EFRAG

European Financial Reporting Advisory Group

Draft Comment Letter

Comments should be submitted by 31 December 2014 to
commentletters@efrag.org

29 October 2014

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

32. Sitzung IFRS-FA am 3.11.2014
32_06c_IFRS-FA_MQI_EFRAG_DCL

Dear Sir/Madam,

Re: *Measuring Quoted Investments in Subsidiaries, Joint Ventures and Associates at Fair Value*

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing 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),* issued by the IASB on 16 September 2014 (the 'ED').

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of definitive IFRS in the European Union and European Economic Area.

Notes to constituents

This comment letter will be finalised by the EFRAG Board which is expected to be in place by 31 October 2014. The EFRAG Board results from the recent and ongoing governance reform. It will be responsible for all EFRAG positions after considering the technical advice provided by the EFRAG Technical Expert Group and the outcome of EFRAG's due process.

Our detailed comments and responses to the questions in the ED are set out in the Appendix.

To summarise, we support the clarification that the unit of account for investments within the scope of IFRS 10 *Consolidated Financial Statements*, IAS 27 *Separate Financial Statements* and IAS 28 *Investments in Associates and Joint Venture* is the investment in a subsidiary, joint venture or associate as a whole rather than the individual financial instruments included within that investment.

However, we are concerned that determining the fair value measurement of an investment in a subsidiary, joint venture or associate, quoted in active market as the product of the quoted price of the financial instrument (P) multiplied by the quantity (Q) of instruments held (i.e. P × Q) will not always result in relevant information. Where the unit of account is the investment in a subsidiary, joint venture or associate, the price paid may include control premiums or discounts and consequently differ from the mathematical product P × Q. The resulting financial information lacks relevance, impairs the assessment of management stewardship and does not faithfully represent the substance of the transaction.

EFRAG notes that the proposed amendment was intended to eliminate divergent practices, with some issuers preparing estimates that were considered to provide relevant information consistent with the investment as a whole being the unit of account. The IASB has nevertheless justified its proposals on the basis that there would not be any better way available than the mathematical product P x Q to measure the fair value of an investment in a subsidiary, joint venture or associate quoted in an active market.

Before reaching such a conclusion, EFRAG believes that the IASB should analyse current practices in measuring fair value of this type of quoted investments including premiums and discounts and reassess where to strike the balance between relevance and reliability.

It is only after such an analysis has been conducted and its results have been publicly debated that EFRAG would – albeit reluctantly - accept the balance struck by the IASB in the ED between relevance and reliability. That is, EFRAG will only accept the proposals if it can be established that there is no better way than P x Q to measure the fair value of an investment in a subsidiary, joint venture or associate quoted in an active market. EFRAG has included in the appendix to this letter questions to constituents in order to gather valuable input to be shared with the IASB.

If you would like to discuss our comments further, please do not hesitate to contact Giorgio Acunzo, Didier Andries, Sebastian Harushimana or me.

Yours faithfully,

Françoise Flores
EFRAG Chairman

APPENDIX

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

Question 1

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?

Notes to constituents

1 *Currently, IFRS 10* Consolidated Financial Statements*, IAS 27* Separate Financial Statements *and IAS 28* Investments in Associates and Joint Ventures *refer to IAS 39* Financial Instruments: Recognition and Measurement *regarding some measurement requirements to assess the fair value of financial assets that are investments in subsidiaries, joint ventures or associates. IAS 39 requires measuring the fair value of individual financial instruments that constitute the investments.*

2 *The ED proposes to clarify that those references to IAS 39 refer only to the measurement basis of the investments (for example, fair value through profit or loss) and they do not prescribe the unit of account of those investments (i.e. the individual financial instruments that make up the investment). Those references aim to ensure consistent application of all measurement requirements in IAS 39 (i.e. treatment of any differences between the fair value at initial recognition and the transaction price).*

