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Re: ***EFRAG draft comment letter on IASB Exposure Draft on Investment Entities (ED/2011/4)***

Dear Francoise,

We are pleased to have the opportunity to comment on your draft comment letter on IASB *Exposure Draft on Investment Entities* (the ED).

General remarks on the usefulness of the ED

OIC understands that on several occasions in the last years the private equity and venture capital industry expressed concerns on the accounting for investment entities, questioning the usefulness for investors of financial statements where investments in controlled entities are consolidated rather than measured at fair value, which is believed the most useful information for investors.

However, we do not believe that users' needs would be best served by eliminating consolidation and we have not found strong evidence that the primary users' need is to have fair value information. In general terms we would prefer that, when the introduction of a new accounting rule is justified invoking the information preferences expressed by some categories of market participants – like in this case, investors – a documented evidence of those preferences (collected during consultation, outreach, etc.) would accompany the exposure draft.

Having said that, we tend to support the alternative view reported in the ED disagreeing with the proposal to introduce an exception to the principle of consolidation. Therefore, we believe that the needs of users of financial statements would be better served by consolidating controlled investees and disclosing the fair value information in the notes or/and providing separate financial statements for the investment entity showing all controlled investees at fair value.

In our opinion, the current IAS 27 and IFRS 10 approach, accompanied with the requirement (to be introduced) of disclosing fair value in the notes and separate financial statements would allow:

a) to be consistent with the general control approach of IAS 27 and IFRS 10;
b) to report in the consolidated financial statement the financial situation of the entire group as a whole and, consequently, the correct picture of the group's leverage and liabilities;
c) to take in any case the benefit of the information on fair value in the notes to consolidated financial statement or/and in the presentation of separate financial statement;
d) to avoid potential risk of abuse of those parent entities that could selectively use investment entities with the aim of excluding certain subsidiaries from the scope of consolidation and by this way hiding the actual financial position of the overall group: <u>financial crisis has clearly demonstrated that many entities sought (and seek) to avoid to consolidate losses or liabilities of certain subsidiaries / SPEs</u>.

Our underlying reasons could be summarized by the current Basis for Conclusions of IFRS 10 BCZ28: "*The Board concluded that for investments under the control of private equity entities, users' information needs are best served by financial statements in which those investments are consolidated, thus revealing the extent of the operations of the entities they control. The Board noted that a parent can either present information about the fair value of those investments in the notes to the consolidated financial statements or prepare separate financial statements in addition to its consolidated financial statements, presenting those investments at cost or at fair value. By contrast, the Board decided that information needs of users of financial statements would not be well served if those controlling investments were measured only at fair value. This would leave the assets and liabilities of a controlled entity unreported. It is conceivable that an investment in a large, highly geared subsidiary would have only a small fair value. Reporting that value alone would prevent a user from being able to assess the financial position, results and cash flows of the group*".

Besides, because the ED provides an exception at the entity level (investment entity yes or not), the ED contradicts IASB approach to avoid requirements that are industry-specific, focusing on the nature of the entities involved rather than on the nature of transactions.

Consolidated financial statements of a non-investment parent of the investment entity

Consistently with the general principle established in IAS 27 and IFRS 10 ("all subsidiaries must be consolidated"), we would like to retain the IASB anti-abuse rule providing that a parent of an investment entity – regardless of whether is an investment entity or not – shall consolidate all entities that it controls, including those controlled through an investment entity. In this way no derogation will be granted to that general principle.

Potential conflicts with EU Accounting Framework

We would like to emphasize that potential conflicts with European accounting framework could arise from the endorsement of the draft standard on investment entities.
As per the EU Commission's 2003 interpretation[1], since the Reg. 1606/2002 only applies to consolidated financial statements, it takes effect only where such consolidated accounts are otherwise required. The determination of whether or not a company is required to prepare consolidated accounts should be made by reference to the Seventh Council Directive as implemented in each jurisdiction by the national law. If according to these European provisions, consolidated accounts are so required, endorsed IFRSs would dictate the scope of consolidation and, therefore, which entities should be included in those consolidated accounts and how they should be treated.
The endorsement of the Exposure Draft as it stands now would produce a paradoxical outcome in the case of an investment entity which owns only controlled entities. In fact, while the Seventh Directive would require the investment entity to prepare consolidated financial statement, the draft standard will prevent consolidation of all the controlled entities owned by the investment entity. A formal but not substantial compliance with the interpretation process described above would take place: Accounting Directives (as implemented in each members State) would require to prepare consolidated financial statement, while consolidated financial statement will no longer exist in practice.

Yours sincerely,

Angelo Casò
(OIC Chairman)

[1] EU Commission - Comments concerning certain Articles of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards and the Fourth Council Directive 78/660/EEC of 25 July 1978 and the Seventh Council Directive 83/349/EEC of 13 June 1983 on accounting, Brussels, November 2003.