



Michelle Sansom
Accounting Standards Board
5th Floor, Aldwych House
71 – 91 Aldwych
London
WC2B 4HN

The Association of
Investment Companies
9th Floor 24 Chiswell Street
London EC1Y 4YY
Telephone 020 7282 5555
Fax 020 7282 5556
enquiries@theaic.co.uk
www.theaic.co.uk

26 April 2012

The Future of Financial Reporting in the UK and Republic of Ireland (EDs 46, 47 & 48)

Dear Michelle

The Association of Investment Companies ('AIC') is the trade body representing over 340 investment companies, managing assets in excess of £80bn. Our Members are closed-ended investment companies whose business is to invest in a diversified portfolio of shares and securities, property and other assets to provide returns for their shareholders. These returns will normally be in the form of dividends, interest and capital gains. Our Members will generally measure their investments at fair value with changes recognised in profit or loss. Investment companies are one of the main forms of collective investment vehicle available to UK investors, along with unit trusts and OEICs.

Our Members are domiciled both in the UK (investment trusts, venture capital trusts) and offshore (predominantly in the Channel Islands); with the vast majority listed on the London Stock Exchange. At present, over 250 of our Members are UK companies.

The AIC is, of course, recognised by the ASB as a SORP-issuing body and issued its most recent SORP (Statement of Recommended Practice: Financial Statements of Investment Trust Companies and Venture Capital Trusts) in 2009.

Most of our UK Members do not produce consolidated accounts (simply because they have no subsidiary companies) and, notwithstanding that they have the option to produce their individual company accounts in accordance with EU-adopted IFRS, most of them (we estimate around 70%) produce their accounts in accordance with UK GAAP. However, where our UK Members do produce consolidated accounts as listed companies they will, of course, produce them in accordance with EU-adopted IFRS.

Consequently, the future of UK GAAP is of fundamental importance to many of our Members and the AIC is pleased to have the opportunity to comment on the Revised Exposure Drafts ('EDs').

1) General Position

The AIC supports the ASB's latest proposals and agrees with the decision not to extend the application of EU-adopted IFRS beyond that already set out in company law.

However, in addition to the questions posed by the EDs, we have some specific points that we wish to communicate to the ASB.

2) Format of the EDs

The AIC has two suggestions with regard to the format of the EDs:

1. When a defined term is used in the EDs it is written in bold but, it seems, only the first time it is used. For example, in paragraph 1.8 of FRS 102 '**qualifying entity**' is in bold, but it is not written in bold in paragraphs 1.9, 1.10, 1.11 and 1.12. The AIC **recommends** that wherever a defined term is used it should be in bold type.
2. The language used in the EDs seems to be based on IFRS rather than the Companies Act. For example, inventories rather than stock or statement of financial position rather than balance sheet (indeed paragraph 4.1 of Section 4 of FRS 102 states that the statement of financial position can also be called the balance sheet). As the EDs relate to the Companies Act, the AIC suggests that the ASB considers using Companies Act language where relevant.

3) Consolidation

One key element for investment companies is the proposal that a subsidiary should be excluded from consolidation where it is held exclusively with a view to subsequent resale and this is defined (on page 273 within the Glossary of Terms of FRS 102) to include an interest '*which is held as part of an investment portfolio*'.

However, one major issue arises from the wording used in the ED:

- Paragraph 9.9 (b) of Section 9 states that a subsidiary should be excluded from consolidation where '*the interest in the subsidiary is held exclusively with a view to subsequent resale and the subsidiary has not previously been consolidated in the consolidated financial statements.*'

Unless transitional arrangements are put in place, this wording would appear to prevent investment companies from excluding from consolidation any existing subsidiaries held as part of an investment portfolio which have already formed part of a consolidation, but exempt from consolidation any subsidiaries which are held as part of an investment portfolio which are established after the EDs have been adopted.

Consolidated accounts would presumably have to be prepared for as long as the original subsidiaries continue to be held which would lead to diverse financial presentation and be confusing to users of the financial statements. The AIC

therefore **recommends** that subsidiaries in existence before the proposals are adopted (including early adoption if appropriate) should be excluded from the requirement to have not previously been consolidated.

The AIC also has a concern that the wording of paragraph 9.9A which refers to 'a subsidiary meeting the requirements of paragraph 9.9(b) and held as part of an investment portfolio....' could cause confusion. A subsidiary held as part of an investment portfolio is one of the requirements of 9.9(b) and it is **recommended** that the wording of 9.9A be changed to 'a subsidiary held as part of an investment portfolio shall be measured at fair value.....'.

4) Statement of Cash Flows (Section 7 of FRS 102)

There is no statutory requirement to produce a statement of cash flows and investment companies are increasingly being recognised in accounting standards and elsewhere as different from other types of company. In addition, open-ended investment funds that meet special conditions, and other types of entity whose main business involves investment portfolios, are exempt from the requirement to produce a statement of cash flows.

