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16 January 2015

Dear Sir

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

We are pleased to comment on the above Exposure Draft (the ED). Following consultation with the BDO network[1], this letter summarises views of member firms that provided comments on the ED.

We strongly disagree with the proposal to require the fair value measurement of quoted investments in subsidiaries, joint ventures and associates to be calculated on the basis of the quoted price of each individual financial instrument multiplied by the quantity of those financial instruments held (a 'P x Q' approach). The application of this approach would result in certain investments which are purported to be measured at fair value not being measured on that basis, because the amount recorded in the financial statements would not reflect the price that would be paid by a market participant, as contemplated in the definition of fair value in IFRS 13. It would also result in losses being recorded (whether from remeasurement of an investment purchased during a reporting period, particularly those purchased close to a reporting date, or from some impairment tests carried out on the basis of fair value less costs of disposal) where no economic loss exists. We also consider that the proposals are inconsistent with the Conceptual Framework.

We note that many of the points we have raised in our detailed comments were raised by Board members during the IASB's deliberations. Notwithstanding this, we believe that the IASB needs to reconsider its position. We also note that, during the discussions at an IASB meeting at which reference was made to IFRS 13 being converged with US GAAP, the IASB staff indicated that they had spoken to the FASB staff who had said that under US GAAP an approach of 'P x Q' would be used whenever there was a level 1 input. Although we are not normally in favour of creating GAAP differences, in this case we believe that there is sufficient justification.

[1] Service provision within the international BDO network of independent member firms ('the BDO network') in connection with IFRS (comprising International Financial Reporting Standards, International Accounting Standards, and Interpretations developed by the IFRS Interpretations Committee and the former Standing Interpretations Committee), and other documents, as issued by the International Accounting Standards Board is provided by BDO IFR Advisory Limited, a UK registered company limited by guarantee. Service provision within the BDO network is coordinated by Brussels Worldwide Services BVBA, a limited liability company incorporated in Belgium with its statutory seat in Brussels. Each of BDO International Limited (the governing entity of the BDO network), Brussels Worldwide Services BVBA, BDO IFR Advisory Limited and the member firms is a separate legal entity and has no liability for another such entity's acts or omissions. Nothing in the arrangements or rules of the BDO network shall constitute or imply an agency relationship or a partnership between BDO International Limited, Brussels Worldwide Services BVBA, BDO IFR Advisory Limited and/or the member firms of the BDO network.
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Our responses to the questions in the ED are set out in the attached Appendix.

We hope that you will find our comments and observations helpful. If you would like to discuss any of them, please contact me at +44 (0)20 7893 3300 or by email at abuchanan@bdoifra.com.

Yours faithfully

Andrew Buchanan

Global Head of IFRS

Appendix

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 agree that the unit of account for those investments is the investment as a whole.

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 x 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 the financial statements.

We strongly disagree with the proposed amendments.

We note that IFRS 13 defines fair value as:

> 'The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.'

If a controlling interest (or an interest which gives rise to significant influence) in equity instruments issued by another entity is sold, the price received will often reflect a significant influence/control premium. This is consistent with the unit of account being the investment as a whole, and not a large number of individual equity instruments. Consequently, we disagree with the Board's conclusion that it is appropriate to follow the second approach outlined in paragraph BC8(b), and consider that the appropriate approach is the first which is summarised in paragraph BC8(a). Consequently, for those investments which are composed of individual financial instruments that have a level 1 price, where a significant influence/control premium is material, the valuation will be level 2 or level 3 (albeit that it would be necessary to take into account the quoted price of the individual financial instruments in any level 2 or level 3 valuation). We also note that the IASB's proposed requirement to determine fair value using a 'P x Q' approach appears to be inconsistent with the proposed requirement that the unit of account is the investment as a whole.

We disagree with the IASB's assertion in paragraph BC10 that 'P x Q' measurements are 'more relevant, objective and verifiable'. While they are certainly objective and verifiable (and reliable, because it is possible to refer directly to a quoted market price), in the event that a material significant influence/control premium exists the 'P x Q' measurement will not be relevant as it will not reflect the actual fair value of the investment.

