Japan Venture Capital Association (JVCA)
http://www.jvca.jp

December 28, 2011
Via website posting: http://www.iasb.org/
Re: Exposure Draft: **Investment Entities (ED/2011/4)**

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sir/Madam:

Japan Venture Capital Association (JVCA) welcomes the opportunity to comment on the Exposure Draft: Investment Entities (ED/2011/4).

JVCA is the association of the members from venture capital firms.
Venture capital firms of Japan manage investment funds in the form of limited partnerships and serve as general partner of the limited partnerships.
JVCA's members of venture capital firms are various types of investment companies; some are independent entities, and others are subsidiaries of financial holding companies, banks, or trading companies.
The subsidiary types of venture capital firms manage the limited partnerships with a parent entity who serves as the limited partner.
Those subsidiary venture capital firms strongly concern the current proposals that do not permit the extension of the exclusion from the investment entity to a parent entity above it unless the criteria for exclusion are met.

JVCA along with those member firms have provided comments attached in response to the specific questions posed by the Board:

Questions and JVCA's comments on the 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?

Comment:

We agree that there is such a class of entities, commonly thought of as an investment entity in nature. However, we request the Board to reconsider the proposed requirements for an entity to be qualified as an investment entity.

We specifically support the proposition that "an investment entity should not consolidate controlled entities and instead measure them at fair value through profit or loss."

Our members are "investment entities" that engage in the business of investing in growth companies for the purpose of achieving capital appreciation and investment returns by investing its own capital or the capital of investment funds they manage as a general partner (i.e., venture capital companies that are also a general partner of the limited partnerships). They have exist-strategies with respect to all of their investments and therefore their main business purpose is to make profits upon the sales of their investee companies.

The sales price of such investee companies depends on various factors including their growth potential, future cash flows, appraisal value used by the buyer, the supply-demand balance in the market, etc., and does not necessarily coincides with the amount of net assets stated in their financial statements. Therefore, we believe that an investment entity should not consolidate their investee companies and instead measure them at fair value through profit or loss.

However, the criteria for determining when an entity is an investment entity as proposed in the ED seem to presume that only investment funds can be qualified as an investment entity and to suggest that investment fund managers and venture capital companies cannot be qualified as an investment entity. In the venture capital/private equity industry in Japan, there are many corporate-form "investment entities" engaging in the investment business, such as investment fund managers, corporations concurrently engaging in other types of investment services, or companies whose parent is a holding company or an investment bank. We believe that the requirements for an entity to be qualified as an investment entity should be developed in consideration of the actual practice in the

industry described above.

In addition, the ED proposes only the criteria for determining when an entity is an investment entity. Under Japanese GAAP (ASBJ Guidance No.22 *Guidance on Determining a Subsidiary and an Affiliate*), there exists a so-called 'venture capital clause' which allows investee companies that are held for investment purposes not to be consolidated if they satisfy all of the following four requirements, even if they are controlled by an investor such as a venture capital company:

(1) The investor has a reasonable plan to transfer most of the voting rights in the investee whether by sale of shares in the investee or otherwise;

(2) There are no or few transactions between the investor and the investee company other than the investment in the investee company by the investor that was carried out in the normal course of business by the investor;

(3) The investee company cannot be regarded as a vehicle to which the business of the investor is transferred or an agent of the investor who conducts business on behalf of the investor; and

(4) No synergy effect will be expected between the investor and the investee company and there is no possibility of consolidation of the investee company.

The above Guidance addresses the subject matter in a very rational manner by taking into consideration the perspectives of both the investor and the investee company.
In this way, it is possible to define an investment entity without limiting its applicability to investment funds by including the perspective of investee companies. Therefore, we suggest that the Board revise the criteria for determining when an entity is an investment entity as currently proposed in the ED in consideration of the characteristics of Japanese venture capital and private equity investment companies and by referencing Japanese GAAP.

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?

Comment:
We do not agree.
We request the Board to reconsider the criteria detailed in paragraphs 2.(d), B14, B15, and B16 regarding the pooling of funds. Specifically, we request that the criterion required by the paragraph "the entity must have investors that are unrelated to the entity's parent (if any), and they must in

aggregate hold a significant ownership interest in the entity" be removed.

If investment entity accounting cannot be applied to wholly owned PE investees held for business purposes by a group because of the failure to meet the pooling of funds criterion (paragraph 2. (d)), those PE investees would be required to be consolidated. This will significantly reduce the usefulness of the financial statements. In addition, the specific meaning of the wording within B14 "hold a significant ownership" is not clear. If literally interpreted, because the word "significant" is used instead of "majority", a 40% ownership by the external investor in the above example is deemed "significant".