As is the case for open-ended investment funds and the other entities, statements of cash flows for the vast majority of investment companies do not represent useful information for users of the investment company's financial statements but consume resources to produce and present. The AIC therefore **recommends** that investment companies which meet all of the conditions set out in paragraph 7.1A (c) should be excluded from the requirement to produce a statement of cash flows.

5) Going Concern

Going concern related issues impact on investment trusts and venture capital trusts from time to time not because they are in financial difficulties but, for example, because they are approaching the end of their fixed life. Investment companies are very unusual, if not unique, in as much as some of them are launched with a termination date built into their structure.

The AIC's SORP (paragraph 11) deals with going concern and the AIC believes that the wording in paragraphs 3.8 and 3.9 of FRS 102 would not generally be problematic for our Members. However, as it could be argued that the management of such a company intends (in fact it has no option) to liquidate the entity from the moment it is launched, albeit that the liquidation is several years ahead, the wording of 3.8 could be amended to deal with this.

The AIC therefore **recommends** that the second sentence of paragraph 3.8 be amended to read something like:

'An entity is a going concern unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so within 12 months of the accounting signing date. In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future.'

6) Financial Instruments

Accounting for financial instruments is another key element for investment companies and, as stated above, our Members generally measure their investments at fair value with changes recognised in profit or loss.

Based on our reading of Sections 11 and 12 of FRS 102, it would not be possible for investment companies to fair value UK Gilts or other debt instruments held in their portfolio. Consequently, it appears that investment companies will have little option but to choose the IAS 39 route.

The AIC therefore **recommends** that within the provisions of Sections 11 and 12 there is included an option to designate a financial asset as at fair value through profit or loss where conditions similar to those set out in paragraph 9 (definitions of four categories of financial instruments) of IAS 39 are met.

7) Statement of Comprehensive Income and Income Statement

Paragraph 5.3 of Section 5 of FRS 102 states that a change from a single-statement approach to a two-statement approach is a change of accounting policy to which Section 10 of FRS 102 applies. It seems unlikely that much of Section 10 will apply to what is basically a change of presentation and it is **recommended** that the ASB reconsiders whether the requirement of paragraph 5.3 is appropriate.

8) Liabilities and Equity

Paragraph 22.5(b) of Section 22 states that a puttable instrument is not classified as equity if the amount due to the holder is measured on some basis other than as set out in FRS 102.

Although 22.5(b) is part of paragraph 22.5, we are not certain whether this restriction refers to paragraph 22.4(b) in the same way as paragraph 22.5(a). In any event, we are unclear as to the extent of 22.5(b) and whether assets measured in accordance with, for example, a company's articles would cause a puttable instrument otherwise classifiable as equity to be treated as a liability.

It is **recommended** that the ASB reconsiders paragraph 22.5(b) and adds further explanation if it is considered to be an example of the circumstances where a puttable instrument must be classified as a liability.

9) Specialised Activities – Funding Commitments

Paragraph 34.57 of Section 34 sets out the conditions when an entity shall recognise a liability when it has made a commitment. It is not clear to us why this is included within the section of FRS 102 dealing with specialised activities as commitments can presumably be made by entities generally. The Appendix to Section 34 dealing with Funding Commitments seems to be drafted from the perspective of grantors and beneficiaries which suggests that it should apply to charities and the like, but this limited applicability has not been stated.

If the provision does apply generally, then in the case of our Members some will make commitments to invest in limited partnerships and other funds or investments as money is required by those funds/investees. Clearly there is a commitment, but there will be no transfer of economic benefits as the amount paid will be matched by an asset i.e. the increased value of the fund/investee.

However, paragraph 34.57 (or any other paragraph) does not seem to make an exception for these circumstances, which would lead to the company recognising the commitment as a liability but also recognising an asset of equal value.

Clearly the existence of such commitments can represent important information for users of financial statements, but the AIC **recommends** that in the circumstances of investment companies having obligations to invest where the amount to be paid will be matched by an asset, disclosure of the commitment, rather than recognition as a liability, is the appropriate treatment. The AIC also **recommends** that the ASB reconsiders whether Section 34 is the appropriate place for funding commitments to be placed within FRS 102 and, in any event, amends the wording (including underlying the heading) so that its applicability is clear.

10) SORPS

The AIC is very pleased that the ASB has listened to representations from the AIC and others and included proposals to continue to permit SORPs to be issued for specialist sectors like investment trusts and venture capital trusts.

We also note that SORPs will continue to be developed in conjunction with the ASB and include a statement from the board of the ASB – both of which we strongly support.

Exposure Draft Questions

11) QUESTION 1

The ASB is setting out the proposals in this revised FRED following a prolonged period of consultation. The ASB considers that the proposals in FREDs 46 to FRED 48 achieve its project objective:

To enable users of accounts to receive high-quality, understandable financial reporting proportionate to the size and complexity to the entity and users' information needs.

Do you agree?

