STAFF PAPER

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Project	**Fair Value Measurement**		
Paper topic	Unit of account—Transition provisions		
CONTACT(S)	Mariela Isern	misern@ifrs.org	+44 (0) 20 7246 6483

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Introduction

1. In October 2012, the IFRS Interpretations Committee (the 'Interpretations Committee') received a request to clarify the unit of account for financial assets that are investments in a subsidiary, joint venture or associate. A similar request was also received by the IASB in December 2012. The submission to the Interpretations Committee also requested clarification on the interaction between the use of Level 1 inputs and the unit of account when:
   (a) measuring the fair value of quoted investments in subsidiaries, joint ventures and associates ('measuring the fair value of quoted investments');
   (b) measuring the recoverable amount of a cash-generating unit (CGU) that corresponds to a quoted entity on the basis of fair value less costs of disposal ('measuring the fair value of the recoverable amount of a quoted CGU'); and
   (c) applying the portfolio exception set out in IFRS 13 *Fair Value Measurement*.
2. The question regarding the unit of account for investments in subsidiaries, joint ventures and associates was discussed by the IASB at its February and March 2013 meetings. The IASB tentatively decided that the unit of account is

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the investment as a whole rather than the individual financial instruments that make up the investment.

3. The interaction between the use of Level 1 inputs and the unit of account in the case of investments in subsidiaries, joint ventures, associates and in the case of a CGU that corresponds to a quoted entity, was discussed at the IASB meetings in February, March and May 2013.[1] The IASB tentatively decided that:

   (a) the fair value measurement of an investment composed of quoted financial instruments should be the product of the quoted price of the financial instruments (P) multiplied by the quantity (Q) of instruments held (ie $P \times Q$);

   (b) the recoverable amount of CGUs that correspond to quoted entities measured on the basis of fair value less costs of disposal should be based on the product of their quoted price (P) multiplied by the quantity (Q) of instruments held (ie $P \times Q$); and

   (c) the clarification about the fair value measurement of quoted investments in subsidiaries, joint ventures and associates should be made to the Standards that deal with the accounting of those investments and that the clarification about the measurement of the recoverable amount of CGUs on the basis of fair value less costs of disposal should be made to the Standard that deals with the impairment test for CGUs.[2]

4. In December 2013 the IASB discussed the application of the portfolio exception as set out in IFRS 13 for portfolios that comprise only Level 1 financial instruments whose market risks are substantially the same. The IASB tentatively decided that:

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[1] The Agenda Papers discussed at the IASB meetings in February, March and May 2013 can be found at:
http://www.ifrs.org/Meetings/Pages/IASBFebruary2013.aspx
http://www.ifrs.org/Meetings/Pages/IASBMarch2013.aspx and
http://www.ifrs.org/Meetings/Pages/IASBMay2013.aspx

[2] The Standards affected by the proposed amendments are: IAS 27 *Separate Financial Statements*, IAS 28 *Interests in Associates and Joint Ventures*, IAS 36 *Impairment of Assets* and IFRS 10 *Consolidated Financial Statements*.

(a) the measurement should be the one resulting from multiplying the net position by the Level 1 prices; and

(b) the Exposure Draft that clarifies the fair value measurement of quoted investments in subsidiaries, joint ventures and associates and the fair value measurement of the recoverable amount of a quoted CGU (the 'Exposure Draft') should include a non-authoritative example to illustrate the application of the portfolio exception for a portfolio that comprises only Level 1 financial instruments whose market risks are substantially the same.[3]

Purpose of this paper

5. This paper makes recommendations on the transition provisions for the proposed amendments for both entities reporting under IFRS (see paragraphs 6–16) and first-time adopters (see paragraphs 17–18).

Transition provisions

6. The proposed amendments to the fair value measurement of quoted investments and the fair value measurement of the recoverable amount of quoted CGUs will represent a change in the measurement of those assets for entities that do not currently measure them by applying P × Q. The staff believe those changes are closely aligned to a change in accounting estimates. In accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* a change in an accounting estimate shall be recognised prospectively.

