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

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.

Macquarie Group Limited is not an authorised deposit-taking institution for the purposes of the Banking Act 1959 (Cwth), and its obligations do not represent deposits or other liabilities of Macquarie Bank Limited ABN 46 008 583 542 (MBL). MBL does not guarantee or otherwise provide assurance in respect of the obligations of Macquarie Group Limited.

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 <u>choice</u> 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 <u>requirement</u> 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 <u>investor</u>. 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?