3 *The IASB is also seeking feedback on the assumptions underlying the proposals in the ED; namely that the unit of account is set by the nature of an entity's relationship with an investee, based on the level of control or influence in that investee. That is, the relationship is the relevant characteristic for those investments to be included within the scope of IFRS 10, IAS 27 and IAS 28. Accordingly, that characteristic (i.e. the level of control or influence) determines that the relevant unit of account in those Standards is the investment to which that key characteristic applies, instead of the individual financial instruments that make up the investment.*

EFRAG's response

EFRAG agrees that the unit of account for investments within the scope of IFRS 10, IAS 27 and IAS 28 is the investment as a whole to which the level of control or influence is assessed in scoping the investment in those Standards, instead of the individual financial instruments that make up the investment. However, we believe that the proposed clarification should be included in the body of the Standards otherwise it would not be authoritative.

4 EFRAG agrees that the unit of account for investments in subsidiaries, associates and joint ventures is the investment to which the Standards apply.

5 However, we believe that the IASB should include all relevant accounting guidance in the Standards and not in the Bases for Conclusions, which should only reflect the arguments that the IASB considered in forming its views. Accordingly, we believe that the proposed clarification regarding the unit of

account for investments in subsidiaries, associates and joint ventures should be included in the body of the Standards otherwise it would not be authoritative.

Interaction between Level 1 inputs and the unit of account for investments in subsidiaries, joint ventures and associates

Question 2

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 × 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.

Notes to constituents

6 *The ED proposes to amend IFRS 10, IAS 27 and IAS 28 to clarify that even though the unit of account for investments in subsidiaries, joint ventures and associates is the investment as a whole, if those investments are made up of financial instruments that have a quoted price in an active market (i.e. a Level 1 input), the fair value measurement of those investments should be the product of the quoted price multiplied by the quantity of financial instruments held, without adjustments.*

7 *The IASB explains in the Basis for Conclusions of the ED that the resulting measurements are more relevant, objective and verifiable when they are based on unadjusted Level 1 inputs. In addition, the resulting measurements would also be more closely aligned with the following principles in IFRS 13:*

(a) *maximisation of the use of relevant observable inputs and minimisation of the use of unobservable inputs; and*

(b) *Level 1 inputs should be used without adjustments whenever they are available.*

8 *In addition, the IASB noted that the measurement of controlling interests at fair value had become more relevant following the amendments to IFRS 10 relating to investment entities. In this regard, the IASB noted that, in accordance with IFRS 10, an investment entity, or other members of the group containing the entity, should not obtain benefits from its investees that would be unavailable to other investors in the investee.*

9 *The IASB noted that the main impact of the proposed amendments would be on entities such as investment entities who measure subsidiaries, joint ventures and associates at fair value in their consolidated financial statements. In most other cases, this measurement would only apply in separate financial statements at an entity's election. Consequently, the IASB believes that the proposed amendments affecting Level 1 fair value measurements will have limited effects.*

EFRAG's response

EFRAG is concerned that these proposals will not always result in relevant information because where the unit of account is the investment in a subsidiary, joint venture or associate, the price paid may include control premiums or discounts and consequently differ from the mathematical product P × Q. The resulting financial information lacks relevance, impairs the assessment of management stewardship and does not faithfully represent the substance of the transaction.

Therefore, before finalising these proposed amendments, EFRAG believes that the IASB should analyse current practices in measuring fair value of this type of quoted investments including premiums and discounts and reassess where to strike the balance between relevance and reliability.

It is only after such an analysis has been conducted and its results have been publicly debated that EFRAG would – albeit reluctantly - accept the balance struck by the IASB in the ED between relevance and reliability. That is, EFRAG will only accept the proposals if it can be established that there is no better way than P x Q to measure the fair value of an investment in a subsidiary, joint venture or associate quoted in an active market.

