EFRAG
European Financial Reporting Advisory Group

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

15 January 2015

Dear Sir,

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.

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, may obscure 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 the fair value of this type of quoted investment including premiums and discounts and reassess where to strike the balance between relevance and reliability.

We have understood from the EFRAG User Panel that users accept the proposed P x Q approach as a solution because it puts greater emphasis on reliability and verifiability. To serve this purpose, EFRAG thinks that the IASB should consider developing guidance to bring fair value estimates that are consistent with the unit of account of the investment to a reasonable level of reliability. The IASB could liaise with the International Valuation Standards Council to receive support to that purpose.

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,

Roger Marshall
Acting President of the EFRAG Board

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?

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.

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

2 However, we believe that the IASB should include all relevant accounting guidance in the Standards and not in the Bases for Conclusions, as the Bases for Conclusions 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.

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, may obscure 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.

We have understood from the EFRAG User Panel that users accept the proposed P x Q approach as a solution because it puts greater emphasis on reliability and verifiability. EFRAG thinks that the IASB should consider developing guidance to bring fair value estimates that are consistent with the unit of account of the investment to a reasonable level of reliability. The IASB could liaise with the International Valuation Standards Council to receive support to that purpose.

3 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, may obscure 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.

4 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.

5 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.

6 We have understood from the EFRAG User Panel that users are ready to accept the proposed P x Q approach as a solution because it puts greater emphasis on reliability. Given this concern, we recommend that further work on developing reliable measurement techniques is warranted. Specifically, as well as analysing current practices, EFRAG thinks that the IASB should consider developing guidance to bring fair value estimates that are consistent with the unit of account of the investment to a reasonable level of reliability. The IASB could liaise with the International Valuation Standards Council to receive support to that purpose.

7 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*).

8 Regarding the transactions in paragraph 7(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?

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?

EFRAG's response

EFRAG supports the illustrative example.

9 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.

10 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?

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.

11 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.

12 If the IASB were to finalise these proposals after having assessed the result of the analysis recommended in paragraph 5 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.

13 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.

Other comments

14 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.

15 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.

16 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.

17 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.