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Purpose of this paper

1. This paper addresses questions received about the unit of account for financial assets that are investments in subsidiaries, joint ventures and associates that are measured at fair value. In particular, the IASB has received a question on whether the fair value of such investments should reflect the measurement of the investment as a whole or of the individual financial instruments included within that investment.

2. This paper is structured as follows:

    (a) background leading to the questions raised about the unit of account (paragraphs 4–5);

    (b) the staff's analysis and recommendation on determining the unit of account (Issue 1—paragraphs 6–24); and

    (c) the staff's analysis of, and recommendation on, the interaction between the unit of account and fair value measurement (Issue 2—paragraphs 25–49).

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3. Appendices 1 and 2 of this paper include third party correspondence that raise questions about the unit of account for particular items measured at fair value (see paragraph 5 below).

Background

4. During the development of IFRS 13 *Fair Value Measurement* and the amendments to Topic 820 *Fair Value Measurement* in the *FASB Accounting Standards Codification*®, the IASB and the US national standard-setter, the Financial Accounting Standards Board (FASB), received questions about the unit of account for items measured at fair value that are made up of multiple individual financial instruments—that is, stakeholders wanted to know **what** they were measuring when measuring the fair value of an 'investment' (ie is it the investment as a whole or the individual financial instruments that make up the investment?). The IASB and the FASB (the boards) discussed this matter at their joint meeting in October 2010. At that meeting the boards reaffirmed that the fair value measurement project was to address 'how' to measure fair value and not 'what' is being measured at fair value. They decided that clarifying the unit of account when measuring the fair value of an investment was outside the scope of the Fair Value Measurement project.[1]

5. Some stakeholders have raised similar questions recently (including in the context of measuring controlling interests in investment entity subsidiaries). Appendices 1 and 2 include two letters received on the matter. Both letters raise the unit of account issue which is covered in Issue 1 of this paper (see paragraphs 6–24). The letter in Appendix 1 includes a second issue: the interaction between the use of Level 1 inputs and the unit or account for financial assets and cash-generating units, which is covered in Issue 2 of this paper (see

[1] This topic was discussed at the joint meeting in October 2010 (see IASB Agenda Paper 2E/FASB Agenda Paper 16 at: http://www.ifrs.org/Current-Projects/IASB-Projects/Fair-Value-Measurement/Summaries/Pages/IASB-October-2010.aspx).

paragraphs 25–49) and the interaction between the use of Level 1 inputs and the IFRS 13's portfolio exception, which will be addressed at a future meeting.

Issue 1: Determining the unit of account

The measurement requirements

6. The first step when measuring fair value is to determine **what** is being measured. The determination of 'what' takes into account the asset or liability that another Standard specifies can or must be measured at fair value. The question of 'what is that asset or liability' must be answered before its fair value can be measured. IFRS 13 defines unit of account as:

> The level at which an asset or a liability is aggregated or disaggregated in an IFRS for recognition purposes.

7. For most financial instruments, the unit of account is clear and, as a result, 'what is being measured' is clear. IAS 32 *Financial Instruments: Presentation* defines a *financial instrument* as "any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity" (ie a contract that gives rise to an individual financial asset or an individual financial liability). IAS 32 and IAS 39 *Financial Instruments: Recognition and Measurement* address the accounting for individual financial instruments.

8. The unit of account for investments in subsidiaries, joint ventures and associates is, however, less clear.[2] In particular, reaching a conclusion about the unit of account for those investments is more challenging because the measurement requirements in those Standards, as shown in the table on the next page, refer to IFRS 9 *Financial Instruments* and IFRS 9 refers to the fair value measurement of individual financial instruments (see paragraphs B.5.4.3–B.5.4.17 of IFRS 9).