7. Any changes to the fair value measurements caused by the proposed amendments would not represent a change in the *measurement basis* but would instead be a modification to how the fair value measurements is determined for the specific

[3] The Agenda Paper discussed at the IASB meeting in December 2013 can be found at: http://www.ifrs.org/Meetings/MeetingDocs/IASB/2013/December/AP11-Fair%20Value%20Measurement.pdf

cases mentioned above. Consequently, because there is no change in the measurement basis, it would not constitute a change in accounting policy.[4]

8. Further support for the above view can be found in IFRS 13. Paragraph 66 of IFRS 13 aligns revisions in the fair value measurements as a result of a change in the valuation technique to a change in accounting estimate:

> 66 Revisions resulting from a **change in the valuation technique** or its application shall be accounted for as a **change in accounting estimate** in accordance with IAS 8. However, the disclosures in IAS 8 for a change in accounting estimate are not required for revisions resulting from a change in a valuation technique or its application. The proposed amendments represent a revision in the methodology followed to determine the fair value measurements of quoted investments and the recoverable amount of quoted CGUs. **[emphasis added]**

9. As mentioned above, because the proposed amendments represent changes in how the fair value measurements are determined, they should be considered as a change in accounting estimate and be applied prospectively.

10. In addition, when IFRS 13 was issued it required prospective application of its requirements because, in accordance with paragraph BC 229 of IFRS 13, “the IASB concluded that a change in the methods used to measure fair value would be inseparable from a change in the fair value measurements (ie as new events occur or as new information is obtained, eg through better insight or improved judgement). […] Therefore, the IASB concluded that IFRS 13 should be applied prospectively (in the same way as a change in accounting estimate)”.

11. The staff believe that the changes that the proposed amendments might cause could be analogised to any of the changes in entities’ fair value measurements that the application of IFRS 13 could have triggered. Consequently, they should have the same transition provisions as the ones required by IFRS 13 (ie prospective application).

12. Last but not least, when measuring the recoverable amounts of quoted CGUs on the basis of fair value less costs of disposal, retrospective application of the proposed amendments would raise some additional challenges:

[4] This is aligned to paragraph 35 of IAS 8 which states that that “a change in the measurement basis applied is a change in an accounting policy, and is not a change in an accounting estimate”.

(a) it could lead to a reversal of goodwill impairment. We note that this would be in contravention to the requirements in paragraph 124 of IAS 36 *Impairment of Assets*, which prohibits reversing an impairment loss recognised for goodwill in a subsequent period. Please see Appendix 1 to this paper for an illustration of the matter above; and

(b) it could represent undue cost. This is because an impairment loss recognised for other assets of a CGU in previous reporting periods may need to be fully or partially reversed or it may need to be recognised or increased. This would mean, for example, that entities would need to change the base of the assets they had impaired by adjusting amortisation and the corresponding accumulated amortisation balances. The extent of the cost would of course depend on the number of quoted CGUs and the number of comparative periods presented; and

(c) it might not translate into useful information. We believe that the usefulness of information about the impact of the proposed amendments on previous periods' impairment losses would be restricted to only those instances in which an entity has incurred an impairment loss or has reversed an impairment loss during the reporting period in which it implemented the amendments. The staff believe that, in those cases, the need for useful information could be satisfied with disclosure requirements on transition (see paragraph 16).

13. For the reasons above, the staff recommend that:

(a) the proposed amendments to the measurement of quoted investments at fair value should be applied prospectively. We recommend that the proposed transition provision should explicitly state that an entity should adjust its opening retained earnings to account for the effect of the change in measurement as a catch-up adjustment and recognise the change in measurement of the quoted investment during the reporting period in profit or loss for the period in which the amendments are being applied. Appendix 2 illustrates this recommendation; and

(b) the proposed amendments to the measurement of the recoverable amount of quoted CGUs on the basis of fair value less costs of disposal should be applied prospectively.

14. We also recommend that early application of the amendments be permitted. This would allow entities to apply the measurement requirements as soon as practicable, thereby improving comparability in measurement.

Disclosures on transition

15. In the case of the measurement of quoted investments at fair value, the staff recommend that an entity should disclose the adjustment in its opening retained earnings caused by the amendments. This will assist users of financial statements to assess the impact on transition by distinguishing the part of the change that is attributable to the catch-up adjustment from the part of the change that is attributable to the performance of the investment during the period the amendments are being applied.

