ED254 sub 2

AASB 11 February 2015
Agenda paper A2 (M143)

Submission ED 2014/4: Measuring quoted investments in subsidiaries, joint ventures and associates at fair value

December 2014

IPA INSTITUTE OF PUBLIC ACCOUNTANTS

Partnership beyond numbers

17 December, 2014

The Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West
Victoria 8007

By email: standard@aasb.gov.au

Dear Madam

Measuring Quoted Investments in Subsidiaries, Joint Ventures and Associated at Fair Value

Introduction

The Institute of Public Accountants (IPA) welcomes the opportunity to comment on the Exposure Draft ED 2014/4 *Measuring Quoted Investments in Subsidiaries, Joint Ventures and Associates at Fair Value* (proposed amendments to IFRS 10, IFRS 12, IAS 27, IAS 28 and IAS 36 and Illustrative Examples for IFRS 13). While the IPA supports the IASB attempt to address divergent practice in the fair value measurement of investments in subsidiaries, joint ventures and associates, we consider that the proposals in ED 2014/4 are flawed.

The IPA is a professional organisation for accountants recognised for their practical, hands-on skills and a broad understanding of the total business environment. Representing more than 35,000 members in Australia and in over 65 countries, the IPA represents members and students working in industry, commerce, government, academia and private practice. Through representation on special interest groups, the IPA ensures the views of its members are voiced with government and key industry sectors and makes representations to Government including the Australian Tax Office (ATO), Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA) on issues affecting our members, the profession and the public interest. The IPA recently merged with the Institute of Financial Accountants of the UK, making the new IPA Group the largest accounting body in the SMP/SME sector in the world.

Executive summary

We consider that the proposals in Draft ED 2014/4 have a number of flaws and, therefore, should not proceed as proposed:

1. There is a logical inconsistency in determining the unit of account of investments in subsidiaries, joint ventures and associates as the investment and not the financial instrument and then apply a measurement basis at a financial instrument level.

2. The assertion the investment is the appropriate unit of account is problematic. The IPA can envisage the situation when an investment in a subsidiary consists of various financial instruments (ordinary shares, convertible notes and loans) each with their own rights and obligations which would affect any valuation. As such, the IPA does not believe it is always appropriate for the unit of account to be set at the investment level.

3. While the Price x Quantity (PxQ) basis for determining the fair value of investments in subsidiaries, joint ventures and associates is prima facie consistent with the market based approach of IFRS 13, the IPA believes this premise is not always valid. Given the relative size of parcel of shares and the significant influence or control provided by such parcels quoted market process may not be the only factor market participants consider when determining the fair value of quoted shares that may represent the investment in a subsidiary, joint venture or associate.

Given these reservations the IPA believes, that although the divergence in practice of determining the fair value of investments in subsidiaries, joint ventures and associates which are listed entities, the proposal to mandate such investments be carried at a fair value measurement methodology based solely on PxQ does not reflect all the factors a market participant may consider. Therefore, the IPA recommends the IASB provide more comprehensive guidance factors to be considered on the determination of fair value investments, associates and joint ventures that are listed entities, rather than mandate a simplistic rule.

Our detailed comments and responses to the questions in the Exposure Draft are set out in Appendix A.

If you would like to discuss our comments, please contact me or our technical advisers Mr Stephen LaGreca (stephenlagreca@aol.com.) or Mr Colin Parker (colin@gaap.com.au), GAAP Consulting.

Yours faithfully

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APPENDIX A

Question 1 – The unit of account for investments in subsidiaries, joint ventures and associates

The IASB concluded that the unit of account for investments with the scope of IFRS 10, IAS 27 and IAS 28 is the investment as a whole rather than the individual financial instruments with that investment.
Do you agree with this conclusion? If not, why not and what alternative do you propose?

IPA response

While the IPA considers there are good arguments for the proposition that the unit of account for investments in subsidiaries, joint ventures and associates that are listed entities is the investment, where the investment comprises multiple financial instruments the proposition is not appropriate. Such an investment may not only comprise ordinary shares in the listed entity but also loans (subordinated or unsubordinated/secured or unsecured) and convertible financial instruments (secured or unsecured). Each of these instruments will have their own rights attached to them and may be integral in establishing control or significant influence. However, their unique rights would make it inappropriate to always consider them part of a single unit of account being "investment in X".