9. The question that has been raised is whether those references to IFRS 9 should be understood to refer only to the measurement basis of the investments (ie fair value

[2] These investments are accounted for in accordance with IFRS 10 *Consolidated Financial Statements*, IAS 28 *Investments in Associates and Joint Ventures* and IAS 27 *Separate Financial Statements.*

through profit or loss) or whether they should also be understood to prescribe the unit of account of those investments (ie the individual financial instruments that make up the investment). The table below includes the specific requirements that illustrate this issue **[emphasis added]**:

Investment	Measurement requirements in Standards [emphasis added]
Subsidiaries, joint ventures, associates	IAS 27.10: When an entity prepares separate financial statements, it shall account for investments in subsidiaries, joint ventures and associates either: (a) at cost, or **(b) in accordance with IFRS 9**.
Associates, joint ventures	IAS 28.18: 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, […], 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**.
Subsidiaries held by an investment entity	IFRS 10.31: … an investment entity shall measure an investment in a subsidiary at fair value through profit or loss **in accordance with IFRS 9**.

10. Following the measurement requirements in the table above, an entity would measure those investments at fair value through profit or loss in accordance with IFRS 9. Fair value is now defined in IFRS 13, which states that "the unit of account for the asset or liability shall be determined in accordance with the IFRS that requires or permits the fair value measurement" (IFRS 13.14).

11. But, based on the requirements in the table above, would the unit of account for those investments be defined by the Standards that prescribe the accounting for those investments (ie IAS 27 *Separate Financial Statements*, IAS 28 *Investments in Associates and Joint Ventures* and IFRS 10 *Consolidated Financial Statements*) or by IFRS 9?

12. In the following paragraphs we aim to answer that question on the unit of account by applying the principles in IFRS and by analysing the effect that other factors could have in any of the potential answers to this question.

What are the characteristics of the investment held?

13. As mentioned above, the accounting for investments in subsidiaries, joint ventures and associates is prescribed in IAS 27, IAS 28 and IFRS 10. The nature of an entity's relationship with an investee, based on the level of control or influence in that investee, is the relevant characteristic for those investments to be included in the scope of those Standards. As a result, that characteristic (ie the level of control or influence) would highlight that the relevant unit of account in those Standards is the **investment to which that (key) characteristic applies** rather than the **individual financial instruments that make up the investment**.

14. The staff believe that the key question here is what is the most relevant indicator to determine the unit of account for investments whose accounting is prescribed by IAS 27, IAS 28 and IFRS 10? The staff think that the unit of account for those investments is determined by the features that led them to being included in the scope of those Standards, and that this conclusion should not depend on their measurement. In other words, the fact that the investment is measured at fair value should not affect its unit of account. Instead, the unit of account affects the measurement. That is why, as noted above, IFRS 13 relies on the Standards that require or permit the fair value measurement to determine the unit of account.

15. However, we note that some might think that, for example, having control of an investee is entity-specific. In their view, in the example of control, a parent **chose** to obtain a controlling interest investment (and could just as easily **choose** to exit its interest by selling multiple non-controlling interests) and note than an entity's choice to enter into a transaction in a particular way is not relevant in measuring fair value, which is a market based measurement. Consequently, they believe that the level of control or influence is not a relevant indicator in the decision on whether the unit of account is the investment. The staff do not share this view. The IASB has determined that the information needed about an investment in a

'controlling' interest is different from that needed about investments without control or other influence. As a result, different accounting and disclosures are required for each of those situations. The staff also note that when the IASB was developing IFRS 13, it did not intend to change the unit of account prescribed by other Standards.

Should the legal form influence the unit of account?

16. The staff believe that focusing on a particular characteristic of the investment (ie the level of control or influence) that makes investments in subsidiaries, joint ventures and associates have a different nature and, as a result, be in the scope of different Standards, would assist in reaching an economically sensible conclusion on the unit of account. Such a conclusion on the unit of account would reduce or eliminate the risk that entities create legal structures to take advantage of a conclusion on the unit of account that lacks economic sense. The example below illustrates this matter.

> Example
>
> A private equity fund owns a 60 per cent interest in two independent, yet substantially operationally similar, entities (Entity A and Entity B). The rights conveyed to the private equity fund by both ownership interests enable it to have control of both Entity A and Entity B.
>
> Entity A's capital structure consists of two ownership shares, one representing a 60 per cent interest held by the private equity fund and one representing a 40 per cent interest held by another party.
>
> Entity B's capital structure consists of 100 identical ownership shares, of which the private equity fund owns 60.

17. If the IASB concludes that the unit of account is the individual financial instrument(s) rather than the investment as a whole, similar interests (in terms of the level of control or influence conveyed to the investor), such as those the private equity fund holds in Entity A and Entity B, could have units of account that convey to the investor different rights. Those different rights could affect the measurement of the interests very differently even though they are accounted for in the same way (see paragraph 30(a) below).

