STAFF PAPER

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Project	Fair Value Measurement—Unit of Account
Paper topic	Research on the proposed measurements in the Exposure Draft—Feedback received from users and preparers
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Background

1. This paper continues the discussions on the Exposure Draft ('the ED') *Measuring Quoted Investments in Subsidiaries, Joint Ventures and Associates at Fair Value.* In July 2015, the Board tentatively decided that further research should be undertaken with respect to the fair value measurement proposals for investments in subsidiaries, joint ventures and associates when these investments are quoted in an active market (quoted investments). The Board also decided that further research should be undertaken with respect to the measurement proposals for the recoverable amount of cash-generating units (CGUs) on the basis of fair value less costs of disposal when they correspond to entities that are quoted in an active market (quoted CGUs).

2. In November 2015, the staff presented the outcome of the research undertaken thus far. That work entailed an assessment of the population that might be affected by the proposed measurement in the ED (see paragraph 5), together with feedback received from valuation specialists, accounting firms, securities regulators, the Accounting Standards Advisory Forum (ASAF) and staff of the Financial Accounting Standards Board (FASB).[1]

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[1] The Board discussed Agenda Papers 6A and 6B at its November 2015 meeting. These papers can be found at http://www.ifrs.org/Meetings/MeetingDocs/IASB/2015/November/AP06A-Fair-Value-Measurement.pdf and http://www.ifrs.org/Meetings/MeetingDocs/IASB/2015/November/AP06B-Fair-Value-Measurement.pdf

3.   This paper presents the feedback received from users of financial statements ('users'), preparers of financial statements ('preparers') and the Global Preparers Forum (GPF). In addition, this paper also includes a request the Board made at its November 2015 meeting. At that meeting, the Board asked the staff to perform a review of the disclosures that investment entities typically provide regarding the fair value measurements of their quoted investments.

4.   This paper is structured as follows:

    (a)   Measurement proposals in the ED—(see paragraph 5);

    (b)   Summary of the feedback received—(see paragraphs 6–14);

    (c)   Detailed feedback received from:

        (i)   users—(see paragraphs 15–32);

        (ii)   preparers—(see paragraphs 33–39);

        (iii)   the GPF—(see paragraphs 40–47); and

    (d)   Review of the disclosures provided by investment entities regarding the fair value measurements of their quoted investments—(see paragraphs 48–49).

Measurement proposals in the ED

5.   The ED proposed that:

    (a)   the fair value measurement of quoted investments should be based on the product of the quoted price for the individual financial instruments that make up the investment (P) and the quantity of financial instruments (Q), ie $P \times Q$; and

    (b)   the recoverable amount of quoted CGUs on the basis of fair value less costs of disposal should be based on the product of the quoted price (P) and the quantity of financial instruments held (Q), or $P \times Q$.

Summary of feedback received

Users

6.   The staff conducted outreach with users covering investment entities and users covering both financial institutions and capital-intensive industries such as metals and mining across different jurisdictions including Europe, North America and Africa. The majority of users generally preferred the measurements arising from applying P × Q in respect of quoted investments, because this measurement was considered to be more verifiable and transparent rather than being more relevant.

7.   The staff noted that the majority of users covering investment entities in jurisdictions such as Europe or North America were in favour of measuring quoted investments at fair value by applying P × Q. The same views were also shared by users covering non-investment entities in financial services in Europe. Some of these users highlighted that they place more reliance on measurements based on quoted market prices than on measurements derived from valuation techniques such as the discounted cash flow (DCF) method, because they do not fully trust the assumptions used by management when these valuation techniques are applied.

8.   In contrast, the views of the users covering non-investment entities in industries such as mining or other extractive activities in Europe and Africa were mixed, with some commenting that the fair value measurements obtained by applying valuation techniques may be more relevant. These users think that in many instances the use of quoted market prices of entities in cyclical industries such as mining, or the use of quoted prices provided by some emerging markets, would not result in relevant measurements because of excessive market volatility or because of lack of transparency and liquidity in those markets.

9.   The staff note that many users that are generally in favour of the measurements resulting from applying P × Q consider those measurements as offering only a good *starting-point* for the purpose of deriving their own views on the fundamental value of those investments. In the process of deriving their views on that fundamental value, these users may, however, conclude that the quoted price includes a degree of noise that does not necessarily reflect the underlying cash flow-generating ability of the investee and that, as a result, needs to be

stripped out. The staff have noted that the soundness of the reasons why users decide to strip out volatility in profit or loss that they perceive as having no content value depend on the richness of each user's analysis process. However, the underlying common feature of those processes is that the measurement obtained from applying $P \times Q$ is not necessarily a measurement that these users consider as being final and unique and not open to question, but that it is instead a transparent and verifiable starting-point from which to derive their conclusions.

