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The Chair
Australian Accounting Standards Board
PO BOX 204
Collins Street
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10 February 2015

Dear Ms Peach

**Ernst & Young's global submission to the IASB on the Invitation to comment –
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, IAS 36 and Illustrative Examples for IFRS 13)**

Please find enclosed Ernst & Young's global submission to the IASB on the above discussion paper.

Yours sincerely

Ernst & Young

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International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

15 January 2015

Dear Board members,

Invitation to comment - 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, IAS 36 and Illustrative Examples for IFRS 13)

Ernst & Young Global Limited, the central coordinating entity of the global EY organisation, welcomes the opportunity to offer its views on Exposure Draft ED/2014/4 *Measuring Quoted Investments in Subsidiaries, Joint Ventures and Associates at Fair Value* (Proposed amendments to IFRS 10, IFRS 12, IAS 27, IAS 28, IAS 36 and Illustrative Examples for IFRS 13) (the ED).

We support the Board in its efforts to address the implementation issues that have arisen in applying the requirements of IFRS 13 *Fair Value Measurement*. We believe that providing clear guidance will help to reduce diversity in practice. Clarifying the unit of account for subsidiaries, joint ventures and associates is also helpful.

We are concerned that the proposed measurement requirements are contrary to the core principle already contained in IFRS 13 (i.e., to measure fair value of an asset on a basis that is consistent with its appropriate unit of account). Furthermore, the proposed amendments would result in different fair value measurement requirements for investments that are listed in active markets and those that are either listed in markets that are not active or are not listed. This would likely place additional pressure on the definition of an active market.

We believe the use of the quoted price of an individual equity instrument is only appropriate when measuring the fair value of individual equity instruments in accordance with IAS 39 *Financial Instruments: Recognition and Measurement* or IFRS 9 *Financial Instruments*. Therefore, using the quoted price of an individual equity instrument (without adjustment) to measure the fair value of investments in subsidiaries, joint ventures and associates is inconsistent with the proposed unit of account for those investments (i.e., the investment as a whole). Therefore, if the Board elects to proceed with the amendments proposed in the ED, we would strongly recommend that:

- ▶ They be characterised as an exception to the principle in IFRS 13
- ▶ The reason(s) for deviating from the principle in IFRS 13 be clearly explained in the Basis for Conclusions

We also note that the proposed amendments may have a consequential impact to other standards. Please refer to our response to Question 2 in the attached Appendix for further details.

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 – Response to questions

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

The IASB concluded that the unit of account for investments within the scope of IFRS 10, IAS 27 and IAS 28 is the investment as a whole rather than the individual financial instruments included within that investment (see paragraphs BC3-BC7).

Do you agree with this conclusion? If not, why and what alternative do you propose?

We believe that providing clarification regarding the unit of account for subsidiaries, joint ventures and associates is helpful. However, it is not clear why the exposure draft (ED) only proposes to include this clarification in the Basis for Conclusions, rather than within the applicable standards. We consider it necessary to incorporate such guidance within the body of IFRS 10 *Consolidated Financial Statements*, IAS 27 *Separate Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures*.

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 $P \times Q$, without adjustments (see paragraphs BC8-BC14).

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 of the information provided to users of financial statements.

While we appreciate the intention to increase the robustness of the fair value measurement of investments in associates, joint ventures and subsidiaries, we are concerned that the proposed measurement requirements are contrary to the core principles contained in IFRS 13 (i.e., to measure fair value of an asset on a basis that is consistent with its appropriate unit of account).

We believe the use of the quoted price of an individual equity instrument is only appropriate when measuring the fair value of individual equity instruments in accordance with IAS 39 *Financial Instruments: Recognition and Measurement* or IFRS 9 *Financial Instruments*. Therefore, using the quoted price of an individual equity instrument (without adjustment) to measure the fair value of investments in subsidiaries, joint ventures and associates is inconsistent with the proposed unit of account for those investments (i.e., the investment as a whole).

