level of consolidation. For example, where an ultimate non-investment entity parent consolidates a subsidiary investment entity parent and its subsidiaries, but the subsidiary parent applies fair value through profit or loss for its subsidiaries. This proposal contradicts the rationale behind BC3 that investors are more interested in the fair value of entities consolidated by an investment entity (as noted in the response to question 1).

The majority of HoTARAC members do not support the disconnection between the reporting of subsidiaries as investment entities and the parent entity. This creates confusion for the users and does not support the comparability characteristic of useful information included in the IASB Conceptual Framework.

A minority of HoTARAC members agrees with the underlying logic of requiring non-investment parent entities of investment entities to consolidate all controlled subsidiaries.

HoTARAC broadly agrees with the concerns raised in paragraph BC20 on the potential for accounting inconsistencies and manipulation of financial statements if the parent entity retains the fair value treatment on consolidation.

Further, the ED (in the summary of information before question 6 of the IASB's invitation to comment section) suggests that the Board 'thinks' that "in most cases, investment entities do not have non-investment entity parents". HoTARAC believes the IASB should support broad statements of this type with empirical evidence.

Question 7 – Disclosure (paragraphs 9 and 10)

(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?

HoTARAC reiterates its opposition to the proposed industry-specific exemption from consolidation.

(a)

HoTARAC agrees with the disclosure requirements of paragraph 9, but disagrees with those of paragraph 10.

HoTARAC supports principle-based requirements. However, the ED not only proposes a principle-based requirement in paragraph 9, it goes on to provide rule-based disclosure requirements in paragraph 10 and the application guidance of paragraphs B18 and B19 (there is risk the examples of B19 may be considered to be a requirement from an auditor's perspective particularly given that these are included in Appendix B that is an integral part of the standard). HoTARAC agrees with the conclusion of BC22 that a key piece of useful information to users is understanding an investment entity's exposure to risk. HoTARAC recommends that a comment to reflect this be included in the disclosure objective contained in paragraph 9. This principle-based requirement should, in HoTARAC's view, be sufficient to cover the rule-based requirement included in paragraph 10. Paragraph 10's requirements could in turn be transferred to Appendix B as examples to comply with the paragraph 9 disclosure objective.

HoTARAC acknowledges that the Board has considered the potential burden of providing the level of disclosure required and provided assistance by including paragraph B20 and in paragraph B18 permitting including subsidiary financial statements in a parent entity's financial statements to reduce duplication of effort.

As mentioned above, HoTARAC agrees with the conclusion of paragraph BC21 not to propose additional fair value measurement disclosures and paragraph BC25 on focussing on the nature and financial effect rather than prescribing disclosures.

(b)

HoTARAC does not agree with the application guidance of paragraphs B18 and B19 for the reasons outlined above.

HoTARAC supports paragraph B20 on the need to avoid duplication.

Question 8 – Transition (paragraph C2)

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?

HoTARAC agrees with prospective application. Specifically, HoTARAC agrees with the rationale provided in BC26 that retrospective disclosure would be impracticable, could involve hindsight and would be too onerous.

HoTARAC proposes that if the ED proceeds, it should have the same effective date as the IFRS 10 suite of standards and therefore agree with the related comments in BC32 that adoption should be contemporaneous with IFRS 10, IFRS 11, IFRS 12 and IAS 28.

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?

(a)

The majority of HoTARAC do not agree to the amendment to IAS 28.

As noted in the ED this would impact on those entities currently applying the exemption that did not qualify as investment entities. Additionally, application of the exemption for those entities qualifying as investment entities would be mandatory. The majority of HoTARAC disagree with the ED proposals, but at a minimum they should be voluntary.

HoTARAC does not believe the rationale for this change in paragraphs BC28 and BC29 of producing information more relevant to users of financial statements has been justified in the ED.

A minority of HoTARAC members is of the view that the mandatory measurement exemption should only apply to investment entities this being consistent with the ED's proposals.

(b)

A majority of HoTARAC members considers this marginally preferable as it would have less impact on entities applying the existing exemption. As noted in the responses to the other questions, HoTARAC has significant concerns on the proposals being mandatory if an entity meets the criteria for an investment entity.

Other Comments

HoTARAC has noted significant editorial matters below.

HoTARAC recommends the proposed amendment to IAS 28 *Investments in Associates and Joint Ventures* of the third bullet point of Appendix D be justified or reviewed as this does not appear consistent with the underlying logic of the ED's proposals that a non-investment entity parent be required to consolidate an investment entity subsidiary.

HoTARAC has had difficulties in articulating its response because, as discussed in the responses to questions 1 and 2, 'investment entities' has been poorly defined.

Basis for Conclusions' Benefits and Costs

- HoTARAC questions the benefit to users of the ED. For example, two different methods are used to account for the same controlled entity where there is a 'non-investment-entity parent'. This is contrary to the principles-based rationale found in the newly released IFRS 11 which sort to reduce subjectivity and apply consistent accounting rules for similar controlled joint arrangements.
- HoTARAC disagrees with paragraph BC31 that the proposals are an improvement to IFRS because, as outlined in our responses above, they add further subjectivity to accounting standards, introduce an industry-specific exception to the consolidation principle, and lack a robust conceptual underpinning.
- HoTARAC notes that paragraph BC30 provides a different objective of financial reporting to that of paragraph OB2 of the Framework¹.