10. When considering the measurement proposals for quoted CGUs, in general, the users that were in favour of a measurement resulting from applying $P \times Q$ for quoted investments also thought that this measurement should be applied for the purpose of measuring the recoverable amount of quoted CGUs on the basis of fair value less costs of disposal. However, for a few of these users, the level of comfort provided by measurements resulting from applying $P \times Q$ was not as high as in the case of quoted investments. This is because this measurement could result in the impairment of, in many cases, long-lived assets. Mixed views were expressed by users covering the mining industry in Europe and Africa, who commented that measurements obtained by applying valuation techniques such as the DCF method, rather than the measurement resulting from applying $P \times Q$, would result in more relevant measurements for the recoverable amount of those CGUs.

Preparers

11. The staff conducted outreach activities with preparers of financial statements representing the investment entities and mining industries from Europe and North America and noted that most preparers were of the view that $P \times Q$ would not result in a relevant measurement for quoted investments. In particular, preparers commented that there is a lack of alignment between the unit of account (ie the investment as a whole) and the proposed measurement on the basis of $P \times Q$ (ie there is no Level 1 price available for the investment as a whole). In addition, in their view, $P \times Q$ would not result in a measurement that reflects an exit price in the principal market where these quoted investments are sold.

12. When considering the measurement proposals for quoted CGUs, most preparers also commented that $P \times Q$ would not result in a relevant measurement. In

particular, they noted that there is a disconnect between the measurements obtained by applying $P \times Q$ for a quoted CGU and the measurement of the recoverable amount of the group of assets constituting the CGU. In addition, some of the preparers mentioned that it was unlikely for a CGU to correspond exactly to a quoted entity because of items included in the quoted entity that would generally not be included within the perimeter of the CGU.

GPF

13. Most GPF members generally did not think that $P \times Q$ would result in a relevant measurement for quoted investments and noted that the price that an entity would receive in a sales transaction would be different compared to the price of a single share, because of items such as control premiums (ie $P \times Q$ did not represent an exit price).

14. One GPF member noted that the same reasons why they do not consider the measurements resulting from applying $P \times Q$ to be relevant measurements for quoted investments would also apply in the case of quoted CGUs.

Detailed feedback received

Users

15. The staff conducted outreach activities with users to better understand their views relating to the measurement proposals in the ED for quoted investments and for the recoverable amount of quoted CGUs on the basis of fair value less costs of disposal. We conducted outreach with the following users:

    (a)   three users covering investment entities—these users analysed public investment entities and were mostly sell-side analysts based in Europe with one user being a credit analyst based in North America;[2]

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[2] Sell-side analysts are employed by 'sell-side' institutions or firms. Sell-side refers to investment firms that sell securities and assets to money management firms and corporate entities. They may be considered intermediaries (eg investment banks or brokerage firms) that both perform research and conduct the actual purchase of securities. Source: http://www.investinganswers.com/

(b)   five users covering non-investment entities—these users analysed entities within the mining and metals, resources and financial services sectors. These users were mainly sell-side analysts based in Europe with one analyst based in North America; and

(c)   two user representative bodies from Europe and Africa—the participants within these user representative bodies were users that covered entities across a number of different industries, including the financial services and mining industries.

16.   We discussed the following topics with users:

(a)   their views on the measurement proposals in the ED for quoted investments and the measurement of the recoverable amount of quoted CGUs on the basis of fair value less costs of disposal; and

(b)   whether Day 1 gains or losses (ie the differences between the acquisition price of quoted investments and their subsequent measurement at $P \times Q$) would provide relevant information.

Users' views on the measurement proposals for quoted investments

17.   Even though there was not a consensus view on the preferred measurement, most users generally preferred the measurements arising from applying $P \times Q$ when dealing with quoted investments measured at fair value. When asked what the key driver behind their preference was, these users commented that $P \times Q$ was their preferred measurement because of its **verifiability** rather than its **relevance**. Some users covering the mining and financial service industries based in Europe acknowledged that this was a pragmatic view. Apart from being a simple measurement that can be easily verifiable, these users provided the following comments to back up their support for $P \times Q$:

(a) $P \times Q$ is the most reliable measurement that best reflects the market value of quoted investments. Even though a few of these users commented that the exit price realised when an entire quoted investment is sold would not always equate to $P \times Q$, they still preferred the verifiability and reliability that a measurement on the basis of $P \times Q$ provides.

