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ED250 sub 3

Mr. Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Canon Street, London, EC4M 6XH
United Kingdom
(By Electronic Submission at www.iasb.org)

MACQUARIE

CC:
Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West
Melbourne, VIC, 8007
(By Electronic Submission: standard@aasb.gov.au)

15 September 2014

Dear Mr Hoogervorst,

IASB Exposure Draft ED 2014/2 – *Investment Entities: Applying the Consolidation Exception*

We are responding to Exposure Draft ED 2014/2 – *Investment Entities: Applying the Consolidation Exception* issued by the International Accounting Standards Board (IASB). Our responses to the questions included within the consultation document are provided in the attached Appendix.

We agree with two of the proposed changes in the Exposure Draft to IFRS 10 that clarify the consolidation requirements for an intermediary subsidiary of an investment entity, and for subsidiaries that provide services.

We disagree with the proposal requiring a non-investment entity investor to apply the equity method using the fair values applied by an investment entity associate to its interests in subsidiaries. We recommend a non-investment entity investor apply the equity method using underlying consolidated information and only use fair value when impractical. We consider the proposal to retain the fair values used by associates to be conceptually inappropriate, inconsistent with the proposal for joint ventures holding subsidiaries, and inconsistent with the uniform accounting requirements under IAS 28 for associates operating without a subsidiary legal entity structure.

If you have any questions in relation to this submission, please do not hesitate to contact me at +61 2 8232 5193.

Yours sincerely

Frank Palmer
Accounting Policy & Advisory Team Leader
Macquarie Group Limited

About Macquarie Group

Macquarie Group is a global financial services provider. It acts primarily as an investment intermediary for institutional, corporate and retail clients and counterparties around the world.

Macquarie has built a uniquely diversified business. It has established leading market positions as a global specialist in a wide range of sectors, including resources, agriculture and commodities, energy and infrastructure, with a deep knowledge of Asia-Pacific financial markets.

Alignment of interests is a longstanding feature of Macquarie's client-focused business, demonstrated by its willingness to both invest alongside clients and closely align the interests of shareholders and staff.

Macquarie's diverse range of services includes corporate finance and advisory, equities research and broking, funds and asset management, foreign exchange, fixed income and commodities trading, lending and leasing and private wealth management.

Macquarie Group Limited is listed in Australia (ASX:MQG; ADR:MQBKY) and is regulated by APRA, the Australian banking regulator, as the owner of Macquarie Bank Limited, an authorised deposit taker. Macquarie also owns a bank in the UK, Macquarie Bank International Limited, which is regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

Founded in 1969, Macquarie employs more than 13,900 people in 28 countries. At 31 March 2014, Macquarie had assets under management of $A427 billion.

APPENDIX

Question 1 – Exemption from preparing consolidated financial statements
The IASB proposes to amend IFRS 10 to confirm that the exemption from preparing consolidated financial statements set out in paragraph 4(a) of IFRS 10 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 in accordance with paragraph 31 of IFRS 10. Do you agree with the proposed amendment? Why or why not?

We agree with the proposed amendment to paragraph 4(a) of IFRS 10. Without this proposed clarification, the 2012 amendments could have the consequence of imposing consolidation for an intermediate subsidiary of an investment entity. This would increase compliance costs for such entities.

Question 2 – A subsidiary that provides services that relate to the parent's investment activities
The IASB proposes to amend IFRS 10 to clarify the limited situations in which paragraph 32 applies. The IASB proposes that the requirement for an investment entity to consolidate a subsidiary, instead of measuring it at fair value, applies only to those subsidiaries that act as an extension of the operations of the investment entity parent, and do not themselves qualify as investment entities. The main purpose of such a subsidiary is to provide support services that relate to the investment entity's investment activities (which may include providing investment-related services to third parties). Do you agree with the proposed amendment? Why or why not?

We agree with the proposed amendment to clarify the circumstances when a subsidiary should be consolidated by an investment entity.

Question 3 – Application of the equity method by a non-investment entity investor to an investment entity investee

The IASB proposes to amend IAS 28 to:

a) Require a non-investment entity investor to retain, when applying the equity method, the fair value measurement applied by an investment entity associate to its interests in subsidiaries; and
b) Clarify that a non-investment entity investor that is a joint venturer in a joint venture that is an investment entity cannot, when applying the equity method, retain the fair value measurement applied by the investment entity joint venture to its interests in subsidiaries.

Do you agree with the proposed amendments? Why or why not?