Alternative Views

HoTARAC has outlined many of its concerns with the ED in the responses to questions 1 to 8. HoTARAC's view is consistent with many of the alternative views of Warren J McGregor, Sir David Tweedie and Tatsumi Yamada in relation to conceptual weaknesses in the ED. HoTARAC particularly supports:

- AV1, AV2 and AV3 – if the criteria for control is met the entity should be consolidated otherwise the financial statements are less representationally faithful. The concept of control is fundamental to the preparation and presentation of financial statements and central to determining the boundaries of a reporting entity as mentioned in HoTARAC's response to ED 2010/2 *Conceptual Framework for Financial Reporting: The Reporting Entity*.
- AV4-AV8 – HoTARAC agrees that the Basis for Conclusions paragraphs BC3-BC6 are not persuasive enough for an exception to the principle all controlled entities should be consolidated (as discussed in the response to IASB question 1 above).
- AV9-AV12 – HoTARAC agrees that financial reporting requirements should be principle-based and contain few, if any, exceptions which need to be carefully constructed. HoTARAC also agrees that significant pressure could easily be placed on the criteria/definition of an investment entity so entities can avoid the cost of consolidation and/or seek to avoid revealing the underlying financial position of controlled entities given its highly subjective nature. Consequently, HoTARAC also agrees that the proposals might result in a reduction in the quality of financial reporting (and thus is not an improvement as suggested by BC31) and that the Interpretations Committee may therefore be required to expend considerable resources on maintaining this exception.

¹ OB2 of the Framework states the objective of financial reporting as "to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity".

- AV13 – HoTARAC shares Mr Yamada’s concern in relation to the differing treatment where there is a non-investment-entity parent.

Alternative approach:

The majority of HoTARAC propose the following alternative approach:

- ED objective: Disclosure of fair value for assets held for investment purposes that are consolidated. Similar to assurance transactions and superannuation plans, the focus is on the transaction/economic event rather than the entity.
- Investment assets could be defined as assets held for capital appreciation and/or investment income (excluding loans which may be reported at amortised cost as per the finalised requirements of IFRS 9).
- Requirement: Disclosure of fair value for these asset types on a principle-based approach such as ED 220 paragraph 9.

Advantages of this approach:

- Consistent with the consolidation concept and other IFRSs.
- Provides additional information to users and acknowledges users’ needs.
- Principle-based.
- Flexible enough to meet US GAAP requirement (additional disclosure for reporting by US companies would still be consistent with IFRSs).
- Does not attempt to define an investment entity, which increases subjectivity and the potential for management manipulation.
- Meets high quality standards criteria. In particular, it retains comparability between entities (e.g. parent/subsidiary).

Editorial Matters

HoTARAC appreciates the IASB presenting the proposal as a single draft IFRS for the convenience of the reader and acknowledge that the draft IFRS proposals, if it proceed as outlined in ED 220 will require amendments to IFRS 10 and IFRS 12. Accordingly, it would be appreciated if the IASB made these IFRSs freely available on their website to allow constituents to properly review the ED proposals and alignment with IFRS 10 and IFRS 12. HoTARAC has used the Australian IFRS equivalent standards AASB 10 and AASB 12 to assess the proposals. HoTARAC notes:

- Defined terms:
 - ‘Affiliate’ is first used in the draft Application Guidance paragraph B6 and is not italicised. This term is currently not used in IFRS 10, which is where Appendix D of the ED proposes to add the defined term and associated application guidance paragraphs. HoTARAC recommends deletion of this term from the Application Guidance and from the Appendix A as it creates more confusion between the entities that are controlled by entity A and the entity that controls entity A, the former should be referred to as controlled

entities or subsidiaries; the latter as the parent entity A. There is no need to bring another term.

- HoTARAC questions the inclusion of the term 'control' in the draft and referencing it to IFRS 10; IFRS 10 defines 'control of an investee' not 'control' (IFRS 10 does not cover control of assets).
- Investment entity definition/criteria:
 - B7, B12 (and possibly others) refer to 'the definition of an investment entity ...' but this is not a 'defined term' in Appendix A, rather it is a set of 'criteria' in paragraph 2. Note that Appendix D states that the definition will be added to IAS 27, but it is unclear whether this definition will be the draft's paragraph 2 criteria or something else given that paragraph 2 will be added to IFRS 10. HoTARAC also notes that the amendment to IAS 28 as per the commentary in Basis for Conclusions BC28 use the draft's paragraph 2 criteria.
- Appendix D other amendments to IFRSs (i.e. alignment issues):
 - Proposes amendments in the first dot point of page 24 without providing a detailed example of the amendment (most importantly, wording) for which to comment on to ensure its appropriateness.
 - Amendments to IFRS 10 (Appendix D, page 24). HoTARAC believes that:
 - the reference to IFRS 10 paragraph 18 should be paragraph 19 (but again given that the example is not provided it is difficult to determine). Also, IFRS 10 guidance paragraph B81 is not in the 'accounting requirements' guidance section (which starts at B86).
 - the draft IFRSs paragraphs 2 and 3-5 should follow after IFRS 10 paragraph 18 and not IFRS 10 paragraph 17.
 - the draft IFRSs paragraphs 6-8 should follow after IFRS 10 paragraph 26 and not IFRS 10 paragraph 25. Additionally, this new section should require a title, i.e. 'Measurement of controlled entities for investment entities'.
 - there may be other editorial alignment issues with IFRS 10 and possibly with the other IFRSs (with one noted below), but have not completely assessed the alignment of the draft IFRS with that of the other standards it proposes to amend.
 - IAS 28 *Investments in Associates and Joint Ventures* (as amended in 2011) second dot point refers to paragraph 13B of IAS 28. This paragraph was in the IAS 28 applicable prior to the 2011 amendments. HoTARAC believes the proposed amendment refers to paragraph 18 which is consistent with the summary of information before question 9 of the IASB's invitation to comment section of the ED.

- Alternative Views:
 - AV14: HoTARAC believes the disagreement is with paragraph 6 and not paragraph 8 given that the requirement disagreed with is contained in paragraph 6 and not paragraph 8.