International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

15 September 2014

Dear Sirs,

Re: BVCA response to the IASB exposure draft ED/2014/2 Investment entities, applying the consolidation exception

The British Private Equity and Venture Capital Association ("BVCA") is the industry body for the private equity and venture capital industry in the UK. With a membership of over 500 firms, the BVCA represents the vast majority of all UK based private equity and venture capital firms, as well as their professional advisers. This submission has been prepared by the BVCA's Legal & Technical Committee, which represents the interests of BVCA members in legal, accounting and technical matters relevant to the private equity and venture capital industry.

As major investors in private companies, and some public companies, our members have an interest in financial reporting matters, the conduct and information presented by such companies, and the burdens placed on the management of such companies.

Private equity ownership involves the close alignment of interests between investors and the management of a company, and this leads to closer and often more informal relationships than between comparable forms of ownership. As such, the level of communication between these parties tends to be high, and to a level that covers the areas investors require.

General

During the development of IFRS 10 we advocated a principles based approach whereby the definition of an investment entity would be based on the substance of the underlying entity. We pointed out the need to take into account that some structures meant that investment entities might have other activities alongside investments. However, we have always held the view that the fundamental principle is that investment entities should be able to show their investments at fair value while consolidating these other activities. We see no difference whether the structure of the investment entity group is to hold these businesses in separate entities from their investments or in the same entity.

We therefore do not agree with a set of rules which goes against this approach as we believe that it undermines the achievement of the original objective of the standard. We therefore consider that a business purpose approach be taken rather than an entity approach because using fair value to measure the operational business activities of an investment entity rather than the investment activities gives a misleading picture of performance and a lack of comparability between groups just because of their legal structure.

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We also consider that grouping portfolio companies beneath a company that is purely a holding company, as opposed to treating them separately, is also against the principles which underpin the standard and would lead to different disclosure based on how the group was structured which we think is not useful.

Answers to specific questions

Q1. We agree with the proposed amendment to confirm that the exemption from preparing consolidated financial statements continues to be available to a parent entity that is a subsidiary of an investment entity, even when the investment entity measures its subsidiaries at fair value.

However, we note that in the UK, the Companies Act 2006 will still require sub-group consolidation. We hope that, over time, the Companies Act 2006 will also be updated to bring it into line with IFRS.

Q2. We do not agree with the proposed amendment to clarify that the requirement for preparing consolidated financial statements applies only to subsidiaries that act as an extension of the operations of the investment entity parent which do not themselves qualify as investment entities.

While we continue to support the investment entity approach adopted by the IASB, we consider that subsidiaries that are investment entities but have activities that are an extension of the operations of an investment entity parent should have their investment activities fair valued and operational activities consolidated when preparing the accounts of the parent. We consider that this applies the substance of the investment entity approach and that the proposal does not as it will vary depending on the form of the structure of the group.

It is our suggestion therefore that all investments of investment entities in a group should be presented at fair value through profit and loss except those that are an extension of the parent's own operational activities (such as investment related services and intermediate holding companies). This would mean that all investments that are an extension of the group's own activities would be consolidated whether they were held by an investment entity or not. We believe that this would be the most useful approach for investors and would retain the principles based approach which was the intention of the original standard and would mean that for groups that are identical in all respects other than in their legal structure, the same accounting presentation and results would apply.

As they stand, the proposals will lead to a difference in revenue, and costs and the classification of profits and balance sheet items of groups that are identical in nature but different in structure.

We also suggest that there might be practical difficulties in fair valuing businesses that are an extension of the group's activities as opposed to separate portfolio investments.

We accept that additional disclosure would be necessary for companies to explain what had been consolidated and what had been fair valued but we think that this is a better approach than to move away from the principle explained above.

Q3. We agree with the proposal to require a non-investment entity to retain, when applying the equity method, the fair value measurement applied by an investment entity associate. As the investor does not have control over the associate, it would seem sensible that it should preserve the accounting adopted by the associate relating to its business activities. We see no reason why this should not be extended to Joint Ventures for the same reason. This would lead to the simple rule that if it controls it consolidates in full; if it does not, it inherits the accounting adopted.

If the JV partner were to be an investment entity that party would use fair value accounting so that there should be no need to prepare information to allow consolidation, a task which would seem to lead to burden without benefit.

The BVCA would of course be willing to discuss further this submission and, if you so wish, you should contact Gurpreet Manku.

Yours faithfully

Simon Witney
Chairman – BVCA Legal and Technical Committee