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By Email: standard@aasb.gov.au

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Dear Kevin

Exposure Draft Investment Entities (ED 220 – IASB ED/2011/4)

Grant Thornton Australia Limited (Grant Thornton) is pleased to provide the Australian Accounting Standards Board with its comments on ED 220 which is a re-badged copy of the International Accounting Standards Board's (the Board) Exposure Draft Investment Entities (ED/2011/4)

Grant Thornton's response reflects our position as auditors and business advisers to the Australian business community. We work with listed and privately held companies, government, industry, and not-for-profit organisations (NFPs). This submission has benefited with input from our clients, Grant Thornton International which will be finalising a global submission to the IASB by its due date of 5 January 2012, and discussions with key constituents.

We have considered the ED, as well as the accompanying draft Basis for Conclusions. In summary, our main views are as follows:

- we support the proposed exemption although we believe the decision on whether to proceed with it should be primarily determined by the needs of users

- we have a number of concerns over the proposed criteria for identifying an investment entity, in particular whether they will result in the scope of the proposed exemption being too narrowly drawn

- we believe that further consideration needs to be given to the proposed exemption to situations involving single investor entities. We do not believe that groups should be able to do whatever they wanted in practice. Reliance on the 'business model concept' by itself may not be enough and that there needed to be some emphasis on external investors requirements

- we believe that where an investment entity is controlled by a non-investment entity, it should be possible for the exemption from consolidation to extend to the parent

- we do not believe there is any need to change the scope of IAS 28.

- We do not share the preliminary view of the AASB on concerns about the conceptual underpinning for proposals and their rules-based nature.

We expand on these comments in our responses to the specific questions raised in the ED's Invitation to Comment section, which are set out in the Appendix.

If you require any further information or comment, please contact me.

Yours sincerely
GRANT THORNTON AUSTRALIA LIMITED

Keith Reilly
National Head of Professional Standards

A. IASB invitation to comment questions

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?

We believe that there is a class of entities that may hold controlling interests in investments for capital appreciation and/or investment income rather than for operational purposes.

While we believe that consolidation will generally provide the most relevant and useful information for a group, we are aware that the current requirement to consolidate any portfolio holdings controlled by a parent, has been one of the most contentious issues for such investment entities. In particular, there have been concerns over the usefulness of financial statements which allow information on the trading activity of a small number of investee companies to distort the reported investment performance of an entity's overall investment portfolio.

Where this is the case, allowing them to account for such holdings at fair value through profit or loss rather than by consolidating them may more accurately reflect the underlying reasons for holding the investments.

We therefore support the proposed exemption from consolidation for 'investment entities'. We believe however that the Board should primarily be influenced by the needs of users in deciding whether to proceed with this project. If users are telling the Board that the financial statements they are receiving are not providing useful information, then the Board should listen to their views.

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?

While we are supportive of the proposed exemption when viewed as a whole, we have a number of concerns over specific aspects of the proposed criteria for identifying an investment entity which we set out below. In particular we are concerned whether they will result in the scope of the proposed exemption being too narrowly drawn, thereby preventing those companies most in need of it from using it.

Nature of the investment entity/business purpose

We believe these two criteria are broadly appropriate. We suggest however that the proposed exemption could be made more principles-based by combining the two criteria, with the overall emphasis being on the business model being that of an investment entity.

Unit ownership

We question how this criterion will affect those investment entities whose capital structure consists of tranches which differ in their exposure to risk. In a waterfall type structure, each

unit of ownership may not necessarily represent a specifically identifiable portion of the net assets of the investment entity. This would mean such entities would not be able to use the proposed exemption even though they are in nature investment entities.

We also suggest that further application guidance is added to address situations where an investment entity has ownership interests that do not meet the criteria for equity classification.

Pooling of funds

We agree that the ability of investors to benefit from professional investment management is an important aspect of what we consider to be an investment entity. As set out in our answer to question 6, however, we believe that an entity with a single investor unrelated to the fund manager should be eligible to qualify as an investment entity. Accordingly, we do not see why it should not be possible to look through to the ultimate investors of a non-investment entity in the same way as is envisaged for an investment entity parent in B16 of the ED. As currently worded, we can see the criterion leading to problems for entities such as pension plans' master funds. It appears that such entities would not be able to use the exemption although we would consider them to be investment entities by nature.

