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

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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?

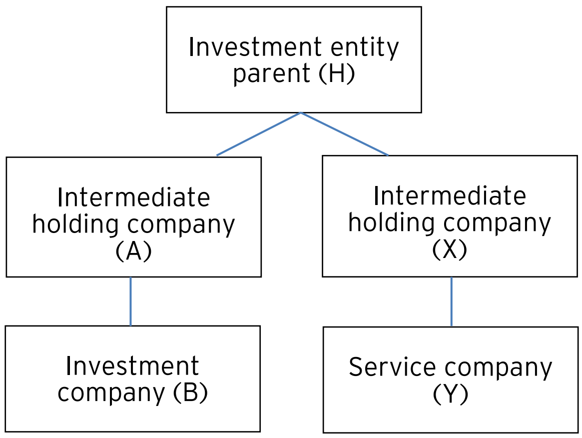
The investment entity exception was introduced to provide the most meaningful information to users of the financial statements. We have observed practical difficulties in applying the exception, particularly in the case of multi-layer structures, some of which are highlighted in the examples below. Given 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.

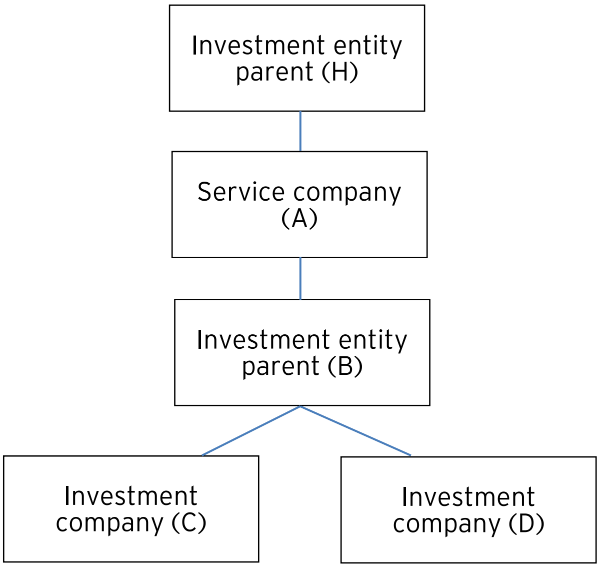
Example 1



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.

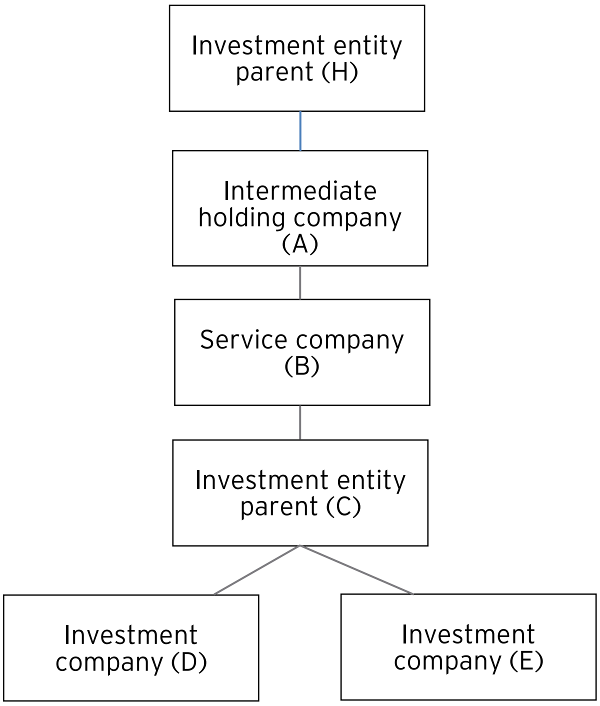
We note that paragraph BC12 in the Basis of Conclusions to the amendments states: '... if a subsidiary provides investment-related services as an extension of the investment entity's core activities, then the subsidiary would qualify for the limited exception in paragraph 32 of IFRS 10. Otherwise, the 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.