(b)   As a method, $P \times Q$ is less based on judgement and more transparent than valuation techniques that often include management assumptions that are subjective and prone to manipulation (ie $P \times Q$ would result in a more prescriptive requirement, which would prevent the manipulation of financial information). In this respect, some users stated that they place more reliance on a measurement based on quoted market prices than a measurement derived from valuation techniques such as the DCF method. These users noted that the DCF method was very much based on judgement and was easily susceptible to oversights (for example, when deriving the cost of capital for discounting purposes). On this point, it was noted that some users often do not fully trust the assumptions used by management when the fair value measurements have been obtained by applying a valuation technique. In addition, disclosures provided in the financial statements are often not sufficient for users to fully understand the assumptions management used in the measurements for the purposes of assessing their appropriateness.

(c)   Users that did not necessarily agree with a measurement resulting from $P \times Q$ commented that they could accept such a measurement if the value of the quoted investment measured on the basis of $P \times Q$ was not material in the investor's financial statements.

18.   During these discussions the staff noted that some of the users that had a general preference for $P \times Q$ also considered instances for which $P \times Q$ may not always be the most relevant measurement:

(a)   A user covering investment entities commented that the relevance of the measurement resulting from $P \times Q$ would depend on the business model of the investment entity. For example, if the investment entity held quoted investments with the aim of restructuring or actively managing them, such as many private equity entities, then a valuation technique may result in measurements that are more relevant, because the market price may not necessarily reflect accurately what management has done internally. In contrast, if the business model of the investment entity was more aligned to

trading, then applying P × Q would result in a more relevant measurement for those investments.

(b) One user commented that if the investment is quoted in a market that is efficient and well-functioning, then P × Q is the most appropriate measurement. However, if the quoted price fluctuates for reasons other than the investment's underlying fundamental factors (for example, the price fluctuations are due to a market's technical characteristics such as market liquidity), then that user stated that an analyst should scrutinise the factors affecting the quoted price in more detail. That user also said that the resulting fair value measurement of the investment should exclude effects that do not relate to the ongoing cash flow-generating ability of the investee if possible. In other words, if the change in the quoted price is not representative of future changes in that quoted price, or those fluctuations represent temporary rather than permanent changes, then these changes in the quoted price should not be considered in the measurement of the quoted investment. In this respect if, for example, the quoted price changes as a result of news that the market has interpreted as the investee being able to achieve enhanced cash flows in the future, then these price changes should be considered in the fair value measurement of the investment. However, if the quoted price changes because there are large block trades in the market, then that price change does not contain relevant information for the purpose of valuing the investment and, consequently, those changes in the price should not be captured in the fair value measurement of those investments.

(c) Some users acknowledged that their preference for P × Q was to some degree partial. In other words, these users preferred P × Q to be the measurement by which the quoted investments were accounted for in the statement of financial position. However, they did not consider that the profit or loss effect from applying P × Q necessarily provided useful information and they would, in many cases, strip that effect out from their analysis of the investment.

(d) In some instances, prices may be exceptionally volatile (for example, the quoted prices of shares of entities in cyclical industries such as mining and

resources) and, consequently, the quoted price on a particular reporting date if used for measuring the fair value of the quoted investment may not faithfully represent the fair value of the investment. In such circumstances, some users commented that they would rather use an average or 'smoothed' quoted price (for example, the volume-weighted average price (VWAP)) instead of using the quoted price at the reporting date. One user noted that VWAP may also be more appropriate for quoted investments that are thinly traded.

(e)   One user commented that $P \times Q$ is the most appropriate measurement for investments in quoted joint ventures and associates, but less so for investments in quoted subsidiaries. In this regard, this user and another user both noted that using the quoted price of entities that have a small percentage of free float shares to measure the fair value of an investor's controlling interest in that entity may not be appropriate.