Staff's recommendation

18. The staff believe that the determination of the unit of account should consider the nature and characteristics of the asset or liability. One of the key characteristics of an investment is the level of control or influence of an investor in an investee. The investor's level of control or influence over an investee leads to investments in subsidiaries, joint ventures and associates each having a different nature (each of these is different from an investment in an individual financial instrument, which is usually covered by IFRS 9). This supports the view that the unit of account of financial assets that are the subject of those Standards should be the investment as a whole, not the individual financial instrument(s) that make up the investment.

19. In addition, the staff note that such a conclusion on the unit of account would be consistent with the IASB's decision in 2011 to amend the scope exception in IAS 28. That scope exception allowed interests in joint ventures and associates held by venture capital organisations, or mutual funds, unit trusts and similar entities, including investment-linked insurance funds, to be measured at fair value through profit or loss in accordance with IFRS 9. The IASB made this amendment to clarify that that measurement option is an exemption from the requirement to measure those interests using the equity method, rather than an exception to the scope of IAS 28 for the accounting for joint ventures and associates held by those entities (see paragraphs BC10–BC14 of IAS 28).

20. Taking into account the questions received on the unit of account for the fair value measurement of such investments, the staff think that the IASB should clarify the unit of account for subsidiaries, joint ventures and associates in IAS 27, IAS 28 and IFRS 10.

21. The staff note that the term 'investment' is included in the accounting requirements of those Standards, as shown in the table in paragraph 9 above. However, those same requirements also include references to IFRS 9, for which the unit of account is an individual financial instrument.

22. The staff recommend amending IAS 27, IAS 28 and IFRS 10 to make it clear that the investment is measured at fair value, with gains or losses to be recognised in

profit or loss in accordance with IFRS 9. For example, paragraph 18 of IAS 28 could be amended as follows:

> … the entity may elect to measure investments in those associates and joint ventures at fair value. Gains or losses on investments measured at fair value shall be recognised in ~~through~~ profit or loss in accordance with IFRS 9.

23. The staff think that any amendments should make it clear that:

    (a) the unit of account is determined by IAS 27, IAS 28 and IFRS 10;

    (b) the fair value is to be measured in accordance with IFRS 13; and

    (c) any gains or losses arising from those investments measured at fair value should be recognised in profit or loss in accordance with IFRS 9.

Questions for the IASB

Question 1 – Unit of account
(a) Does the IASB agree with the staff's conclusion that the unit of account in the Standards dealing with the accounting for subsidiaries, joint ventures and associates should be the investment as whole? (b) Does the IASB agree that the reference to IFRS 9 in the measurement requirements of those Standards was not meant to refer to the unit of account of the asset being measured (or permitted to be measured) at fair value through profit or loss?

24. The next section (Issue 2) analyses the interaction between the unit of account and fair value measurement and aims to address concerns raised in the letter included in Appendix 1. This issue is only relevant if the IASB answers 'yes' to Question 1(a) above.

Issue 2: Interaction between the unit of account and fair value measurement

25. If the IASB concludes in Question 1(a) that the unit of account **is the investment as a whole**, the staff believe that IFRS 13 provides sufficient guidance to measure such investments at fair value when they result in Level 2 or Level 3 fair value measurements (see paragraphs 28–31). However, the staff believe that if Level 1 inputs are available for the financial instruments that make up the investment, the IASB will still need to consider whether the fair value measurement of the investment as a whole can move away from unadjusted Level 1 measurements (see paragraphs 32–46).

26. If the IASB concludes in Question 1(a) that the unit of account **is the individual financial instrument(s)**, the staff believe that IFRS 13 provides sufficient guidance to measure those investments at fair value regardless of the level of the fair value hierarchy in which they are categorised (see paragraphs 28–46).

27. The staff's analysis of the interaction between the unit of account and fair value measurement in this section addresses the implications of the conclusion on the unit of account (ie the investment as a whole or the individual financial instrument(s)) for the resulting measurements. The analysis of this interaction is based on whether the fair value measurement results in:

    (d) a Level 2 or Level 3 fair value measurement (see paragraphs 28–31); or

    (e) a Level 1 fair value measurement (see paragraphs 32–46).