In addition to failing to reflect the actual fair value of an investment, resulting in a potential misstatement of profit or loss, the proposed approach would also give rise to entities recording losses when no economic loss exists. This is because, for an investment composed of individual financial instruments that have a level 1 price, where an entity pays a significant influence/control premium and measures its investment at fair value through profit or loss it would be forced to write down the value of its investment to the 'P x Q' amount. This will particularly be the case where an investment is acquired shortly before a reporting date.

We also disagree with the conclusions set out in paragraph BC11, that the exclusion of control premium is consistent with the investment entities amendment to IFRS 10, specifically that:

> '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...'

We note that the types of activities referred to in IFRS 10.B85I and BC242 relate to whether an investing entity, or other members of the group containing the investing entity, obtain benefits which are consistent with acting in some operating or strategic capacity. This is not the same as an enhanced valuation due to the existence of a control premium.

We also consider that the proposed approach would be contrary to the guidance set out in the Conceptual Framework. This is because, for those investments to which a significant influence/control premium does apply, the amount purported to represent fair value that would be included in the financial statements would not in fact represent the actual fair value of the investment. It is difficult to see how this is consistent with the text set out in Chapter 1 *The objective of general purpose financial reporting*. We also consider that it would not meet the qualitative characteristics of useful financial information set out in Chapter 3, and note that paragraph QC5 states that:

> 'The fundamental qualitative characteristics are relevance and faithful representation.'

Because the proposals would force entities that measure investments at fair value through profit or loss to record certain of those investments at an amount that does not represent the fair value amount that would be paid by market participants in the event of a sale of those investments, the valuations of those investments would not appear to meet either of these qualitative characteristics.

We acknowledge that the IASB might feel that a 'P x Q' valuation is more reliable, and that there would be more consistency in the valuations of the related investments by different entities. In contrast, a valuation that took into account a control premium (and which would

therefore be either a level 2 or level 3 valuation) might be viewed as being more susceptible to error with the potential for a range of values to be calculated by different entities for the same (or a similar) investment. However, paragraph QC15 of the Conceptual Framework notes that:

> '...free from error does not mean perfectly accurate in all respects. For example, an estimate of an unobservable price or value cannot be determined to be accurate or inaccurate. However, a representation of that estimate can be faithful if the amount is described clearly and accurately as being an estimate, the nature and limitations of the estimating process are explained, and no errors have been made in selecting and applying an appropriate process of developing the estimate.'

Consequently, in balancing the qualitative characteristics, it is not necessary to have absolute accuracy. Instead, it is necessary that amounts included in financial statements are verifiable, and in this context we note the guidance in paragraph QC26 of the Conceptual Framework:

> 'Verifiability helps assure users that information faithfully represents the economic phenomena it purports to represent. Verifiability means that different knowledgeable and independent observers could reach consensus, although not necessarily complete agreement, that a particular depiction is a faithful representation. Quantified information need not be a single point estimate to be verifiable. A range of possible amounts and the related probabilities can also be verified.'

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 the financial instruments held (Q), or P x 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 strongly disagree with the proposed amendments.

Please see above for points we have noted above in our response to question 2, which are also relevant to question 3.

We note that the proposal to require the use of a 'P x Q' valuation for investments that are composed of financial instruments that have a Level 1 price could result in certain entities recording charges for impairment in profit or loss, where no economic impairment loss exists.

For example, in the investment property sector, investment properties are often measured at fair value in accordance with IAS 40 *Investment Property*, reflecting the present value of each property's estimated future cash flows. For the purposes of an impairment test for the consolidated entity as a whole (which contains additional assets, including goodwill for groups that have acquired other entities), the carrying amount is compared with its fair value less costs of disposal. When an entity in the investment property sector is listed on a capital market, the market capitalisation of an entity in the investment property sector is often less than its net asset value. If a control premium was not taken into account, an unwarranted charge for impairment could be recorded.

Question 4 - Portfolios

The IASB proposes to include an illustrative example in 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 agree that the proposed illustrative example is consistent with paragraph 48 of IFRS 13.

However, we are not convinced that proposed paragraph IE47F is appropriate, as it appears to be inconsistent with the requirements of IFRS 13. IFRS 13.69 is clear that if a level 1 price exists for an asset or liability, that price is required to be used without adjustment. In the example, this would be the bid price, provided that this was the price that would be used by market participants (see IFRS 13.70 and 71). Consequently, we suggest that proposed paragraph IE47F is deleted.

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 with the proposals.