19.   A few users mostly covering the metals and mining industries and based in Europe and North America, and a user representative body based in Africa, were of the view that $P \times Q$ would not result in a relevant measurement. The volatility of the fair value measurements resulting from applying $P \times Q$ was not perceived to be relevant for assessing an entity's long-term strategic investments. They also thought that fair value determined by applying a valuation technique would result in more meaningful measurements. In particular, these users noted the following:

(a)   The share prices of entities in certain industries such as mining or any other extractive activities can be highly volatile and, consequently, applying $P \times Q$ would result in measurements that would lead to distorted earnings figures, which is not ideal for analytical purposes.

(b)   A few users and a user representative body from Africa stated that certain markets, such as some emerging markets, are not considered to be efficient because of their lower degree of liquidity, their strong reliance on foreign currency investment flows, their lower transparency and the existence of information asymmetry. For these users, measurements on the basis of applying $P \times Q$ in those markets would not result in relevant measurements, because the quoted price may not reflect the underlying value of the quoted

investment. In these instances, these users would generally also carry out their own measurements using in many cases a DCF method.

(c)   The fair value measurement should reflect the value of the underlying investment. In this regard, a DCF method was considered to be the preferred method to reflect this value, although these users also acknowledged that DCF was subject to manipulation, because it was based on management assumptions. To mitigate this, one user emphasised that these management assumptions should be seriously questioned, in particular when the fair value measured by applying valuation techniques presents significant deviations from the measurement derived by applying $P \times Q$ and if these deviations persist over time.

(d)   A few users stated that they would prefer the entity to measure the fair value of its quoted investments by applying a valuation technique and disclosing the significant assumptions used. These users stated that they normally carried out their own calculations and that they could also easily obtain the $P \times Q$ value by themselves. Having the fair value measurement carried out by the entity would represent for them more information that they would use together with their own calculations and with the measurement obtained by applying $P \times Q$, for the purpose of deriving their own views on the fair value measurement of the quoted investment. Another user commented that regardless of the measurement basis by which those investments are being accounted for in the entities' financial statements, users would undertake their own calculations to value those quoted investments and would then compare the value that they have derived to the $P \times Q$ value and/or the value provided by the entity if applicable.

(e)   In markets that are highly volatile, especially emerging markets, $P \times Q$ could affect the assessment of an entity's solvency, because that measurement could lead to significant unrealised fair value losses being reflected in an entity's statement of changes in equity.

20.   A few users noted that, regardless of the measurement basis, the information arising from the carrying value of these quoted investments in the financial

statements was not relevant except in limited instances such as when a loan covenant is associated with a quoted investment.

Day 1 gains or losses

21. The staff asked users their view on Day 1 gains or losses, because this matter was raised by some respondents to the ED as a concern resulting from applying a measurement on the basis of $P \times Q$. In that respect, these respondents noted that one of the consequences of applying $P \times Q$ were Day 1 gains or losses, which they did not agree with because, in their view, it resulted in a distorted effect in profit or loss that had no information value. The users that we contacted expressed mixed views as to whether Day 1 gains or losses provided relevant information.

22. Some users covering different industries such as mining and financial services based mostly in Europe, and who generally preferred fair value measurements obtained by applying $P \times Q$, commented that Day 1 gains or losses do provide useful information. These users commented that Day 1 gains or losses provide insight into whether the acquisition price for the quoted investment was reasonable and contributes to users' understanding of how management deploys capital for investments (that is, Day 1 gains or losses provide useful information for assessing management stewardship).

23. Another user was of the view that Day 1 gains or losses should make users reflect as to whether these gains or losses change their perception of the entity that holds the investment and whether the market appropriately captures the underlying value of the investment. In other words, according to this user, users should investigate the reasons that gave rise to the Day 1 gain or loss. In this context, users should consider whether these reasons were a result of external factors that affected the market as whole or whether the Day 1 gain or loss can be attributed specifically to the organic value of the investment.

24. Some other users, covering mostly the mining sector from Europe and Africa, commented that Day 1 gains or losses would not provide useful information. In particular, these users provided the following comments:

(a) The fair value measurement of a controlling investment on the basis of a valuation technique is typically greater than the market valuation using

$P \times Q$ because of the inclusion of control premiums and in this case the Day 1 losses do not have informational value.

(b)   Day 1 gains or losses may simply be due to the reaction of the market to the transaction (ie it constitutes volatility for a single day and does not add useful information about the value of the investment itself) and are viewed by these users as an item that causes 'noise' in profit or loss and prevents them from understanding the underlying and ongoing cash flow-generating ability of the investment. As a result, these users typically remove this item from earnings when they undertake an analysis of the entity.