We disagree with the proposal in part a) of question 3, because it will result in differing applications of the equity method for investments in associates and investments in joint ventures without a conceptual basis for such a difference. Our reasons are further explained below.

Currently, a non-investment entity (non-IE) investor consistently applies the equity method of accounting for investments in all associates and joint ventures. The Board's proposal in part b) of question 3 for a non-IE investor to not retain the fair values applied by the IE joint venture is based upon the Board affirming that the equity method is the appropriate conceptual measurement for interests in joint ventures (including their underlying subsidiaries).

The 2012 IE amendments were not meant to affect the financial statements of a non-IE parent, even if it controls an IE subsidiary. Similarly, we consider the non-IE parent's accounting should not change for an IE associate. This would be consistent with the general requirement in IAS 28 to equity account associates and joint ventures. However, under these proposals, a non-IE investor investing in associates would retain the IE's fair values for underlying subsidiaries. This creates different accounting outcomes depending on the investor's form of investment (associate or joint venture) and the type of investee (investment entity associate vs. non-investment entity associate).

The 2012 amendments specifically did not allow a non-IE ultimate parent to retain the fair values of subsidiaries held by an intermediary IE subsidiary. A non-IE parent consolidates all of its underlying subsidiaries. The Board considers that a non-IE parent does not have the same unique business model as its IE subsidiary, and therefore it is inappropriate for the non-IE parent to retain the fair value accounting applied by its IE subsidiary. We consider this logic equally should apply to a non-IE investor investing in IE associates. The non-IE investor does not have the same unique business model as that of the IE associate, and should align the IE associate's accounting policies to its own as part of the equity accounting process.

As noted in the 2014 Exposure Draft's Basis of Conclusions (BC18-19), in making the 2012 amendments the IASB did not wish to change existing practice under IAS 28 and therefore did not amend IAS 28. It was also noted that unwinding the fair value information is conceptually consistent with the IFRS 10 requirement for a non-IE parent to consolidate all of its subsidiaries, including those held through an IE subsidiary. The current proposal for the non-IE parent to retain fair value used by an IE associate is not consistent conceptually.

Further, IAS 28 currently provides an entity that is a venture capital organisation, mutual fund, unit trust or similar entities including investment-linked insurance funds with the choice to fair value or equity account investments in associates and joint ventures. A non-IE investor does not have a choice for its direct investments in associates and joint ventures. We consider this Exposure Draft will create a fair value through profit or loss measurement requirement based on the type of investment (IE or non-IE) rather than consistently focussing on the type of investor.

Policies should align to the parent

We are also concerned about the inconsistency that the 2014 Exposure Draft may cause with the application of existing standards. Currently IAS 28 paragraphs 35-36 require that an investor adjust the associate's results to apply uniform accounting policies. The application of these uniform accounting policies is based on the nature and accounting policies of the investor. The 2014 Exposure Draft will change this so an investor's accounting is determined based on the type of investment. As noted below, this will result in different accounting outcomes depending on legal structure for similar investments.

Access to required information

The main reason for the proposal to retain fair values used by IE associates appears to be in response to practical concerns raised about the perceived difficulty of obtaining underlying information. Many IFRS preparers, including ourselves, have been investors in associates that have been measuring their investments at fair value in their own financial statements

(using the option to fair value associates available to certain types of entities under IAS 28, or because they apply another accounting framework that fair values subsidiaries).

Since adopting IFRS in 2005, we have been able to obtain the required additional information to make adjustments to the investee's results to enable us to apply equity accounting under current IFRS in both of these situations. For existing unlisted investments, we have been able to achieve this by obtaining the information from the investee companies at our request. Alternatively, we have obtained the subsidiary information from publically available sources such as the company registrar in the relevant jurisdiction.

We disagree that accessing information for equity accounting adjustments differs depending upon whether an investment is an associate or joint venture. For a sophisticated investor, a key due diligence item in deciding to make a material investment in an entity (that might for accounting purposes be an associate or joint venture) is the ability to obtain sufficient information to apply the equity method of accounting in order to comply with statutory financial reporting obligations. We also expect an investor that has significant influence over a material associate to have access to this information through the relationship that gives them significant influence.

An exception if impractical to obtain information

It may be that in unusual circumstances, some non-IE investors have found it difficult to the point of impractical to obtain the information for underlying subsidiaries held by its associates. Only in these cases would we recommend IAS 28 provide the ability for a non-IE investor to retain the fair values used by the IE associate. This impracticability exception would maintain a consistent conceptual approach for the many investors able to obtain the information.