10 We are concerned that the proposals will result in information that may not be the most relevant in that the proposals ignore market price adjustments that take into account the nature of the investment as a whole. The price paid for an investment at acquisition will include premiums or discounts and consequently differ from the mathematical product P × Q, resulting in day two gains or losses. That is, we assume that the day one transaction price is the fair value according to paragraph 58 of IFRS 13 *Fair Value Measurement* and the day two carrying amount is measured according to the mathematical product P × Q. Alternatively, a day one gain or loss would need to be recognised if the acquisition was measured at P × Q on acquisition date. In such cases, the mathematical product P × Q may not represent fair value for the investment as a whole. The resulting financial information lacks relevance, impairs the assessment of management stewardship and does not faithfully represent the substance of the transaction because of the recognition of a day one or day two gain or loss irrespective of the existence of underlying economic reasons that led to the payment of a premium.

11 However, we acknowledge that these proposals are based on the fact that the IASB believes that there does not seem to be any better way available than the mathematical product P x Q to measure the fair value of an investment in a subsidiary, joint venture or associate quoted in an active market.

12 Therefore, EFRAG believes that the IASB should analyse current practices in measuring fair value of this type of quoted investments including premiums and discounts and reassess where to strike the balance between relevance and reliability.

13 It is only after such an analysis has been conducted and its results have been publicly debated that EFRAG would – albeit reluctantly - accept the balance struck by the IASB in the ED between relevance and reliability. That is, EFRAG will only accept the proposals if it can be established that there is no better way than P x Q to measure the fair value of an investment in a subsidiary, joint venture or associate quoted in an active market.

Questions to constituents:

14 In circumstances where you assess the fair value of an investment quoted in an active market using valuation techniques that consider more than the price and the quantity of the financial instruments making up that investment, how do you measure changes in the fair value of premiums and discounts? Please explain how this measure is reliable.

15 If the IASB were to proceed with these proposals (i.e. P x Q), would you support additional disclosures on premiums and discounts that have not been included in the fair value of an investment? Please explain.

16 Do you believe that circumstances exist where these proposals would not result in useful information for users? Please explain.

17 Furthermore, we believe that the IASB should also consider consequential amendments to current Standards in the following circumstances:

(a) Investments that are in the scope of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*;

(b) Transactions that result in the loss of control over a subsidiary (i.e. paragraph 25(b) of IFRS 10); and

(c) Transactions that occur in acquisitions in stages of an investment that meets the definition of a business (i.e. paragraph 42 in IFRS 3 *Business Combinations*).

18 Regarding the transactions in paragraph 17(c) above, we acknowledge that the IASB explains in the Basis for Conclusions in the ED that it expects to deal with them in the post-implementation review of IFRS 3. However, we do not support piecemeal changes to IFRSs that may result in financial information that is not comparable at least over the period until the PIR of IFRS 3 results in changes to current guidance in that Standard (if it does result in changes).

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

Question 3

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 × 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?

Notes to constituents

19 *The ED also proposes to amend IAS 36* Impairment of Assets *to clarify that in measuring the recoverable amount of an asset that is an investment in a*

subsidiary, joint venture or associate that is quoted in an active market, the fair value less costs of disposal shall be based on the product of the quoted price multiplied by the quantity of the financial instruments that make up the investment, without adjustment.

EFRAG's response

EFRAG would accept these amendments were the IASB to conclude that there is no better way than P x Q to measure the fair value of an investment in a subsidiary, joint venture or associate quoted in an active market.

Portfolios

Question 4

The IASB proposes to include an 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?

Notes to constituents

20 *The ED proposes to add in IFRS 13 an example of an entity (entity A), which holds a group of financial assets and financial liabilities consisting of a long position of 10.000 financial assets and a short position of 9.500 financial liabilities whose market risks are substantially the same. Entity A manages that group of financial assets and financial liabilities on the basis of its net exposure to market risks. The fair value measurement of all the financial instruments in the group is categorised within Level 1 of the fair value hierarchy.*

21 *The example describes the mid-price available. It describes also the most representative bid and ask prices for the group of financial assets and financial liabilities.*

22 *According to the example, the net long position (500 financial assets) is measured on the basis of the price that would be received to sell (i.e. the bid price). Alternatively, the example allows measuring the net long position at the mid-price adjusted by a bid-offer reserve.*

EFRAG's response

EFRAG supports the illustrative example.