Other comments

25.   The staff asked users for their views regarding the recommendations provided by respondents to the ED in relation to the fair value measurement of quoted investments. The recommendations received were the following:

(c)   Recommendation 1—setting up a rebuttable presumption so that $P \times Q$ is presumed to be the measurement that best represents the fair value of quoted investments unless an entity can identify a measurement that more faithfully represents fair value; and

(d)   Recommendation 2—measuring the fair value of the quoted investments using either a valuation technique or adjusted Level 1 inputs, disclose the measurement resulting from $P \times Q$ and provide a reconciliation to explain the difference between the two measurements.

26.   A few users commented that, if given the choice, they would prefer Recommendation 1. One user noted that Recommendation 2 would provide users with all of the information they would require (ie measurement of the investment on the basis of a valuation technique, disclosure of the $P \times Q$ value and disclosures of the reconciling items) but he would nevertheless prefer Recommendation 1.

27.   One user commented that if there was a quoted price available for a particular investment, he would want that information communicated in the financial statements. This user was indifferent regarding whether this information was communicated through disclosures or by measuring the quoted investment at $P \times Q$.

Users' views on the measurement proposals for quoted CGUs

28. Users expressed mixed views regarding the measurement proposals in the ED for the measurement of the recoverable amount of quoted CGUs on the basis of fair value less costs of disposal.

29. Some users commented that applying P × Q when measuring the recoverable amount of quoted CGUs on the basis of fair value less costs of disposal was their preferred option, because those measurements were more verifiable and transparent. However, other users, mostly covering the metals and mining industries and based in Europe and Africa, commented that measurements obtained by applying valuation techniques such as the DCF method, rather than measurements resulting from applying P × Q, would be the most relevant ones.

30. The users who agreed with measurements resulting from applying P × Q when measuring the recoverable amount of quoted CGUs on the basis of fair value less costs of disposal noted that if a quoted market price was available then this price should always be given preference over a valuation technique. Some of these users also commented that the assumptions used by entities when undertaking valuation techniques could be subject to manipulation and could not typically be relied upon. In addition, disclosures provided in the financial statements relating to the assumptions used by management for these valuation techniques were inadequate and did not allow users to assess the appropriateness of the measurements and, consequently, of the impairment test under IAS 36 *Impairment of Assets.*

31. One user commented that his starting-point for measuring the recoverable amount of quoted CGUs would be P × Q because of its reliability and verifiability. He would then consider whether the quoted price was a relevant input for measuring the recoverable amount of the specific quoted CGU on the basis of fair value less costs of disposal. This user would do so by analysing and assessing if any decreases in the carrying value of the quoted CGU resulting from applying P × Q could be considered to be a permanent or temporary decrease.

32. Those users who were not in favour of applying P × Q when measuring the recoverable amount of quoted CGUs on the basis of fair value less costs of disposal noted that the market volatility associated with quoted share prices was unrelated

to the underlying value of the group of assets of the CGUs and provided the following comments:

(a)   Measurements resulting from applying a valuation technique such as the DCF method may better reflect the fair value measurement of quoted CGUs compared to $P \times Q$ because the quoted price may be excessively volatile, especially in cyclical industries and not represent faithfully the fair value of the quoted CGU (that is, the quoted share price may be abnormally low compared to the book value of equity on a per share basis). On this point it was noted that assumptions used in the DCF method should consider a market participant's perspective. For example, for measuring the recoverable amount of quoted CGUs in the commodities sector, a few users stated that it would be preferable if the estimated cash flows were based on the average market price of the commodity over several years rather than a contractual price at a point in time.

(b)   The quoted price may be affected by unrelated factors such as market sentiment and could result in a meaningless measurement because in these circumstances the quoted price would not reflect the characteristics of the underlying CGU.

Preparers

33.   The staff conducted outreach activities with three preparers of financial statements representing the mining and investment entities industries from Europe and two preparer organisations ('preparers') from Europe and North America representing the investment entities industry, to better understand their views relating to the measurement proposals in the ED for both quoted investments and quoted CGUs.

34.   The responses provided by preparers are summarised in paragraphs 35–37.

Quoted investments

35.   This section captures the feedback from preparers in the investment entities industry. This is because these preparers are required or allowed to measure the

fair value of their quoted investments at fair value.[3] In contrast, non-investment entities preparers are only permitted to measure investments in quoted entities at fair value in their separate financial statements, with the majority of them choosing cost as the measurement basis (see Agenda Paper 6B discussed at the November 2015 IASB meeting). We have gathered the feedback of non-investment entities' preparers in the section relating to quoted CGUs (see paragraph 37).