Structuring

The Basis of Conclusion to the 2014 Exposure Draft suggests that retaining the fair value of an IE associate is acceptable because there is considered less opportunity for structuring by an investor. While an investor may not be able to influence an associate's existing legal structure when investing subsequently, we consider an investor can negotiate the legal means through which it gains exposure to the underlying investments, and thereby achieve a different accounting outcome.

Other observations

While considering these proposals, we found it necessary for a non-IE parent to assess whether all of its associates qualify as investment entities, including those associates themselves not currently applying IFRS. Consider an associate that applies US GAAP and considered an investment company, or one that applies another GAAP, (e.g. Korean or UK GAAP). This forces more work on an investor complying with IFRS than for an investee not applying IFRS.

One of the elements of the investment entity definition is that an IE measures and evaluates the performance of investments on a fair value basis. IFRS 10.B85K clarifies that an entity demonstrates this element of the definition by 'providing investors with fair value information and measuring substantially all of its investments at fair value in its financial statements whenever fair value is required or permitted in accordance with IFRSs.' As a result, questions arise for a non-IE investor:

- How does the non-IE investor determine the IE status of an associate whose reporting framework does not allow or require fair value to be used in its local GAAP financial statement for investments?
- Should the non-IE investor ignore the financial statement measurement and consider all other means of communicating the associate's performance?
- Should the associate's inability to apply fair value measurement in its financial statements (due to a local GAAP requirement) preclude it from being an IE by its non-IE investor?

Similar issues arise when an associate transitions from local GAAP to IFRS. If local GAAP never permitted fair value for investments in underlying associates and joint ventures, does that mean the associate automatically fails the IE definition?

Angus Thomson
Acting Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West VIC 8007

via email: standard@aasb.gov.au

19 September 2014

Dear Angus

Re: Exposure drafts 249 and 250 and Invitation to Comment 30

I am enclosing a copy of PricewaterhouseCooopers' response to the following International Accounting Standards Board's documents:

- ED/2014/1 *Disclosure Initiative (Proposed amendments to IAS 1)* (ED 249)
- ED/2014/2 *Investment Entities: Applying the Consolidation Exception,* and
- *Request for Information on Post-implementation review: IFRS 3 Business Combinations* (ITC 30).

The letters reflect the views of the PricewaterhouseCoopers (PwC) network of firms and as such include our own comments on the matters raised in the requests for comment. PwC refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

AASB specific matters for comment on ED 249 and ED 250

We are not aware of any regulatory or other issues that could affect the implementation of the proposals for not-for-profit and public sector entities.

The proposals in ED 249 are consistent with our own efforts in streamlining financial reports which we consider to be more relevant and useful for users. We therefore consider they are in the best interests of the Australian economy.

Tier 2 supplement to ED 249

We agree with the AASB's proposal to exclude paragraph 85B from the tier 2 disclosures.

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I would welcome the opportunity to discuss our firm's views at your convenience. Please contact me on (03) 8603 5371 if you would like to discuss our comments further.

Yours sincerely,

Margot Le Bars
Partner, PricewaterhouseCoopers

pwc

Mr Michael Stewart
Director of Implementation Activities
International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

15 September 2014

Dear Sir

Exposure draft: Investment Entities: Applying the Consolidation Exception Proposed amendments to IFRS 10 and IAS 28

We are responding to your invitation to comment on the Exposure Draft on behalf of PricewaterhouseCoopers.

Following consultation with members of the PricewaterhouseCoopers network of firms, this response summarises the views of member firms who commented on the Exposure Draft. "PricewaterhouseCoopers" refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

We support the proposed amendment to allow an entity that is a parent, and whose ultimate parent produces financial statements in which the entity is measured at fair value, to be exempt from preparing consolidated financial statements where the other conditions for exemption are met.

We believe there is some confusion and inconsistency within the standards as to whether financial statements produced by an investment entity are consolidated or separate financial statements. We believe it would be helpful to separately define "investment entity financial statements" and use this definition as the basis for clarifying and resolving the inconsistency.

We agree that the proposed amendment to clarify that a subsidiary which is an investment entity and provides investment-related services to third parties should not be consolidated addresses the question put to the Interpretations Committee. However we have some concerns as to the possible consequences of the proposed amendments and suggest some alternative wording.

We do not support the proposed amendments to require that a non-investment entity investor apply a different method of equity accounting to an investment in a joint venture than it does to an investment in an associate. We believe the amendments would introduce unnecessary complexity to equity accounting and the information required to perform the proposed accounting will not always be available.