23 EFRAG supports the illustrative example that clarifies the application of paragraph 48 of IFRS 13 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.

24 However, we believe that if the IASB were to finalise these proposals it should make clearer in the title of the amendments that the illustrative example addresses a different issue than the one related to the fair value measurement of investments in subsidiaries, joints ventures and associates quoted in an active market.

Transition requirements

Question 5

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?

Notes to constituents

25 *The ED proposes that for the amendments to IFRS 10, IAS 27 and IAS 28, an entity should adjust its opening balance of 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 ED also proposes that the amendments to IFRS 12* Disclosure of Interests in Other Entities *and IAS 36 should be applied prospectively.*

26 *The effect of the amendments is recognised and disclosed in the opening balance of retained earnings (or other component of equity) of the reporting period in which the amendments are first applied.*

27 *In the case of quoted cash-generating units, the amendments regarding the measurement of the recoverable amount on the basis of fair value less costs of disposal are to be applied prospectively.*

28 *The clarifications about the fair value measurements of quoted investments in IFRS 10, IAS 27 and IAS 28 are extended to IFRS 12.*

29 *Finally, early application of the requirements is permitted*. *However, if an entity applies the proposed amendments in any of the Standards early, it must also apply the other proposed amendments in the other Standards at the same time.*

EFRAG's response

With the exception of proposed amendments to IAS 36, EFRAG recommends retrospective application of the requirements, as this would result in comparable information for all reporting periods presented if the IASB were to conclude that there is no better way than P x Q to measure the fair value of an investment in a subsidiary, joint venture or associate quoted in active market.

30 EFRAG notes that the IASB proposes transition guidance for these amendments that is consistent to those that applied when IFRS 13 was first adopted. That is, paragraph C2 of IFRS 13 requires prospective application of the Standard. However, EFRAG considers that IFRS 13 has been applicable for some time and practices are well developed.

31 If the IASB were to finalise these proposals after having assessed the result of the analysis recommended in paragraph 12 above; EFRAG believes that these amendments should be applied retrospectively in order to provide comparable information. Retrospective application should not be impracticable because the measurement is based on a Level 1 fair value measurement and would not result in the undue use of hindsight.

32 However, for the reasons given in paragraph BC33 of the ED, EFRAG supports the prospective application of the amendments to IAS 36 to avoid the reversal of any previous impairment of goodwill identified in the carrying amount of the investments.

Question to constituents:

33 Do you think that, with the exception of the proposed amendments to IAS 36, the proposals in this ED should be applied retrospectively which would have the benefit of providing comparable information over the past reporting periods, or do you think that the proposals in this ED should be applied prospectively in order to avoid the possible issues listed in paragraph BC33 of the ED? Please explain.

Other comments

34 EFRAG notes that paragraph 10A of the proposed amendments to IAS 27 refers to IFRS 9 *Financial Instruments*. We believe that this drafting should be improved by also referring to IAS 39, as jurisdictions and individual entities may have not yet endorsed/adopted IFRS 9, whose effective date is 1 January 2018.

35 EFRAG notes that the proposed amendments to IFRS 12 only clarify the additional guidance on measurement that the IASB proposes to add to IFRS 10, IAS 27 and IAS 28. We are unsure whether these proposals are needed.

36 We consider that the IASB should have proposed amendments to paragraph 69 of IFRS 13 that deals with inputs to valuation techniques and paragraph 79 that deals with adjustments to Level 1 inputs. In our view, improving general guidance and principles on fair value measurements would be better than proposing to amend individual standards by including rules for specific situations.

37 Finally, we would like to note that it is not clear from the ED where the IASB intends to place the Basis for Conclusions (e.g. within IFRS 10, IFRS 13, IAS 36, IAS 27, or IAS 28) once it finalises this project.