36.   The most relevant comments of preparers in the investment entity industry are as follows:

(a)   A representative from a preparers' organisation representing the investment entities industry in North America commented that private equity entities generally hold unquoted investments, which they measure at fair value using a valuation technique. For a private equity entity, one of its investment exit strategies involves an initial public offering ('IPO') of the investee. In many cases that exit strategy leads to the private equity entity keeping a portion of shares in the investee, which it sells at a later stage. In this instance, the private equity entities do not necessarily think that it is appropriate to apply $P \times Q$ to their retained interest, because they do not think this is a relevant measurement. In contrast, this representative from the preparers' organisation was of the view that applying $P \times Q$ may be more appropriate for other types of funds with a trading strategy (see bullet (c)).

(b)   One preparer from Europe was in favour of $P \times Q$ and noted that this measurement is objective, widely understood and can be easily verified. He noted that if a Level 1 price was available, it should be prioritised and used,

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[3] Paragraph 31 of IFRS 10 *Consolidated Financial Statements* states: '[…] an investment entity shall not consolidate its subsidiaries or apply IFRS 3 when it obtains control of another entity. Instead, an investment entity shall measure an investment in a subsidiary at fair value through profit or loss in accordance with IFRS 9.'
Paragraph 18 of IAS 28 *Investments in Associates and Joint Ventures* states: 'When an investment in an associate or a joint venture is held by, or is held indirectly through, an entity that is a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure investments in those associates and joint ventures at fair value through profit or loss in accordance with IFRS 9.'
Paragraph 10 of IAS 27 *Separate Financial Statements* states: 'When an entity prepares separate financial statements, it shall account for investment in subsidiaries, joint ventures and associates at either: (a) at cost; (b) in accordance with IFRS 9; or (c) using the equity method as described in IAS 28. […]'

because this was the underlying principle of the fair value hierarchy in IFRS 13.

(c)   The preparer representative from the investment entities industry in North America commented that P × Q may be relevant for investment entities such as, for example, hedge funds that have a trading strategy. Some of these investments have open-ended structures that allow periodic redemptions and as a result, P × Q may be more appropriate in this scenario. In contrast, this preparer noted that private equity, venture capital and pension funds did not have periodic redemptions or operate with a trading strategy. Consequently, for those investment entities, P × Q would not result in the most relevant measurement of those entities' investments.

(d)   On the point regarding entities not realising the value represented by P × Q in the event of a sale of their investments, one preparer noted that this anomaly could be addressed through disclosures in IFRS 7 *Financial Instruments: Disclosures* relating to risk concentrations.[4] This preparer commented that an entity that planned to sell a quoted investment would not undertake a bulk sale but would instead sell the investment piecemeal if this would realise a higher value. This preparer also commented that if the management of an entity strongly thought that P × Q did not represent the fair value of their quoted investments faithfully, then they should be able to apply the 'true and fair' override within IFRS, which would then most likely give rise to a Level 3 fair value measurement.[5]

(e)   P × Q would result in Day 1 gains or losses in situations in which an entity acquired a controlling interest in an investee and a control premium was paid as part of the acquisition price, which was not necessarily perceived as an economic loss and might result in a distorted representation of the entity's profit or loss.

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[4] Paragraph 34(c) of IFRS 7 requires an entity to disclose concentrations of risk for each type of risk arising from financial instruments.

[5] Paragraph 19 of IAS 1 *Presentation of Financial Statements* states that in the extremely rare circumstances in which management concludes that compliance with a requirement in an IFRS would be so misleading that it would conflict with the objective of financial statements set out in the *Conceptual Framework*, the entity shall depart from that requirement if the relevant regulatory framework requires, or otherwise does not prohibit, such a departure.

Quoted CGUs

37. Most preparers from the mining industry in Europe commented that P × Q would not result in a relevant measurement when measuring the recoverable amount of quoted CGUs on the basis of fair value less costs of disposal. In particular, they provided the following comments:

    (a) There is a lack of alignment between the unit of account (CGU) and the proposed measurement on the basis of P × Q. However, a preparer in the mining industry stated that it is unlikely for a CGU to correspond to a quoted entity because of items included in the quoted entity that would generally not be included within the perimeter of the CGU. These items would primarily be financial items such as cash borrowings.