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Our responses to the specific questions posed in the invitation to comment are attached as Appendix 1 to this letter and include suggestions to clarify the wording of several of the proposed amendments.

If you have any questions in relation to this letter please do not hesitate to contact Paul Fitzsimon, PwC Global Chief Accountant (001 416 869 2322) or Mary Dolson (020 7804 2930).

Yours faithfully

PricewaterhouseCoopers.

PricewaterhouseCoopers

pwc

Appendix 1

Detailed responses to the specific questions in the Exposure Draft

Question 1: ***Exemption from preparing consolidated financial statements***

The IASB proposes to amend IFRS 10 to confirm that the exemption from preparing consolidated financial statements set out in paragraph 4(a) of IFRS 10 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 in accordance with paragraph 31 of IFRS 10. Do you agree with the proposed amendment? Why or why not?

We support the proposed amendment to allow an entity that is a parent, and whose ultimate parent produces financial statements in which the entity is measured at fair value, to be exempt from preparing consolidated financial statements. As the entity would also be required to meet the other conditions in IFRS 10 para 4(a) in order to claim the exemption, we believe the availability of the exemption would reflect the needs of both users and preparers of the financial statements.

We note that some operating companies which previously produced consolidated financial statements and which are controlled by a Private Equity or other Investment Entity parent might now qualify for the exemption. As the other conditions in IFRS 10 para 4(a) would also need to be met, including agreement by all of the owners that consolidated financial statements are not required, we do not believe this to be inappropriate.

We also support the proposed deletion of the wording that an investment entity "need not present consolidated financial statements". We are aware that in some jurisdictions, local legislation might require the preparation of consolidated financial statements. This requirement, in conjunction with the previous wording in the standard, had resulted in questions over whether investment entities could choose to also prepare consolidated financial statements and describe those financial statements as being IFRS compliant. We consider it appropriate to describe such consolidated financial statements as "special purpose" financial statements rather than "IFRS financial statements", and welcome the clarification provided by the proposed amendment.

We believe there is confusion as to whether the financial statements produced by an investment entity should be viewed as consolidated or separate financial statements:

- IFRS 10 para 32 requires that an investment entity consolidate a subsidiary which provides services relating to the investment entity's investment activities.
- However, IAS 27 para 8A requires that an investment entity present separate financial statements as its only financial statements.

The requirements of the two standards would appear inconsistent. We are also aware that there might be local regulatory requirements in some jurisdictions that traditional separate financial statements in accordance with IAS 27 be produced and some might consider the above paragraphs prevent them from doing so.

To address this concern, we suggest that the financial statements to be prepared by an investment entity be defined. We propose the following additional amendments (double-underlined):

- "IFRS 10 para 4c - an investment entity ~~need not present consolidated financial statements it is~~ that is required, in accordance with paragraphs 31 and 32 of this IFRS, to measure all of its subsidiaries at fair value through profit or loss other than subsidiaries which provide services that relate to the investment entity's investment activities and are consolidated. Such financial statements produced by the investment entity (regardless of whether they do consolidate subsidiaries which provide services that relate to the investment entity's investment activities) are referred to as "*investment entity financial statements.*"

- "IAS27.8A – An investment entity that is required, through the current period and all comparative periods presented, to apply the exception to consolidation for all of its subsidiaries in accordance with paragraph 31 of IFRS 10 presents ~~separate~~ investment entity financial statements (as defined in IFRS 10.4c) as its only financial statements. An investment entity which consolidates subsidiaries in accordance with paragraph 32 of IFRS 10 may present separate financial statements in addition to its investment entity financial statements."

There are two additional areas where we suggest clarification is provided:

a) Investment entity group structures are often complex. An investment entity might have an investment entity subsidiary which in turn has a subsidiary which provides investment-related services.

   It would be helpful to clarify that IFRS 10 para 32 would not require the investment entity subsidiary in such a structure to prepare consolidated financial statements. We suggest the following amendment:

   "Notwithstanding the requirement in paragraph 31, if an investment entity has a subsidiary that provides services that relate to the investment entity's investment activities, and the investment entity does not meet the conditions in paragraph 4a it shall consolidate that subsidiary in accordance with paragraphs 19-26 of this IFRS and apply the requirements of IFRS 3 to the acquisition of any such subsidiary."

b) The current wording in IAS 28.17d might prevent an investment entity which consolidates a subsidiary in accordance with IFRS 10 para 32 from qualifying for the exemption from equity accounting for an associate or joint venture.