In the venture capital/private equity industry in Japan, there are many corporate-form "investment entities" engaging in the investment business, such as investment fund managers, corporations concurrently engaging in other types of investment services, or entities whose parent is a holding company or an investment bank. However, the criteria for determining when an entity is an investment entity as proposed in the ED seem to presume that only investment funds can be qualified as an investment entity and to strongly suggest that investment fund managers and venture capital companies cannot be qualified as an investment entity. We believe that the requirements for an entity to be qualified as an investment entity should be developed in consideration of the actual practice in the industry described above.

Proprietary investment without the presence of multiple investors is widely utilized in Japan, and is one of the general investment models that are followed. As mentioned in our comment on Question 1, under Japanese GAAP, there exists a so-called 'venture capital clause' which allows investee companies that are held for investment purposes to not be consolidated, without requiring the existence of multiple investors.

Consequently, our view is that the introduction of the pooling of funds criterion not only imposes an additional burden on the preparers of financial statements, but also results in a considerable detrimental impact to the users of financial statements as their usefulness is impaired. In addition, financial analysts, one of the main users of financial statements, would have to analyze financial statements by removing the effects arising from the consolidation of such investees.

We believe that the existence of external investors is only one of the potential indicators or characteristics of an investment entity, rather than a required criterion that must be met to qualify as an investment entity, and considering the original intent of the ED (improving the usefulness of financial statements by measuring and disclosing investees held for investment purpose at fair value rather than consolidating them), we recommend that the pooling of funds criterion (in paragraphs

2.(d), B14, B15, and B16) should be deleted.

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?

Comment:

We do not agree. If investees held by a subsidiary are not held for the purposes of control, but are held purely for investment purposes, and this investment purpose remains the same from the standpoint of the parent entity, the parent entity should reflect fair value of these investments in its financial statements even if the parent entity is not an investment entity.

Nevertheless, if all of its controlled entities including the investees of such a subsidiary were consolidated, the financial statements of the parent entity would no longer describe information that would be deemed useful by users of the financial statements in their decision making, and the overall value of the financial statements would be impaired. This is because the users of the financial statements make investment decisions on an entity that holds investments based on the fair values of the investments held by the entity, and do not make such decisions based on how individual assets and liabilities held by each investee are used. Consequently, fair value accounting for investment entities should be retained in the parent's financial statements. It is also reasonable to recognize and respect the reasonableness of the fair value of the assets (investment fund) managed by a subsidiary qualifying as an investment entity.

Also, as noted in our comment on Question 2 above, a so-called venture capital clause exists under Japanese GAAP enabling investees that are held for investment purposes generally not to be consolidated. If these investees were to be newly consolidated on transition to IFRS, a significant amount of cost would be expected to occur, for example, through the need to unify systems and accounting policies within a consolidated group.

We believe that in considering the issues noted above, the disadvantages associated with requiring consolidation of investees outweigh the advantages.

Furthermore, the ED proposes that the application of investment entity accounting depend on whether the investee of non-investment entity is a subsidiary, or an associate or joint venture. As the

required accounting treatment may consequently differ significantly, the application of investment entity accounting in this manner may impair the usefulness of the financial statements.

In respect of the concern raised by the Board that, in the case where a parent company that is a non-investment entity issues new shares to investees of its subsidiary which is an investment entity, thereby giving the appearance of capital enhancement, we believe that the concerns can be addressed by changing the qualifying criteria for the investment entity status or setting a provision that requires consolidation under certain circumstances.

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?

(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?

Comment:

We agree with the use of the disclosure objective outlined in the ED, but believe that some of the disclosure items should be deleted.

We request the Board to reconsider the disclosure items required in paragraph 9. Specifically, we request the Board to delete "the investee's name" and "the proportionate ownership interest in the investee held by the investment entity" from the required disclosure items.

An investment entity has a specific exit strategy for each of its investee companies. Such exit strategies are diverse in nature and in some cases it may be disadvantageous for the investment entity to disclose such information as "the investee's name" and "the proportionate ownership interest in the investee held by the investment entity" in carrying out the exit strategy. Disclosure of such information may also be detrimental to the capital policies of the investee. For these reasons, we are concerned that the interest of investors may be impaired rather than protected as such disclosure may prevent investment entities from maximizing profits from the investment business.

We also request the Board to reconsider the requirements in paragraph 10. Specifically, we request the Board to delete the reference to IFRS 12 *Disclosure of Interests in Other Entities* in this paragraph.

The requirements of IFRS 12 are developed based on the presumption that controlled entities are

consolidated. As such, its disclosure requirement is inappropriate for an entity applying fair value accounting to its investees. Although this inconsistency is addressed in BC 24, the result of the discussion does not seem to be reflected in the ED. Therefore, we request the result of the discussion in BC 24 to be clearly incorporated in the final standard.