The AIC broadly agrees that the proposals achieve the ASB's objective and support the decision not to extend the application of EU-adopted IFRS beyond that already set out in company law. However, it does seem to us that preparers are faced with a confusing amount of choice as to which accounting regime to follow and the AIC **recommends** that the ASB issues further guidance/information on this, perhaps in the form of a document dealing with this single issue.

FRS 101 deals with the circumstances where a qualifying company applies EU-adopted IFRS but in the context of Companies Act individual accounts (i.e. as part of UK GAAP). Nevertheless, it seems to us that this means that EU-adopted IFRS effectively forms part of UK GAAP which will need to be understood and applied by those entities that select this option. In addition, the ASB will have to consider every new international accounting standard and interpretation etc. to determine whether they comply with the Companies Act and the ASB must be resourced to fulfil this role.

12) QUESTION 2

The ASB has decided to seek views on whether:

As proposed in FRED 47

A qualifying entity that is a financial institution should not be exempt from any of the disclosure requirements in either IFRS 7 or IFRS 13; or

Alternatively

A qualifying entity that is a financial institution should be exempt in its individual accounts from all of IFRS 7 except for paragraphs 6, 7, 9(b), 16, 27A, 31, 33, 36, 37, 38, 39, 40 and 41 and from paragraphs 92-99 of IFRS 13 (all disclosure requirements except the disclosure objectives).

Which alternative do you prefer and why?

The AIC does not expect its Members to produce consolidated accounts (and if they do, as listed companies, they will have to produce IAS group accounts and therefore be outside the scope of the EDs). Consequently the AIC has no comments on this question.

13) QUESTION 3

Do you agree with the proposed scope for the areas cross-referenced to EU-adopted IFRS as set out in section 1 of FRED 48? If not, please state what changes you prefer and why.

As stated above with regard to Question 1, the AIC can see issues arising with using EU-adopted IFRS within UK GAAP. However, providing the ASB is prepared to devote whatever resources are required if issues arise then we recognise the proposal as a pragmatic solution.

14) QUESTION 4

Do you agree with the definition of a financial institution? If not, please provide your reasons and suggest how the definition might be improved.

As the vast bulk of our UK membership consists of investment trusts and venture capital trusts, the AIC is content with the definition.

The term 'mutual fund' appears to be very wide in scope and imprecise and the AIC **recommends** that 'mutual fund' be defined.

15) QUESTION 5

In relation to the proposals for specialist activities, the ASB would welcome views on:

- a) Whether and, if so, why the proposals for agriculture activities are considered unduly arduous? What alternatives should be proposed?*
- b) Whether the proposals for service concession arrangements are sufficient to meet the needs of preparers?*

The AIC has no comments on this question.

16) QUESTION 6

The ASB is requesting comment on the proposals for the financial statements of retirement benefit plans, including:

- a) Do you consider that the proposals provide sufficient guidance?*
- b) Do you agree with the proposed disclosures about the liability to pay pension benefits?*

The AIC has no comments on this question.

17) QUESTION 7

Do you consider that the related party disclosure requirements in section 33 of FRED 48 are sufficient to meet the needs of preparers and users?

The AIC supports a disclosure exemption for transactions between wholly-owned subsidiaries and believes that the disclosure requirements in Section 33 are sufficient.

The relationship between an investment trust or a venture capital trust and any third-party manager appointed to run day-to-day management of the company's affairs will not generally fall to be treated as a related party relationship. However, the relationship is important and details of it useful for users of the financial statements. Consequently, and notwithstanding that it will not be a related party relationship, the AIC's SORP sets out detailed disclosure requirements where such an arrangement is in place and it is anticipated that such disclosures will continue to form part of any future SORP.

18) QUESTION 8

Do you agree with the effective date? If not, what alternative date would you prefer and why?

We understand that the EU is intending to issue proposals to amend the Accounting Directives and we note, as explained in FRS 102, that the ASB intends to issue a supplementary exposure draft when the IASB finalises the requirements of IFRS 9.

It is important that preparers have sufficient time to implement the substantial changes being proposed and also that further changes will not follow immediately after the proposals are introduced. Accordingly, it is **recommended** that the ASB monitors the above with a view to delaying the effective date if it appears likely that the standards will require major changes within a relatively short time after January 2015.

Providing the above recommendation is met, the AIC is content with an effective date of January 2015.

However, given the scale of the likely changes we are unsure about the ASB permitting early adoption. In view of the substantial nature of the potential changes, it is **recommended** that the ASB revisits the early adoption point as issuance of the standards approaches.

We would also state that we believe it is vitally important that, following the BIS consultation, changes are made to the Companies Act permitting changes of accounting framework before the proposals become effective.

19) QUESTION 9

Do you support the alternative view, or any individual aspect of it?

The AIC has no comments on this question.

For further information on any issues raised in this paper please contact:

John Stevens email: john.stevens@theaic.co.uk tel: 020 7282 5605