    (b) Some preparers stated that P × Q serves as a reasonableness check for the measurement of the recoverable amount of a quoted CGU on the basis of fair value less costs of disposal but should not be the only prescribed fair value measurement. On this point, one preparer in the mining industry noted that they would assess the reasonableness of the recoverable amount of a quoted CGU with reference to the quoted price of the relevant commodity (for example, quoted copper prices) rather than the quoted equity price. In addition, requiring P × Q as the only fair value measurement would affect how entities undertake their impairment test assessment, because they typically measure the recoverable amount of quoted CGUs by using a wide range of techniques, including P × Q. They then compare and contrast these different values in terms of appropriateness when deriving the fair value measurement to be used in the impairment test.

    (c) In some industries such as mining, entities have investments in subsidiaries that correspond to a quoted CGU with a portion of the investee's shares outstanding, for example 30 per cent, being quoted and attributable to a non-controlling interest (NCI). In these instances, these preparers do not think it is appropriate to measure the recoverable amount of these quoted CGUs on the basis of fair value less costs of disposal using the quoted price of the NCI, because this price is not representative of the enterprise value of an entity that is operating a long-lived asset such as a mine. Furthermore,

the NCI investors are not market participants who would purchase a controlling interest in the CGU but are instead speculative investors who typically trade the free float shares.

(d)   There is a disconnect between the measurement resulting from applying $P \times Q$ for a quoted CGU and a measurement that would take into account the effect of management assumptions. On this point it was noted that if entities were forced to determine the recoverable amount on the basis of fair value less costs of disposal by applying $P \times Q$, they would not be able to reflect items such as the effect of future expansions, which would, in contrast, be reflected if a valuation technique was applied instead.[6]

Other comments

38.   With regard to the recommendations provided by respondents in their comment letters to the ED (see paragraph 25), preparers were generally in favour of Recommendation 2 but commented that providing disclosures about the difference between the measurement derived by applying a valuation technique and the measurement derived by applying $P \times Q$ would be challenging. In particular, they provided the following comments:

(a)   Disclosing the quoted price was sufficient and a reconciliation was not required because such information would be disclosed when fulfilling the disclosures requirements in IFRS 13.

(b)   The information value in providing a reconciliation would depend on the industry in which the entity operates. Entities operating in cyclical industries such as mining typically have volatile share prices and hence any reconciliation between the measurement obtained by applying a valuation technique and the measurement obtained by applying $P \times Q$ would not be meaningful.

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[6] Items such as future expansions may be considered within the fair value measurement to the extent that they would generally be considered by market participants in accordance with paragraph 53A of IAS 36.

(c)   Reconciling items would not be easily auditable, because they may be driven by management estimates and judgements that are subjective in nature.

39.   One preparer representative from the investment entities industry was in favour of Recommendation 1 but noted that if $P \times Q$ was rebutted, the valuation technique applied to measure the quoted investment at fair value should allow only a downward adjustment (ie a blockage factor) to prevent inflated asset values being reported. Nevertheless, this preparer did acknowledge that IFRS 13 prohibits the inclusion of blockage factors in the fair value measurements. In contrast, another preparer from the mining industry noted that Recommendation 1 was not easily understandable and that a rebuttable presumption may be interpreted differently among different entities and would not be easily auditable.

GPF

40.   As part of our work, the staff conducted outreach with the Global Preparers Forum (GPF) members for the purpose of gathering their views on different aspects of the measurement proposals included in the ED.

41.   In particular, GPF members were asked how relevant the fair value measurement of quoted investments and the measurement of the recoverable amount of quoted CGUs on the basis of fair value less costs of disposal is on the basis of $P \times Q$, and whether the proposed measurement in the ED would affect the way in which their organisations measure quoted investments. They were also asked for their views on a recommendation provided by respondents in their comment letters to the ED (see paragraph 25).[7]

42.   Some GPF members were of the view that $P \times Q$ would not result in a relevant measurement for quoted investments and provided the following comments:

(a) $P \times Q$ does not consider the saleability value of a large block of shares, because the price one would receive in a sales transaction would be

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[7] The minutes of this meeting can be found at the following link:
http://www.ifrs.org/Meetings/MeetingDocs/Other%20Meeting/2015/December/GPF/Nov-2015-GPF-minutes.pdf

different compared to the price of a single share because of items such as control premiums.