   We suggest the paragraph be clarified to more specifically reference that situation:

   "The ultimate or any intermediate parent of the entity produces ~~consolidated~~ financial statements available for public use that comply with IFRSs, including the requirements of IFRS 10 Consolidated Financial Statements to consolidate subsidiaries or measure them at fair value or both."

This is another area where providing a definition of "investment entity financial statements" as described above might help provide clarity.

Question 2: ***A subsidiary that provides services that relate to the parent's investment activities***

The IASB proposes to amend IFRS 10 to clarify the limited situations in which paragraph 32 applies. The IASB proposes that the requirement for an investment entity to consolidate a subsidiary, instead of measuring it at fair value, applies only to those subsidiaries that act as an extension of the operations of the investment entity parent, and do not themselves qualify as investment entities. The main purpose of such a subsidiary is to provide support services that relate to the investment entity's investment activities (which may include providing investment-related services to third parties). Do you agree with the proposed amendment? Why or why not?

We agree that the proposed amendments address the question raised regarding the importance of whether investment-related services are provided internally within the group or to third parties. However, we think that the wording of the proposed amendments could be improved to reduce potential abuse.

Previously, some investment entities continued to consolidate subsidiary companies which were themselves investment entities on the basis that the subsidiary was providing an investment-related service as an extension of the parent's activities. Now, if the subsidiary meets the definition of an investment entity it must be measured at fair value instead of being consolidated, even if the investment-related services performed are substantial. This could affect a number of different aspects of financial reporting. We describe two examples of this below.

Transparency of cost information

The specific entity in a group structure in which the operating costs of investment entity activity are recognised could lead to different levels of required disclosure.

For example, if the costs were incurred at a Topco level, such costs would be recognised as expenses in the Income Statement and so be disclosed on a granular basis.

However, if the costs were incurred at a subsidiary level, the costs would form part of the measurement of the subsidiary at fair value performed by Topco. There would be no required disclosure of the components of that fair value, and any detailed disclosure of underlying costs would be on a voluntary basis.

Revenue recognition

The deliberations on IFRS 15 (BC223, IE129-133) concluded that it would likely be appropriate for an entity which provides asset management services to recognise performance-based fees on an actual basis.

Therefore, where investment-related services for third parties are performed at a Topco level, revenue would likely be recognised on that actual basis.

However, if the investment-related service is performed at a subsidiary level, the associated service contracts (including performance fees and carried interests) would form part of the measurement of fair value of the subsidiary by the investment entity. This could lead to an effective acceleration of revenue recognition of performance-based fees. Such a result would appear inconsistent with the deliberations on the revenue project.

To address these concerns we propose the following amendment (double-underlined):

"Notwithstanding the requirement in paragraph 31, if an investment entity has (a) a subsidiary that ~~provides~~ is not itself an investment entity and whose main purpose is to provide services that relate to the investment entity's investment activities (see paragraphs B85C–B85E), or (b) a subsidiary which acts as an extension of the operations of the investment entity (except for those subsidiaries formed in connection with the entity only for legal, regulatory, tax or similar business reasons), it shall consolidate that subsidiary in accordance with paragraphs 19–26 of this IFRS and apply the requirements of IFRS 3 to the acquisition of any such subsidiary."

The proposed additional language is based on previous Board discussions (IFRS 10 para B85H, BC240). We think it would also avoid any unintended consequence of requiring consolidation in Master-Feeder structures (IFRS 10 IE12 to 15).

Question 3: ***Application of the equity method by a non-investment entity investor to an investment entity investee***

The IASB proposes to amend IAS 28 to:

a) **Require a non-investment entity investor to retain, when applying the equity method, the fair value measurement applied by an investment entity associate to its interests in subsidiaries; and**
b) **Clarify that a non-investment entity investor that is a joint venture in a joint venture that is an investment entity cannot, when applying the equity method, retain the fair value measurement applied by the investment entity joint venture to its interests in subsidiaries.**

Do you agree with the proposed amendments? Why or why not?

We are not supportive of the proposed amendments to require that a non-investment entity investor apply a different method of equity accounting to an investment in a joint venture than it does to an investment in an associate.

We believe that having two different types of equity accounting will introduce unnecessary complexity. We do not believe it will always be possible for a joint venturer to obtain the financial information necessary to reverse the fair value accounting performed by the joint venture and instead perform a sub-consolidation at the joint venture level.