Fair value measurements categorised within Level 2 or Level 3

28. Paragraph 69 of IFRS 13 states that an entity "shall select inputs that are consistent with the characteristics of the asset or liability that market participants would take into account in a transaction for the asset or liability".[3]

29. Assuming that the asset that an entity is measuring at fair value is an 'investment', an entity would consider the characteristics of that investment (for example, the

[3] Consideration of the characteristics of the asset or liability in fair value measurement is also addressed in paragraphs 11–12 of IFRS 13. Paragraph 69 of IFRS 13 has been reproduced in paragraph 32 of this Agenda paper.

level of control or influence) in the corresponding fair value measurements to ensure that the resulting measurement reflects those characteristics appropriately. In some cases, such characteristics are included in the fair value measurements in the form of adjustments (for example, premiums or discounts), but not always.[4]

30. If the conclusion is that the unit of account is each of the individual financial instrument(s) that make up the investment, an entity would need to consider the characteristics of that asset (ie the individual financial instrument) in the fair value measurement. As a result, the characteristic of the level of control or influence might, in many cases, not need to be included in the fair value measurements because it is improbable that a single financial instrument gives the investor the right to control or influence an investee (see point (a) below). Some of the implications of the unit of account being an individual financial instrument are as follows:

    (a) Consider the example in paragraph 16. The private equity fund would have a controlling interest in Entity A consisting of an individual financial instrument (ie a share). Because that share gives the private equity fund control of Entity A, control would be a characteristic of the share, and in that case, the fair value measurement of its controlling interest in Entity A would take control into consideration. In the case of the private equity fund's controlling interest in Entity B, the latter consists of 60 ownership shares. When measuring that controlling interest at fair value, the characteristic of control would not be considered in the fair value measurement of the individual financial instruments because those individual financial instruments do not give the private equity fund control of Entity B.

    (b) A Day 1 loss might arise upon the acquisition of an investment for which, for example, a control premium was paid. Similarly (all other

[4] Some valuation techniques would already reflect, for example, the value of control associated with a controlling interest. As a result, it would not be appropriate in those cases to apply a separate control premium adjustment.

things being equal), a gain might arise upon the sale of that investment if a control premium is paid by the buyer.

31. Regardless of the conclusion that the IASB reaches on the unit of account, the staff think that the measurement guidance in IFRS 13 to perform Level 2 and Level 3 fair value measurements is clear enough to perform an appropriate fair value measurement. An entity will always need to consider the unit of account (for example, whether it is the investment as a whole or the individual financial instruments) and the characteristics of the asset or liability when measuring its fair value.

Fair value measurements categorised within Level 1

32. This section analyses whether IFRS 13 is clear with respect to the fair value of investments that are made up of individual financial instruments for which there is a Level 1 price. The requirements in IFRS 13 that are most relevant when measuring the fair value of such investments are as follows **[emphasis added]**:

> 69 An entity shall select inputs that are consistent with the characteristics of the asset or liability that market participants would take into account in a transaction for the asset or liability […]. In some cases those **characteristics result in the application of an adjustment**, such as a premium or discount **(eg a control premium or non-controlling interest discount)**. However, **a fair value measurement shall not incorporate a premium or discount that is inconsistent with the unit of account in the IFRS that requires or permits the fair value measurement […]**. Premiums or discounts that reflect size as a characteristic of the entity's holding (specifically, a blockage factor that adjusts the quoted price of an asset or a liability because the market's normal daily trading volume is not sufficient to absorb the quantity held by the entity, as described in paragraph 80) **rather than as a characteristic of the asset or liability (eg a control premium when measuring the fair value of a controlling interest)** are not permitted in a fair value measurement. In all cases, **if there is a quoted price in an active market (ie a Level 1 input) for an asset or a liability, an entity shall use that price without adjustment when measuring fair value**, except as specified in paragraph 79.

> 80 If an entity holds **a position in a single asset or liability (including a position comprising a large number of identical assets or liabilities, such as a holding of financial instruments) and the asset or liability is traded in an active market, the fair value of the asset or liability shall be measured within Level 1 as the product of the quoted price for the individual asset or liability and the quantity held by the entity.** That is the case even if a market's normal daily trading volume is not sufficient to absorb the quantity held and placing orders to sell the position in a single transaction might affect the quoted price.