Overall then, we would prefer that investors' ability to benefit from professional investment management is considered as part of determining whether an entity's business model is that of an investment entity rather than as part of a separate criterion.

If this criterion is retained, we believe additional guidance should be provided on how to interpret the term 'unrelated' in this context.

Fair value management

We are concerned that some entities, which are commonly thought of as investment entities in nature, will not meet this criterion and will therefore not be able to use the proposed exemption.

Private equity companies for instance hold investments for capital appreciation and/or investment income and will in many cases meet the 'nature of the investment activity' and 'business purpose' criteria. Such entities hold investments with the overall aim of benefiting from increases in the fair value of the investments they hold but often take an active interest in the development of those investments. As a result, they may well evaluate the performance of their investments on a day to day, or even month to month basis, by reference to the operational results of the investment, key performance ratios, etc rather than on a fair value basis. Investment property funds that are actively involved in the development or operation of properties may similarly fail to meet this criterion.

The proposed exemption has surely been developed with such entities in mind, but as currently worded they would be excluded from using it. We therefore suggest that the wording of this criterion is relaxed, and greater emphasis placed on an entity's business model in deciding whether it can use the exemption.

Providing financial information to investors
We do not have any significant concerns over this criterion.

Other points
B9 in the ED states that "an entity should have an exit strategy documenting how the entity plans to realise capital appreciation of its investments". If this is a requirement, we believe that it should be included in the criteria used to determine whether an entity is an investment entity. We would prefer, however, that an exit strategy is instead referred to as an indicator in determining whether an entity's business model is that of an investment entity. It would also be useful to clarify whether the Board believes it is necessary for the entity to have a defined exit strategy for each individual investment. Similarly, whether an entity can hold an investment for investment income purposes without any defined exit strategy and still qualify for the exemption.

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?
We believe that the purpose of introducing an exemption from consolidation for investment entities is to allow them to produce information which reflects their underlying business model. We do not believe this should be affected by whether an investment entity provides investment services to its own investment business. Accordingly we believe that an entity should still be eligible to qualify as an investment entity in such circumstances.

Where an entity provides a significant level of services that relate to the investment activities of entities other than the reporting entity however, the nature of the entity's business model will be different. Given our belief that consolidation will generally provide the most relevant and useful information for a group, we do not think it appropriate to extend the exemption from consolidation to cover such circumstances.

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?

(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.
As mentioned in our covering letter, we believe that it should be possible for the exemption from consolidation to extend to the parent where an investment entity is controlled by a non-investment entity.

If the investment entity exemption is considered to provide the users of the financial statements with more meaningful information, then we do not see why this should not

apply in the case of single investor entities. Accordingly we believe that an entity with a single investor unrelated to the fund manager should be eligible to qualify as an investment entity. Were this not to be the case, we can see problems being encountered in fund of funds type scenarios. The exemption would not be available for use in such situations even though such structures are specifically designed for investment purposes.

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?

We agree that investment entities that hold investment properties should be required to apply the fair value model in IAS 40.

Justification for the proposed exemption from consolidation is based on the premise that users of an investment entity's financial statements find information on investments to be more useful when measured at fair value. It would then be inconsistent to permit such entities to choose to measure any investment properties held under IAS 40's cost model.

We also agree that the measurement guidance otherwise proposed in the ED need apply only to financial assets.

The Exposure Draft thinks of investment entities as holding investments for capital appreciation and/or investment income rather than for operational purposes. Although IFRS includes many instances where a non-financial asset is required or permitted to be measured at fair value, we expect that the scope criteria in IAS 39.5 relating to non-financial assets that can be net settled will be sufficient to ensure that non-financial assets that are actively managed for capital appreciation and/or investment income will be accounted for at fair value.

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?

We disagree with this part of the proposals. If the justification for introducing an exemption from consolidation for investment entities is that it provides more useful information for users by reflecting the nature of such entities' activities more accurately, then it would seem strange to discard this information further up the group. It will also mean that all cost savings from introducing an exemption will be lost in a group where the ultimate parent is not an investment entity.

We acknowledge the anti-abuse concerns that are behind this part of the proposals, however we believe that an entity's principal aim should be to produce information that is useful for their users.