As the investor in the joint venture is ultimately investing in an investment entity rather than in the underlying investments of the investment entity, we believe it would be more appropriate in the equity accounting to reflect the investee as an investment entity. The fair value measurement performed by the investment entity would better-reflect that result.

We also note that the proposed amendments would appear to create a conflict in the existing IAS 28 for movements between an associate and joint venture.

Currently, IAS 28 para 24 states that if an investment in an associate becomes an investment in a joint venture, or an investment in a joint venture becomes an investment in an associate "*the entity continues to apply the equity method and does not remeasure the retained interest.*"

However, the proposed amendments would require a change in measurement. For example, where an investment in an associate becomes an investment in a joint venture, there would be a change from equity accounting for the fair value measurement to equity accounting for a sub-consolidation.

The requirement to remeasure the retained interest does not appear to have been considered within the proposed amendments.

Other observations

Transition requirements

We agree that the proposed amendments should be applied retrospectively.

We suggest it be clarified that the quantitative information required by paragraph 28(f) of IAS 8 is only required for the annual period immediately preceding the date of initial application of this IFRS, and that while an entity may also present this information for the current period or for earlier comparative periods it is not required to do so. This approach would be consistent with the transition requirements of IFRS 10 para 2A.

IFRS 12 Disclosure requirements

IAS 27 para 8A indicates that an investment entity presents separate financial statements. Although IFRS 12 paras 19A to 19G 12 contain disclosure requirements for investment entities, as IFRS 12 para 6 scopes out separate financial statements (unless there are any unconsolidated structured entities), this would appear to scope investment entities from the requirements of the standard.

We think that our proposal in question 1 to define investment entity financial statements as being different from separate financial statements will be an effective method of addressing this problem.

Building a better working world

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The Chairman
Australian Accounting Standards Board
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25 September 2014

Dear Mr Thomson

Ernst & Young's global submission to the IASB on the Invitation to comment – Exposure Draft ED/2014/2 *Investment Entities: Applying the Consolidation Exception (Proposed amendments to IFRS 10 and IAS 28)*

Please find enclosed Ernst & Young's global submissions to the IASB on the above exposure draft.

Yours sincerely

Ernst & Young

Encl:

Building a better working world

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INVESTOR IN PEOPLE

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15 September 2014

Dear Board members,

Invitation to comment – Exposure Draft ED/2014/2 *Investment Entities: Applying the Consolidation Exception (Proposed amendments to IFRS 10 and IAS 28)*

Ernst & Young Global Limited, the central coordinating entity of the global EY organisation, welcomes the opportunity to offer its views on Exposure Draft ED/2014/2 *Investment Entities: Applying the Consolidation Exception (Proposed amendments to IFRS 10 and IAS 28)* (the ED).

We support the Board in its efforts to address the implementation issues that have arisen in applying the exception to consolidation for investment entities. We believe that providing clear guidance on these issues will reduce diversity in practice.

However, we are aware of a number of practical difficulties in applying the exception, particularly to groups with multi-layer structures and request that the Board reconsiders the concepts and practical application of the exception before finalising the amendments. As explained in our response to Question 2, we believe some of the proposed amendments may create the opportunity for structuring transactions solely to achieve an accounting result. We also believe that in some scenarios the accounting treatment will not produce information that is of most value to users of the financial statements.

In addition, we have some concerns regarding the proposed different requirements for associates and joint ventures of non-investment entity parents that are applying equity accounting. Our concerns are explained in our response to Question 3.

Should you wish to discuss the contents of this letter with us, please contact Leo van der Tas on +31 88 407 5035.

Yours faithfully

Ernst + Young Global Limited

Appendix 1 – Response to questions

Question 1 – Exemption from preparing consolidated financial statements

The IASB proposes to amend IFRS 10 to confirm that the exemption from preparing consolidated financial statements set out in paragraph 4(a) of IFRS 10 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 in accordance with paragraph 31 of IFRS 10. Do you agree with the proposed amendment? Why or why not?

We believe that the proposal to allow the exemption in paragraph 4(a) of IFRS 10 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 in accordance with paragraph 31 of IFRS 10), may result in a loss of information when the ultimate parent entity measures all investments in subsidiaries at fair value. However, we support the proposal as we believe there are appropriate safeguards in place in paragraph 4 of IFRS 10 to ensure that users of the financial statements are able to access information, namely the requirement that all shareholders do not object; combined with the additional disclosure requirements contained in paragraphs 19A to 19G of IFRS 12 *Disclosures of Interests in Other Entities*.