As there are no active markets that trade in such units of account, all fair value measurements of investments in associates, joint ventures and subsidiaries would need to be categorised (in their entirety) within Level 2 or Level 3 of the fair value hierarchy. The market price of an individual equity instrument would, therefore, only be appropriate to use as one of many factors considered in measuring fair value for the investment as a whole.

The fact that an investment is comprised of individual financial instruments (as discussed in paragraph BC8(b) of the Basis for Conclusions to the ED) does not, in our view, define or override the unit of account for the investment as a whole. Similar to concerns that a sum-of-the-parts approach may not give a result that is consistent with the fair value of the whole for an item of plant and equipment, we are concerned that using the quoted price multiplied by the quantity held (PxQ) may not be the same as the fair value of the investment in a subsidiary, joint venture or associate, as a whole.

Therefore, if the Board elects to proceed with the amendments proposed in the ED, we strongly recommend they be characterised as an exception to the principle in IFRS 13 and the reason(s) for deviating from the principle in IFRS 13 be clearly explained.

Furthermore, we believe the Board would need to address the inconsistency between listed and unlisted investments. As currently proposed, the fair value of an investment that is quoted in an active market would not include adjustments for premiums relating to control, joint control or significant influence. However, the fair value of an investment that is either quoted in a market that is not active or is not listed could potentially include such adjustments. We believe that this difference would put unnecessary additional pressure on the definition of an active market, as this will be key to determining which measurement requirements are applied, and when such premiums could be considered.

We also believe additional application guidance would be needed to assist constituents in understanding what these control/significant influence adjustments represent and when they may be appropriate if the instrument is not quoted in an active market. As this is a valuation matter, we understand the Board may wish to use its relationships with other bodies, such as the International Valuation Standards Board, to develop such guidance.

If the Board does not agree with the above, but wishes to ensure consistency between the unit of account and unit of measurement, an alternative would be to define the unit of account for investments in subsidiaries, joint ventures and associates as the individual instruments that comprise the investment as a whole. Defining the unit of account as the individual instrument would also be consistent with the unit of account in IAS 39 and IFRS 9. However, we would not support such an approach because of the consequences for investments in subsidiaries, joint ventures and associates, for which the individual instruments that comprise the investment as a whole are not traded in an active market.

Other comments

The proposed amendments affect IFRS 10, IFRS 12, IAS 27 and IAS 28. However, for completeness, we believe amendments would also be needed in respect of:

- ▶ IFRS 3 *Business Combinations* - to address the fair value measurement implications when acquiring a listed subsidiary and fair value measurements of non-controlling interests on acquisition of a subsidiary.
- ▶ IFRS 5 *Non-Current Assets Held for Sale and Discontinued Operations* - to address the fair value of a subsidiary's assets and liabilities (or investments in joint ventures or associates) that have been classified as held for sale. We believe that the use of PxQ in such situations would lead to a possible increase in the volatility of reported earnings as such held for sale assets and liabilities may be sold for a price that is not based on PxQ.

- ▶ IFRS 10 - to address the impact on the fair value measurement of a retained interest in situations where an entity loses control of a subsidiary.

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 costs of disposal should be the product of the quoted price (P) multiplied by the quantity of financial instruments held (Q), or $P \times Q$, without adjustments (see paragraphs BC15-BC19). To determine fair value less costs 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?

We are concerned that the proposed measurement requirements are inconsistent with the definition of a CGU (i.e., the unit of account for testing CGUs for impairment). Requiring the use of Level 1 prices (without adjustment) to measure the fair value of a CGU is inconsistent with the general requirements of IFRS 13 (i.e., to measure fair value assuming the sale of an asset on a basis consistent with its appropriate unit of account (i.e., a sale of the CGU).