33. In IFRS 13 the fair value hierarchy does not influence the unit of account, but by prioritising the use of Level 1 inputs without adjustment whenever available (see paragraphs 69 and 80 of IFRS 13 reproduced above), the implication is that a strict interpretation could result in an asset or a liability being measured differently from its unit of account. For example, an investment could be measured using the sum of the quoted prices for the individual financial instruments within that investment (ie the product of the quoted price multiplied by the quantity held, or PxQ). Consequently, even if the IASB agreed that the unit of account is the investment as a whole, it would still need to clarify how to measure fair value when Level 1 inputs are available for the individual financial instruments that make up that investment (see paragraph 25 above).

34. Depending on what is considered more important (ie the unit of account or the requirement to prioritise Level 1 inputs), this leads to the following views:

    (a) Proponents of **View 1** believe that because Level 1 inputs are defined as quoted prices for identical assets, there is no Level 1 price for the investment as a whole. Instead, the Level 1 price is for the underlying financial instruments, which are not 'the asset' being measured at fair value. Consequently, that Level 1 input cannot be the sole determinant of the fair value of the investment and the investment's fair value must either be measured using another valuation technique or by adjusting the Level 1 input to reflect differences between the investment and the underlying individual financial instruments. Proponents of this view would prioritise the unit of account of the asset or liability that is measured at fair value above the availability of Level 1 inputs.[5]

    (b) Proponents of **View 2** believe that because the investment is made up of individual financial instruments that have a Level 1 price, that Level 1 input must be used and the fair value measurement of those investments would be the product of the quoted price multiplied by the quantity held (PxQ) without adjustments. Proponents of this view would prioritise

[5] Proponents of this view could also use the requirements in paragraph 69 of IFRS 13 reproduced in paragraph 32 to reach this interpretation.

the availability of Level 1 inputs above the unit of account (ie Level 1 inputs always provide the most reliable evidence of fair value).[6]

35. Although the staff think that the guidance in IFRS 13 is clear with respect to the general approach to be used when measuring investments or individual financial instruments categorised in Level 2 or Level 3 of the fair value hierarchy (see paragraphs 28–31), the Standard is less clear about the interaction between the unit of account and the use of Level 1 inputs. As a result, IFRS 13 is open to different interpretations on this point and the staff believe it should be clarified.

36. The staff think there are two options for the IASB to consider:

    (a) Option 1: require an entity to measure the fair value of an investment in accordance with that unit of account (ie as the investment as a whole), regardless of whether there is a Level 1 input for the underlying financial instruments within that investment.

    (b) Option 2: even if the unit of account is the investment as a whole, if a Level 1 input exists for the individual financial instruments that make up the investment, require an entity to measure the fair value of the investment as the product of the Level 1 input (without adjustment) multiplied by the quantity held (PxQ).

37. The staff think that if the IASB chooses to require Option 1, it could also require an entity to disclose the product of the quoted price multiplied by the quantity held (PxQ). Doing so would provide users of the entity's financial statements with the information that would result from Option 2.

38. The following table summarises the issues for the IASB to consider in choosing whether to require Option 1 or Option 2.

[6] Proponents of this view could use the requirements in paragraph 80 of IFRS 13 reproduced in paragraph 32 to reach this interpretation.

Issue	Option 1	Option 2	Staff's assessment of the issue
Consistency between the unit of account and the resulting fair value measurement	Respects the unit of account of the asset (ie the investment) being measured at fair value.	If there is a Level 1 input, this is prioritised without consideration of the unit of account.	Option 1 is superior.
Maximising the use of observable inputs	The measurement would contain inputs that are not observable (for example, adjustments for premiums and discounts that are not observable) resulting in a less objective fair value measurement, and downgrading it to a lower level within the fair value hierarchy. It might have far-reaching consequences. It opens up the possibility of entities analogising to other situations the ability for making adjustments to Level 1 inputs or for not using them at all.	It respects the principle of maximising the use of relevant observable inputs (see paragraph 61 of IFRS 13). Would result in a Level 1 fair value measurement. Level 1 inputs provide the most reliable evidence of fair value.	Option 2 is superior.