Question 2 – Interaction between level 1 inputs and the unit of account for investments in subsidiaries, joint ventures and associates

The IASB proposes to amend IFRS 10, IFRS 12, IAS 27 and IAS 28 to clarify that the fair value measurement of quoted investments in subsidiaries, joint ventures and associates should be the product of the quoted price (P) multiplied by the quantity of financial instruments held (Q) or PxQ without adjustments.
Do you agree with the proposed amendments? If not, why and what alternative do you propose? Please explain your reasons, including commenting on the usefulness to users of financial statements.

IPA response

The IPA believes if the proposition is that an investment in a subsidiary, joint venture or associate is the unit of account, it is not logically consistent to mandate a fair value measurement basis based on individual financial instruments (not withstanding our comments at Question 1).

Furthermore, while the IPA believes the use of observable market inputs should usually be preferred as they most often represent the price a market participant would pay for an asset. However, we are unconvinced this would necessarily be the case in relation to the parcel of financial instruments that comprised an investment in a subsidiary, joint venture or associate that is a listed entity. It could be argued a measurement based an unadjusted PxQ may not be that basis used by market participants because:

1. In many jurisdictions, the trading parcel of shareholdings that could result in change of control may trigger offers at the price paid by the new controlling shareholder to a minority interest. This in effect means the quoted market price may not reflect that premium for control that would accrue to minority shareholders as a result of legal requirements to make an equivalent offer to minority shareholders.

2. The observable market price may be suppressed when there is a parcel of shares available for sale.
3. The minority shares may only be thinly traded and therefore it could be argued that price is not representative.
4. The market price may not reflect the ability or otherwise to dispose of strategic stake.

Furthermore if a PxQ valuation basis was adopted this would entail potentially the requirement for a write down of any investment where a premium was paid for control at the next reporting date, as is quite possible such a premium may not be reflected in the price of shares remaining with outside shareholders. Such a write-off provides no useful information to users of the financial report, particularly if it represents a parent entity only entry. Consequently the IPA recommends the IASB does not simply mandate a measurement basis represented by PxQ for investments in subsidiaries, joint ventures and associates that are listed entities, but rather provide detailed guidance on the factors to be considered when determining the fair value of such investments.

Question 3 – Measuring the fair value of a CGU that corresponds to a quoted entity

The IASB proposes to align the fair value measurement of a quoted CGU to the fair value measurement of a quoted investment. It proposes to amend IAS 36 to clarify that the recoverable amount of a CGU that corresponds to a quoted entity measured on the basis of fair value less cost of disposal should be the product of the quoted price (P) multiplied by the quantity of the financial instrument (Q) or PxQ, without adjustments. To determine fair value less cost of disposal, disposal costs are deducted from the fair value amount measured on this basis.
Do you agree with the proposed amendments? If not, why and what alternative do you propose?

IPA response

For the reasons set out in the response to Question 2, the IPA recommends the IASB provide comprehensive guidance on the factors to be considered when determining fair value of a CGU that is a listed entity rather than mandate a basis of PxQ.

Question 4 – Portfolios

The IASB proposes to include an illustrative example to IFRS 13 to illustrate the application of paragraph 48 of that Standard to a group of financial assets and financial liabilities whose market risks are substantially the same and whose fair value measurement is categorised within Level 1 of the fair value hierarchy. The example illustrates that the fair value of the entity's net exposure is to be measured in accordance with the corresponding Level 1 prices.
Do you think that the proposed additional illustrative example for IFRS 13 illustrates the application of paragraph 48 of IFRS 13? If not, why not and what alternative do you propose?

IPA response

The IPA supports the inclusion of additional illustrative guidance to IFRS 13.48.

Question 5 - Transition provisions

The IASB proposes that the amendments to IFRS 10, IAS 27 and IAS 28, an entity should adjust its opening retained earnings, or other component of equity, as appropriate, to account for any difference between the previous carrying amount of the quoted investment(s) in subsidiaries, joint ventures or associates and the carrying amount of those quoted investment(s) at the beginning of the reporting period in which the amendments are applied.
The IASB proposes that the amendments to IFRS 12 and IAS 36 should be applied prospectively.

The IASB also proposes disclosure requirements on transition and to permit early application.
Do you agree with the transition methods proposed? If not, why, and what alternative do you propose?

IPA response
If the proposal is to be adopted, the IPA supports the proposed transitional requirements.