If the Board elects to proceed with the proposal as currently drafted, we believe the following would need to be addressed:

- ▶ The proposed wording of paragraph 21A of IAS 36 appears inconsistent with the discussion in the Introduction and the Basis for Conclusions to the ED. The Introduction and Basis for Conclusions refers to measuring the fair value of a CGU. However, the proposed wording in paragraph 21A of IAS 36 only refers to an asset. As such, it is not clear whether the Board intends the proposed requirements to apply to impairment testing of:
 - ▶ Investments in subsidiaries, joint ventures and associates when the relevant standards require application of the requirements in IAS 36
 - Or
 - ▶ CGUs that correspond to a quoted entity
 - Or
 - ▶ Both of the above
- ▶ The ED refers to CGUs that correspond to a quoted entity. IAS 36 defines a CGU as smallest identifiable group of assets that together have cash inflows that are largely independent of the cash inflows from other assets. Even if a CGU is largely consistent with a listed entity, the CGU would likely exclude items such as liabilities and tax. As such, situations where CGUs are identical to listed entities may be rare.

Furthermore, the use of the term 'corresponds' in the ED is not clear. That is, does the Board intend for the proposed requirements to apply to:

- ▶ Only those situations where the CGU is identical to the listed entity
 - Or
 - ▶ In some, or all, situations where a CGU is similar to, but not necessarily identical to, a listed entity
- ▶ Additional uncertainties exist about when the proposed requirements may apply. For example:
- ▶ If an entity is testing goodwill for impairment, it may need to do so across a group of CGUs. If the group of CGUs is identical (or similar) to a listed entity, would the entity be restricted to applying a PxQ approach only for purposes of testing goodwill for impairment or would this also have to be considered at a lower level (i.e., individual CGUs that comprise the group of CGUs)?
 - ▶ If goodwill is monitored below the level of a listed entity or if the entity has defined their operating segments below the level of a listed subsidiary: would the determination of fair value less costs of disposal of a CGU that is part of a listed entity be affected by the fair value of the listed entity?

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 an entity's net exposure to market risks arising from such a group of financial assets and financial liabilities 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 and what alternative do you propose?

We support the Board's efforts to provide examples to illustrate application of the requirement of IFRS 13 when measuring the fair value of a portfolio containing financial instruments with offsetting risks. The proposed illustrative example (paragraph IE47B of the ED) only considers situations where: (a) a portfolio is made up entirely of Level 1 assets; and (b) both the asset and liability positions have an identical Level 1 price. We believe there is a risk that constituents may infer principles from this simple example that could lead to unintended consequences. For example, is the coincidental statement made in paragraph IE47F of the ED intended to be a principle? That is, should the net position always reflect the mid-price of the asset adjusted for the bid-offer reserve? This may be particularly important to clarify for situations in which there are different bid-ask spreads for the long and short side of the portfolio. Furthermore, this paragraph raises questions regarding the use of the mid-market practical expedient, as noted in paragraph 71 of IFRS 13. It is unclear in what circumstances this expedient could be applied when an entity applies the portfolio approach.

We believe additional application guidance and/or illustrative examples are needed when a portfolio is comprised of financial assets and liabilities with Level 1 prices, but there are different Level 1 prices for the asset and liability positions (e.g., when the asset is a long listed bond position and the liability is a short futures position). In such circumstances, it is not clear whether an entity would value:

- i) The net position, utilising the price associated with that net position (i.e., the Level 1 asset or liability price, as applicable)

Or

- ii) The assets using the Level 1 asset price and the liabilities using the Level 1 liability price, thereby effectively precluding the group of items from being valued as a portfolio.

Furthermore, in this situation it is not clear how an entity would allocate value for presentation and disclosure purposes if it valued the net position utilising the price associated with that net position (i.e., alternative (i) above). For example:

1. For presentation purposes, would either or both of the gross positions be presented using their corresponding Level 1 price?
2. If both gross positions need to be presented using their respective Level 1 prices, where would an entity present the difference between the sum of the gross amounts and the net amount measured on a portfolio basis?
3. If only one of the gross positions needs to be presented using its corresponding Level 1 price, how would the entity determine which gross position needs to be presented utilising the respective Level 1 price (e.g., is it the gross position that corresponds with the net position)?