Issue	Option 1	Option 2	Staff's assessment of the issue
Consistency in the methodology used for measuring fair value	The measurement methodology would be consistent whether the investment is quoted or unquoted. The fair value measurement would reflect the characteristics of the asset (control, joint control, significant influence) regardless of whether the individual underlying financial instruments are quoted or unquoted. The fact that the underlying financial instrument is quoted or not would be reflected through other characteristics, such as liquidity.	The measurement methodology would differ depending on whether the investment is quoted or unquoted. See comments on this issue for Option 1. This option might be challenging to apply when, for example, an investment in a subsidiary has both quoted and unquoted shares.	Option 1 is superior.
Measurements with economic content	Results in a more economically sound measurement, because it considers the characteristics of the asset (control, joint control, significant influence) that market participants would take into account when pricing the asset.	Level 1 fair value measurements without adjustments might not necessarily result in economically superior measurements to the extent that the Level 1 price reflects the fair value of the underlying financial instruments but not of the investment as a whole.	Option 1 is superior.

Issue	Option 1	Option 2	Staff's assessment of the issue
Day 1 gains and losses	Reduces the possibility of a Day 1 loss arising from paying a premium to acquire an investment that results in control, joint control or significant influence. Similarly, reduces the possibility of a gain upon the sale of such an interest if the buyer pays a premium for control, joint control or significant influence.	A Day 1 loss might arise if a premium was paid to acquire an investment that results in control, joint control or significant influence. Similarly, upon sale there could be a gain if the buyer pays a premium for control, joint control or significant influence.	Option 1 is superior.
Convergence	Current practice under US GAAP is to use Option 2.	Aligned with current practice under US GAAP.	Option 2 is superior.
Usefulness of the information provided by the resulting measurements	The focus of the Fair Value Measurement project was on 'how' to measure fair value and not on 'what' was to be measured at fair value. The measurements resulting from Option 1 and Option 2 are dependent on whether the IASB believes that the relevant unit of account is the investment as a whole in all cases (ie regardless of the existence of underlying individual financial instruments with Level 1 prices). Because this issue was outside the scope of the Fair Value Measurement project, no outreach was undertaken to conclude on which resulting measurement would provide users more useful information (ie the measurement of the investment or the measurement of the underlying individual financial instruments, and their views on whether to prioritise Level 1 inputs in the former case). The		

Issue	Option 1	Option 2	Staff's assessment of the issue
	staff believe that it is important to understand which measurement provides better information for users of financial statements. The staff think that this input can be obtained through outreach carried out during the comment period of any proposed amendments that the IASB deems necessary to address the issues that are the subject of this paper.		

39. If the IASB concludes in Question 1(a) that the unit of account is the investment as a whole, amendments to IAS 27, IAS 28 and IFRS 10 would be required as noted in paragraph 22 above. The following summarises, for information purposes, the additional implications of Options 1 and 2 in terms of amendments to IFRS 13:

    (a) If the IASB chooses Option 1 the staff believe that the IASB might need to amend IFRS 13 to ensure that it is clear that an entity should prioritise the unit of account of the asset or liability over the existence of Level 1 inputs if those inputs are for a different unit of account. Option 1 might also trigger amendments to IFRS 12 *Disclosure of Interests in Other Entities* (see paragraph 37 above).

    (b) If the IASB choses Option 2 the staff believe that the IASB will need to clarify in IFRS 13 that, even though the unit of account is the investment as a whole, if that investment is made up of financial instruments for which there is a Level 1 input, those inputs should be used without adjustment when measuring the fair value of the investment.

40. If the conclusion reached by the IASB on the unit of account is that it is the individual financial instruments, we believe that the guidance in IFRS 13 is clear enough to obtain the fair value measurements of the investments composed of quoted financial instruments. This would result in using Level 1 inputs without adjustments (which would be consistent with measuring the fair value of financial instruments within the scope of IFRS 9 or IAS 39). However, such a conclusion on the unit of account would have similar implications as those described in paragraph 30 above.