(b) $P \times Q$ is not appropriate in instances in which an entity held a quoted equity interest in an investee that was not a controlling interest and subsequently acquired an additional equity interest that, together with the previously held equity interest, resulted in a controlling interest in that investee. The price paid for the second equity interest included a premium over the quoted market price. On this point, it was noted that the price paid for the second equity interest was relatively higher when compared to $P \times Q$, because with that additional equity interest, the entity had control over the investee allowing it to have access to synergies that it could not previously enjoy because it did not have control.

43.   One GPF member commented that they are indifferent to the proposals in the ED as long as the measurement options when accounting for investments in subsidiaries, joint ventures and associates in accordance with IAS 27 (ie cost, fair value or the equity method) remain unchanged. This GPF member also noted that entities often pay an acquisition premium that should not be ignored by the investment's subsequent measurement.

44.   Some GPF members supported one of the recommendations suggested by respondents to the ED (see paragraph 25) of providing a reconciliation between the fair value of a quoted investment derived by applying a valuation technique or adjusted Level 1 inputs and the fair value derived by applying $P \times Q$, together with reasons to substantiate any reconciling items between the two measurements such as, for example, acquisition premiums paid.

45.   A few GPF members commented that it was not very common for entities to have investments in quoted subsidiaries, joint ventures and associates, while one GPF member noted that within their group they had quite a few investments in quoted subsidiaries. Another GPF member commented that they thought that quoted investments were less frequent in Europe while more common in other jurisdictions, for example, South Africa, because of the prevalence of specific organisational structures in that jurisdiction.

46. One GPF member noted that within their group they have a CGU that corresponded to a quoted entity, although it was noted that this was not a common case. Another GPF member noted that $P \times Q$ would not be appropriate when determining the recoverable amount of quoted CGUs on the basis of fair value less costs of disposal, for similar reasons to the ones pointed out for the case of quoted investments.

47. In relation to the some of the points made by users of financial statements regarding the proposals in the ED included in Appendix B of the GPF slide pack that was discussed at the GPF meeting, some GPF members provided the following comments:[8]

    (a) They disagreed with the view that a Level 1 price was the most objective indicator of the price that market participants would transact at, because an entity would not pay the quoted price of an individual share when acquiring a controlling interest in a quoted entity. The most objective indicator of the price that market participants would transact at was the negotiated price and the proposed measurement in the ED may result in the recognition of Day 1 gains or losses when the negotiated price of a quoted investment paid at acquisition differs from its subsequent measurement at $P \times Q$ (which, in their view, was not economically meaningful).

    (b) Day 1 gains or losses do not reflect the risk of doing business, as stated by some users, but instead reflect the risk of using the market price when measuring the fair value of quoted investments rather than a valuation technique or adjusted Level 1 inputs.

Review of disclosures provided by investment entities regarding the fair value measurements of their quoted investments

48. At the November 2015 meeting, the Board asked the staff to review the disclosures that investment entities typically provide in their annual accounts regarding the fair value measurements of their quoted investments. In particular, the Board was

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[8] The slide pack discussed at the GPF meeting in November 2015 can be found at the following link: http://www.ifrs.org/Meetings/MeetingDocs/Other%20Meeting/2015/November/GPF/AP6-FVM-GPF-Nov-2015.pdf.

interested in understanding the type of disclosures those entities had provided in the case in which they had measured their quoted investments at fair value by applying P × Q, but were of the view that that measurement was not appropriate.

49.   To address this request, the staff inspected the annual accounts of a sample of investment entities in different jurisdictions that held quoted investments in subsidiaries, joint ventures and associates. The inspection of these annual accounts revealed that:

(a)   All but one of the entities sampled classified the fair value measurements of those quoted investments within Level 1 of the fair value hierarchy. In none of the annual accounts inspected there were any disclosures that outlined a disagreement in respect of the appropriateness of applying P × Q when measuring the fair value of the quoted investments held.

(b)   In only one instance did an investment entity based in Europe with a quoted investment in a subsidiary use a valuation technique to measure the fair value of that investment. In that particular case, the fair value measurement was classified as Level 3 within the fair value hierarchy. This entity provided disclosures concerning the valuation technique applied and a narrative description of the sensitivity of the fair value measurement to changes in unobservable inputs used in that measurement. This entity did not, however, provide information about what the measurement would have been if P × Q had been applied, nor did the entity provide any information about what the reconciling items could be between their fair value measurement obtained by applying the valuation technique and a measurement on the basis of P × Q.