Similarly, we believe additional application guidance and/or illustrative examples are needed when a portfolio is comprised of assets and liabilities with a mixture of Level 1 and Level 2 prices (i.e., when an entity has both long and short futures contracts with a Level 1 price and also long and short forward contracts with a Level 2 or Level 3 price). In this fact pattern, it is not clear whether an entity would also be required to use Level 1 prices, where applicable (i.e., for the futures contracts), thereby effectively prohibiting the inclusion of these instruments when measuring the fair value of the net exposure. If the measurement of the net exposure is able to be determined without the constraint of using Level 1 prices, additional clarity is needed regarding how an entity would allocate value for presentation and disclosure purposes. For example, would the allocation take into account those items in the portfolio that have Level 1 prices? If so, it would seem that allocation of 'negative value' may be necessary?

Other comments

We note that the table included in proposed paragraph IE47C of IFRS 13 could be misleading. The line of the table with the description 'most representative exit price' includes the mid-price of CU100. However, the example goes on to illustrate that the mid-price of 100 is not the relevant exit price. The reference to 'bid-offer reserve' in proposed paragraph IE47F of IFRS 13 may also cause confusion. For example, the term 'reserve' is typically used in the context of equity, specifically as a subset of an entity's total equity.

We believe additional clarifications could be made to the Basis for Conclusions:

- ▶ BC26(b) - we disagree with statements made in this paragraph that the net position reflects how an entity 'would exit' or close out such outstanding risk exposure. We understand that such items churn at different times. For example, one swap matures (or is closed out early), but other derivatives with different maturities are still in place. New items are then added that have different maturities than the existing ones.
- ▶ BC27(c) - we believe that references to a measurement 'maximising value' in this paragraph may be misleading as currently drafted. That is, a measurement for accounting purposes may reflect, but does not affect, the value that will be derived from a transaction in which it is sold or settled.

Question 5–Transition provisions

The IASB proposes that for 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 (see paragraphs BC32-BC33) and to permit early application (see paragraph BC35).

Do you agree with the transition methods proposed (see paragraphs BC30-BC35)? If not, why and what alternative do you propose?

We agree that amendments affecting only disclosure requirements should be applied prospectively. However, we are concerned that the proposed transition requirements for IAS 36 are inconsistent and contradictory with those for IFRS 10, IAS 27 and IAS 28, which may create additional challenges for entities to apply. We believe a single transition approach would be preferable.

- ▶ It is not clear why the proposed transition approaches for investments and CGUs are inconsistent.
- ▶ The proposed disclosure requirements for CGUs that are impaired in the year of adoption could result in entities determining the retrospective impact, but applying the amendments prospectively.

It is also not clear why there are no proposed transition requirements in relation to the proposed clarifications to the application of the portfolio approach, even though it could change practice.

We believe that entities should have the option to apply the amendments retrospectively, should they wish. However, we support the transition method currently proposed for the amendments to IFRS 10, IAS 27 and IAS 28 and recommend it also be applied to the proposed amendments to IAS 36. That is:

- ▶ Adoption from the beginning of the period in which the amendment is first applied (i.e., the date of initial application)
- ▶ Re-measurement at the date of initial application, with any changes arising due to application of the proposed requirements recognised in opening retained earnings
- ▶ Fair value measurement changes after the date of initial application recognised in profit or loss

Recent amendments to IFRS 10, IFRS 11, IFRS 12 and IFRS 13 require entities to adopt the amendments as a package. We would encourage the Board to require any amendments resulting from this limited scope project to be adopted as a package. Furthermore, since some standards have only become effective in recent years, we believe that retrospective application, if permitted by the Board, should be restricted to the date that the entity adopted the original version of the standards that would be amended.