



For Attention of: Roger Marshall, Chairman Accounting Council
Financial Reporting Council
5th floor, Aldwych House
71-91 Aldwych
London
WC2B 4HN

26 October 2012

Dear Sir,

Re: Financial Reporting in the UK

I am writing on behalf of the British Private Equity and Venture Capital Association (“BVCA”) in relation to the proposed Financial Reporting Standards set out in FRED 46, 47, and 48 for the Future of Financial Reporting in the United Kingdom and Republic of Ireland. The BVCA is the industry body for the UK private equity and venture capital industry. With a membership of over 500 firms, the BVCA represents the vast majority of all UK based private equity and venture capital firms and their advisers. As major investors in private companies, and some public companies, our members have an interest in financial reporting matters relating to those companies, and the burdens placed on the management of such companies.

As published on the FRC website, we note that at the meeting on 6 September 2012 the Accounting Council tentatively decided to recommend to the Financial Reporting Council (“FRC”) that certain amendments should be made to the definition of a Financial Institution.

FRED 43 / FRED 44

In our letter of 3 May 2011 responding to exposure drafts (FRED 43 and 44) relating to Financial Reporting in the UK, we expressed our concerns about the definition of Public Accountability since the definition was linked to the FSA regulatory definitions.

Our concern, at that stage, was that many small private equity managers/advisors (typically limited companies or limited liability partnerships) who are required to be regulated by the FSA, yet are generally privately held entities, would be disadvantaged if they were unable to take account of the reduced disclosure regime and instead had to prepare full IFRS financial statements. Certainly, such private entities cannot be considered entities that should be considered to have Public Accountability.

FRED 46, 47 and 48

We were pleased to note that the revised exposure drafts removed the reference to Public Accountability and we commented on this in our response dated 30 April 2012 to the revised exposure drafts (FRED 46, 47 and 48).

However, the FRC website states that the Accounting Council (meeting of 6 September 2012) has proposed to add to the definition of Financial Institution by inserting text that would include entities that generate wealth from financial instruments. The specific proposed text is published on the FRC website:

“(i) any other entity whose principal activity is to generate wealth from financial instruments. This is intended to cover entities that have business activities similar to those listed above but are not specifically included in the list. It is not intended to include a parent entity whose sole activity is to hold investments in other group entities.”



Whilst we understand the Accounting Council's intent is to set out a principle for the definition of a Financial Institution, rather than simply list the different types of entities to be included, we consider that the definition will have the unfortunate consequence of including our members' Limited Partnership fund entities in the definition which in turn brings additional burdens in the form of narrative and analysis in relation to financial instruments i.e. the investments made by such funds. The additional information required, by virtue of being classified as a Financial Institution, is set out in paragraphs 34.19 to 34.30 of FRED 48.

To be clear, our members generally use Limited Partnership entities as vehicles of choice for establishing a "fund" made up of limited partner investors and a general partner who is responsible for identifying and making investments in private companies. These limited partner entities follow different investment strategies (e.g. seed and start-up venture capital, growth/development capital, management buyouts, management buyins, etc) but their common attribute is that they are governed by a private Limited Partnership Agreement ("LPA") which sets out the arrangements between the limited partner investors and the general partner. Annual financial statements for the fund are prepared by the general partner and delivered to the limited partner investors.

You will be aware that the Department for Business, Innovation and Skills ("BIS") are proposing to amend The Partnerships (Accounts) Regulations 2008 (S.I. 2008/569) (the "2008 Regulations") and the effect of this is that limited partnerships that are qualifying limited partnerships entities will now have to prepare annual financial statements in accordance with UK GAAP. This will add considerably to the costs of preparing annual financial statements because hitherto such limited partnerships have prepared their financial statements in accordance with the accounting principles set out in the LPA which is negotiated between the general partner and the limited partner investors. Such accounting principles did not necessarily include a full application of UK GAAP and the associated disclosures (e.g. consolidation of investee entities or equity accounting of associates may not be required) and did not necessarily require compliance with the Companies Act disclosures.

The main point is that limited partner investors contract with the general partner to determine the principles and format of the limited partnership fund financial statements which meet their particular requirements. This seems wholly appropriate since such financial statements are private to the general and limited partners.

Indeed our members embrace guidelines issued by the International Private Equity and Venture Capital Valuation Board ("IPEV Board") in relation to best practice for Valuation and best practice for Investor Reporting in preparing the limited partnership fund financial statements. Of particular relevance here are the IPEV Investor Reporting Guidelines which are a globally applicable set of disclosure principles and practices designed to provide general partners and their limited partners with guidance in presenting their investments and investment performance over the life of a fund; they are designed to ensure fair presentation and full disclosure of investment information.

Both the Valuation and Investor Reporting guidelines have been developed by industry participants as best practice. The BVCA is not aware of a significant desire from limited partners for the additional financial information and analyses to be included per paragraphs 34.19 to 34.30 of FRED 48. Necessarily, general partners will incur additional costs in gathering and preparing such information and there will also be additional associated audit costs; in all likelihood, these additional costs will be borne by the limited partnership fund. Since the industry participants have already determined guideline frameworks for reporting on investments, the BVCA do not believe this additional disclosure will bring any benefit to the limited partners.

BIS has determined that there are over 20,000 limited partnerships registered in the UK based on Companies House data and has further estimated that there are between 5,000 to 8,000 active private equity limited partnerships operating in the UK. It is these active limited partnerships that



will be subject to the amended 2008 Regulations when they are introduced and the limited partnerships applying the amended 2008 Regulations will have to apply UK GAAP.

Clearly, this amendment to the definition of a Financial Institution potentially affects a lot of UK limited partnership funds operating in the private equity industry who will be required to apply UK GAAP by virtue of the changes to the 2008 Regulations. The BVCA does not consider it is appropriate to classify private limited partnerships as Financial Institutions. The nature of the relationship between the general partner and limited partners is set out in the private LPA and is one between professional investors and a professional fund manager; such funds do not attract monies from retail investors. Therefore, the BVCA are concerned that there has been no consultation on the amendment to the Financial Institution definition, especially as our members are already facing the prospect of extra costs from the need to comply with UK GAAP generally where the 2008 Regulations apply.

The BVCA consider that the proposed amendments to the Financial Institution definition should be reconsidered with the objective of ensuring that UK Limited Partnership funds are not classified as Financial Institutions and therefore not subject to the additional burdensome and costly disclosures of paragraphs 34.19 to 34.30 of FRED 48.

Please feel free to contact me if you would like to discuss further any of the points raised.

Yours faithfully

A handwritten signature in black ink that reads "Mark Florman".

Mark Florman
Chief Executive
The British Private Equity and Venture Capital Association