Question 2 – A subsidiary that provides services that relate to the parent's investment activities

The IASB proposes to amend IFRS 10 to clarify the limited situations in which paragraph 32 applies. The IASB proposes that the requirement for an investment entity to consolidate a subsidiary, instead of measuring it at fair value, applies only to those subsidiaries that act as an extension of the operations of the investment entity parent, and do not themselves qualify as investment entities. The main purpose of such a subsidiary is to provide support services that relate to the investment entity's investment activities (which may include providing investment-related services to third parties). Do you agree with the proposed amendment? Why or why not?

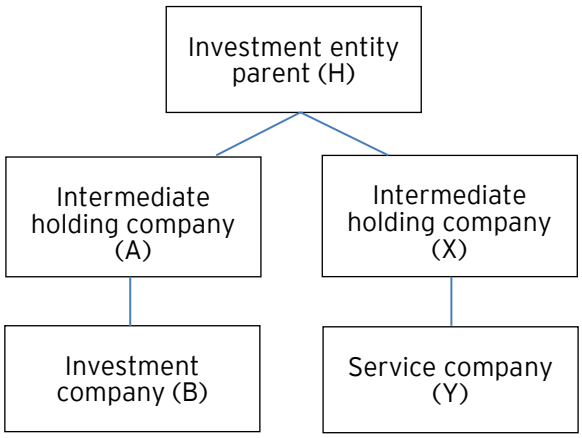
The investment entity exception was introduced to provide the most meaningful information to users of the financial statements. We have observed practical difficulties in applying the exception, particularly in the case of multi-layer structures, some of which are highlighted in the examples below. Given these practical issues, we believe the Board should reconsider the application of the exception to assess at which level in a multi-layer structure, consolidation or fair value information is most useful to users. We believe such considerations may include circumstances where there is an exit strategy for the investments. We acknowledge the challenges in developing a robust and workable model, but we strongly recommend that the Board revisits how the investment entity exception is applied in practice before finalising the amendments.

We have concerns that the amendments as drafted provide structuring opportunities for entities that do not wish to disclose the fair values of individual investments. Under the proposed amendments, what is reported in the financial statements would depend on the group structure, not the substance of the arrangement, which reduces the usefulness of information to users of the financial statements. As drafted, if an entity inserts a new holding company above a portfolio of investments, the financial statements may be very different compared with financial statements for which there is no holding company, as they will be based on fair valuing the investment in the holding company, not fair valuing each investment.

Despite our concerns highlighted above, if the Board intends to issue the proposed amendments, we believe the proposal to clarify that paragraph 32 only applies to subsidiaries that act as an extension of the operations of the investment entity parent and do not themselves qualify as investment entities, will reduce diversity.

We believe that, in practice, it can be difficult to determine which entities are investment entities when they are part of a multi layered group structure.
This is shown in the two examples below.

Example 1

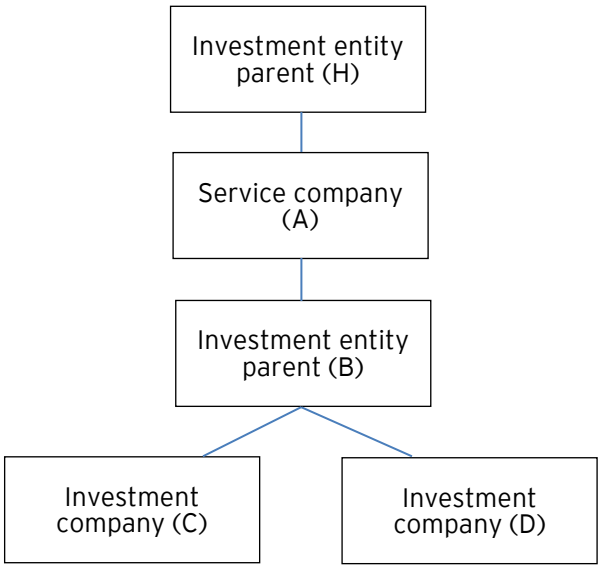


In this example, we think, that after the proposed amendment, IFRS 10 is clear that H will fair value entity A. Entity X is a holding company for entity Y which provides investment services, but is not an investment entity itself. We believe that entity X should be consolidated by H. However, this is not clearly stated in the standard, which could lead to differing interpretations.