Implications for impairment testing

41. Views 1 and 2 in paragraph 34 above also have an impact on the measurement of the fair values of cash-generating units (CGUs) for impairment test purposes when an entity has, for example, quoted subsidiaries. Before analysing the different views, it is worth noting the definition of a CGU in IAS 36 *Impairment of Assets* **[emphasis added]**:

> A cash-generating unit is the smallest identifiable **group of assets** that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

42. Under View 1, the fair value of a CGUs with a Level 1 price would reflect the characteristics of the CGU as a whole (for example, its fair value would reflect the value of control if applicable) and would result in measurements for which Level 1 inputs have been adjusted or another valuation technique (for example, discounted cash flow method or current replacement cost) was used. Consideration of control premiums in the fair value measurements of quoted CGUs would be more closely aligned with 'value in use', because value in use reflects the value of control.[7] In addition, such a measurement would also be aligned with the US GAAP impairment literature, which allows Level 1 inputs to be adjusted for control premiums when measuring the fair value of a reporting unit for impairment testing.[8]

43. Under View 2, the fair value of a quoted CGU would be obtained by using unadjusted Level 1 inputs: ie, it would be the product of the Level 1 price multiplied by the quantity (for example, the number of shares) held. The fair values would be determined on a different basis than value in use. Furthermore, fair value for impairment testing purposes in IFRSs would not be aligned with fair value for impairment testing purposes in US GAAP.

44. The reason why US GAAP allows the use of adjusted Level 1 inputs to obtain the fair value amounts of reporting units for impairment testing purposes is because the US GAAP's impairment testing model does not have a 'value in use' concept. The rationale for why the FASB allowed adjustments to quoted prices for reporting units for impairment testing purposes is similar to the IASB's rationale for having a 'higher of' threshold for recognising impairment in IAS 36.

45. The staff also note that IAS 36 does not refer to IFRS 9 when referring to fair value less costs of disposal for impairment testing purposes. Consequently, the

[7] IAS 36 defines value in use as "the present value of the future cash flows expected to be derived from an asset or cash-generating unit".

[8] See ASC paragraphs 350-20-35-22 through 35-24.

issues outlined above regarding the potential conflict for the unit of account do not apply to this issue—the only question is the interaction with IFRS 13's requirement to prioritise the use of Level 1 inputs.

46. The staff believe that, for impairment testing purposes, because the fair value measurement resulting from Option 1 reflects the unit of account (ie the CGU) and the CGU's other characteristics, Option 1 is superior to Option 2. Having said that, the staff note that because IAS 36 contains a 'higher of' threshold and permits the use of value in use (which reflects the unit of account and the CGU's other characteristics), there is less pressure on having to align fair value measurements to Option 1 for CGUs associated with quoted subsidiaries that have Level 1 prices.

Staff's recommendations

47. The questions set out below are relevant only if the IASB decides in Question 1(a) above that the unit of account is the investment.

48. The staff have different views. We think that the boards' objective in maximising relevant observable inputs and minimising unobservable inputs and in prioritising Level 1 inputs whenever available has its advantages in terms of objectivity and transparency. However, such an approach might not always portray the economics of the asset (ie the investment as a whole) that is being measured. In particular, if the relevant unit of account is the 'investment as a whole', it seems that measuring the fair value of the investment using Level 1 inputs that correspond to a different unit of account (ie to individual financial instruments) does not appear to result in a conceptually sound measurement.

49. However the staff think that deciding on Option 1 or Option 2 (see paragraph 36 above) will not only depend on the analysis of the superiority of one option over the other for each of the issues identified in the table above, but, most importantly, it will depend on the weight that the IASB puts on each of those issues. The staff think that this is something for the Board members to consider and to decide upon.

Questions for the IASB

Question 2 – Interaction between the unit of account and fair value measurement
On the basis of the staff's analysis, which of the options described above does the IASB consider to be the most appropriate for: (a) measuring investments in subsidiaries, joint ventures or associates at fair value whose underlying individual financial instruments have a Level 1 price (paragraphs 32–40): (i) Option 1 (unit of account is considered to be more important), or (ii) Option 2 (prioritisation of Level 1 inputs is considered to be more important)? (b) measuring fair value less costs of disposal for impairment testing purposes (paragraphs 41–46): (i) Option 1 (unit of account is considered to be more important), or (ii) Option 2 (prioritisation of Level 1 inputs is considered to be more important)?