We note that the Board expresses specific concern in the ED about the appropriate accounting if a non-investment entity parent were to issue its equity instruments to an investee of its investment entity subsidiary. An alternative way of addressing this specific concern could be to simply prohibit use of the exemption from consolidation at non-investment parent company level where such a situation has occurred. While we are generally opposed to the introduction of rules-based exceptions such as the one we are suggesting, we note that the Board thinks that in most cases, investment entities do not have non-investment entity parents. If this is the case, then such a prohibition would only apply in very limited circumstances and should therefore have minimal practical impact.

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?

We agree. Having such an objective should help to provide information which is tailored to the individual circumstances of the reporting entity, and which is accordingly more useful to users of the financial statements.

(b) Do you agree with the proposed application guidance on information that could satisfy the disclosure objective? If not, why not and what would you propose instead?

We agree with including this material as application guidance rather than in the main part of the Standard, as it reduces the risk of it being interpreted as a list of requirements.

This risk remains however, even when included in the proposed application guidance. To further reduce the risk of entities making 'boilerplate' disclosures, we suggest additional wording is added to explicitly state that individual items within the list do not need to be disclosed where they are not relevant to the reporting entity's circumstances, and also that the list of examples is not intended to be exhaustive.

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?

We are generally in favour of practical expedients that allow improvements to IFRSs to be made without undue cost. We therefore support prospective application of the proposals and the related transition requirements.

We note however that some investment entities may already have compiled fair value information for their own performance analysis which would enable them to apply the requirements retrospectively. We therefore suggest that entities should have the option of retrospectively applying the proposals where the necessary information is available and the entity wishes to do so.

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?

We disagree. We are unaware of any significant dissatisfaction with the operation of the existing scope exemption in IAS 28 and therefore do not believe that there is any need to amend the Standard.

We acknowledge that there are gains to be derived from aligning the exemption from application of the equity method in IAS 28 with the proposals in the ED in terms of comparability and ease of application. In view of the apparent lack of demand for change from users in this area, however, we question whether these benefits would outweigh the costs of change.

(b) As an alternative, would you agree with an amendment to IAS 28 that would make the measurement exemption mandatory for investment entities as defined in the exposure draft and voluntary for other venture capital organisations, mutual funds, unit trusts and similar entities, including investment-linked insurance funds? Why or why not?

We do not favour making the measurement exemption in IAS 28 mandatory for investment entities as defined in the ED. We believe that entities should be able to select the accounting that most accurately reflects the relationship they have with particular investments. Accordingly, we do not see any need to alter the existing optional exemption from application of the equity method.

Other comments and drafting points

Other comments

We outline below a number of areas where we feel the proposals might be improved.

Deferred tax

We suggest the deferred tax implications of the exemption need to be addressed, in particular whether the initial recognition exemption in IAS 12 applies

Transition provisions

We suggest that the transition provisions need to clarify the accounting in situations involving:

- business combinations
- treatment of non-controlling interests
- treatment of entities that have previously been equity accounted for.

Separate financial statements

We disagree with the proposed amendment to IAS 27 *Separate Financial Statements* which would require an investment entity that prepares separate financial statements to measure its investments in subsidiaries, jointly controlled entities and associates at fair value through profit or loss. We feel this amendment would result in an investment entity's separate

financial statements looking exactly like the consolidated ones, thereby defeating the purpose of producing them.

Drafting points

- we suggest that rental income is added to the list of example of investment income given in paragraph 2(a) of the ED
- paragraph 4 of the ED contains what would be a disclosure requirement - we suggest this is moved to the disclosure section of any final Standard
- paragraph 7(b) does not appear to be an exception to paragraph 6
- paragraph B19 should refer to paragraph 9 not paragraph 10 of the ED
- proposed amendments to IAS 28 – we suggest deleting the reference to parent's retained earnings in the last paragraph as there is not a parent-subsidiary relationship here

B. AASB invitation to comment questions

Question 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;

We agree with the proposal to not provide disclosure relief.

Question 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;

We are not aware of any regulatory issues.

Question 3

Whether, overall, the proposals would result in financial statements that would be useful to users;

We agree that the proposals would result in financial statements that would be useful to users.

Question 4

Whether the proposals are in the best interests of the Australian economy; and

We agree that the proposals are in the best interests of the Australian economy.

Question 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.

We have no further comment.