We note that paragraph BC12 in the Basis of Conclusions to the amendments states: '… if a subsidiary provides investment-related services as an extension of the investment entity's core activities, then the subsidiary would qualify for the limited exception in paragraph 32 of IFRS 10. Otherwise, the subsidiary will be measured at fair value in accordance with paragraph 31 of IFRS 10.' We believe this statement clarifies the IASB's intention and, in our example above, would result in entity X being consolidated as it is providing only investment

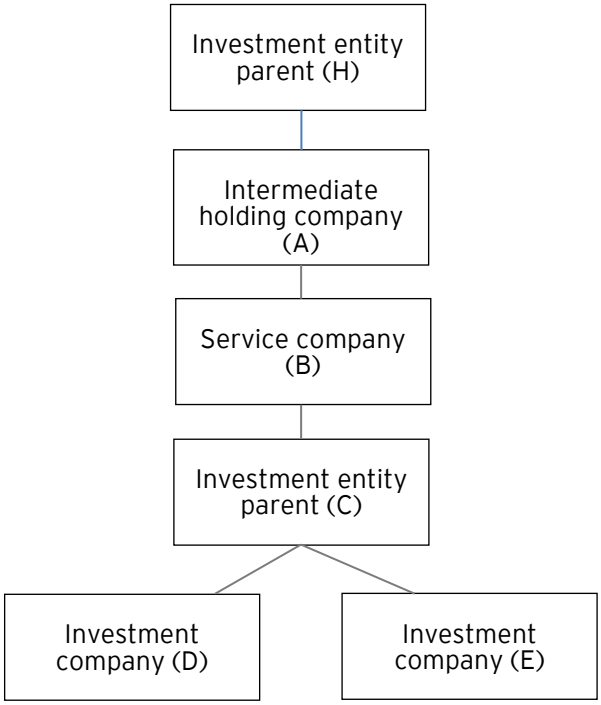
services as an extension of entity H. We recommend that the IASB incorporates this point into the amendments to the standard, not just in the Basis for Conclusions.

Example 2(a)



In this example, entity A provides investment services; it is not itself an investment entity, even though Holding H holds its investments through entity A. Beneath entity A is intermediate investment entity parent B, which holds investments. In this scenario, we believe it is unclear, from the standard proper whether parent H should consolidate entity A or account for it at fair value. However, if, as described above, we apply the considerations explained in paragraph BC12 of the Basis for Conclusions, we believe entity A will be accounted for at fair value. In this example, though, we believe users of the financial statements would have access to more useful information if entity A were consolidated.

Example 2(b)



Similar to example 2(a) above, however now there is an intermediate holding company between parent H and service company B. We believe the intention is for parent H to account for holding company A at fair value, although we do not believe this is clearly stated in the amendments. Similar to the concerns we raised about example 2(a) above, we do not believe that this provides the most useful information to users.

Question 3 – Application of the equity method by a non-investment entity investor to an investment entity investee

The IASB proposes to amend IAS 28 to:
(a) require a non-investment entity investor to retain, when applying the equity method, the fair value measurement applied by an investment entity associate to its interests in subsidiaries; and
(b) clarify that a non-investment entity investor that is a joint venturer in a joint venture that is an investment entity cannot, when applying the equity method, retain the fair value measurement applied by the investment entity joint venture to its interests in subsidiaries.

Do you agree with the proposed amendments? Why or why not?

We agree with the proposed amendment to require a non-investment entity investor to retain the fair value measurement applied by an investment entity associate to its interests in subsidiaries and we believe that unwinding this accounting to consolidate those interests would be impractical.

We have a number of concerns about the Board's view that a non-investment entity investor that is a joint venturer in a joint venture that is an investment entity should not retain the fair value measurement applied by the investment entity, joint venture to its interests in subsidiaries:

- We agree with the view that joint control is not the same as significant influence. However, we also believe that joint control is not the same as control. Therefore, conceptually, investments held by a joint venture do not need to be treated in the same way as investments held by a subsidiary, for the purpose of equity accounting.
- We disagree with introducing two different accounting treatments for investments that are both accounted for under the equity method. If the Board proceeds with the proposal to have different treatments for associates and joint ventures, we believe paragraph 24 of IAS 28 will require clarification. This paragraph states that where an investment in an associate becomes an investment in a joint venture, or vice versa, the entity continues to apply the equity method. However, it is not clear whether the previous accounting would need to be amended if a non-investment entity had an investment in an investment entity associate, which became an investment in an investment entity joint venture.
- In practical terms, we are also concerned that although investors in a joint venture should be able to access the information to allow it to consolidate interests in subsidiaries, this may be difficult and the cost incurred to do so may outweigh any benefit.

Therefore, we believe the Board should consider extending the exemption in (a) above to investments in joint ventures.