16. In the case of the fair value measurement of the recoverable amount of a quoted CGU, the staff believe that in the case in which an entity incurred an impairment loss or an impairment loss reversal during the reporting period in which the amendments are being applied, quantitative information about the impact on the impairment loss amount (ie the impairment loss amount, if any, that would have been recognised) in the immediately preceding period presented if the amendments had been applied would constitute useful information for users of financial statements. Consequently, we recommend including such disclosure requirements on transition.

Question for the IASB

Question 1—Transition provisions
Does the IASB agree with the staff's recommendation to: (a) apply the proposed amendments prospectively; (b) permit earlier application of the proposed amendments; and (c) require the proposed disclosures on transition included in paragraphs 15–16 of this paper?

First-time adopters

17. In general, IFRS 1 *First-time Adoption of International Financial Reporting Standards* requires retrospective application of IFRSs. The transition provisions of IFRS 13 are prospective, but a first-time adopter of IFRS would adopt IFRS 13 retrospectively (ie both the fair value measurements of the first annual financial statements in which an entity adopts IFRSs, and the fair value measurements from the beginning of the earliest period for which the entity presents full comparative information using IFRS, would conform to IFRS 13). This is consistent with paragraph 10 of IFRS 1 [**emphasis added**]:

> 10 […] an entity shall, in its opening IFRS statement of financial position:
> (a) Recognise all assets and liabilities whose recognition is required by IFRSs;
> (b) Not recognise items as assets or liabilities if IFRSs do not permit such recognition;
> (c) Reclassify items that it recognised in accordance with previous GAAP as one type of asset, liability or component of equity, but that are a different type of asset, liability or component of equity in accordance with IFRSs; and
> (d) **apply IFRSs in measuring all recognised assets and liabilities**.

18. IFRS 13 has been effective since 1 January 2013. This means that a first-time adopter adopting IFRS at the time that the proposed amendments are effective would also be adopting IFRS 13 for the first time. Consequently, the staff believe that first-time adopters should apply the amended requirements in their opening IFRS statement of financial position.[5] This will not represent undue cost to first-time adopters, but will mean that they adopt all the Standards (including their amendments) that are effective at the date of their first IFRS financial statements.[6]

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[5] IFRS 1 defines 'opening IFRS statement of financial position' as "an entity's statement of financial position at the date of transition to IFRSs". IFRS 1 also defines 'date of transition to IFRSs' as "the beginning of the earliest period for which an entity presents full comparative information under IFRSs in its first IFRS financial statements".

[6] IFRS 1 defines 'first IFRS financial statements' as "the first annual financial statements in which an entity adopts International Financial Reporting Standards (IFRSs), by an explicit and unreserved statement of compliance with IFRSs".

Question for the IASB

Question 2—First-time adopters
Does the IASB agree with the staff's recommendations about the transition provisions in the case of first-time adopters?

Appendix 1—Consideration of retrospective application for quoted CGUs

1. Retrospective application of the proposed amendments affecting the fair value measurement of the recoverable amount of quoted CGUs can result in a burdensome exercise that might not necessarily translate into useful information. Table 1 illustrates the complexities of applying the proposed amendments retrospectively in the case of an investment in a subsidiary held by Entity A, which is not an investment entity.[7]

2. Assume that Entity A has only an investment in a subsidiary which was acquired in 20X0. Entity A's reporting period ends 31 December 20X0. Its subsidiary is a quoted entity and is also a CGU. Assume also that the proposed amendments are effective as of 1 January 20X1 and that they are required to be applied retrospectively. For both Case 1 and Case 2, Table 1 shows the recoverable amount as estimated by Entity A on 31 December 20X0 and the recoverable amount that would have been obtained if its measurement had been based on $P \times Q$, provided that that amount is higher than the recoverable amount of the CGU on the basis of value in use.

[7] We think that the population of quoted CGUs that are not held by investment entities and that will be subject to impairment tests will be larger than the population of quoted CGUs held by investment entities subject to impairment tests. This is why the staff have based the analysis on the former.

Table 1	Case 1[8]			Case 2[9]	
(In CU[10])	Reported on 31.12.X0	Applying amendments (ie P × Q)		Reported on 31.12.X0	Applying amendments (ie P × Q)
Carrying amount CGU	100	100		100	100
Recoverable amount	80	95		120	95
Impairment loss	(20)	(5)		-	(5)
Comment	This would lead to a reversal of any impairment loss recognised for other assets of the CGU and for any goodwill allocated to the CGU.			In conformity with paragraph 104 of IAS 36, this would lead to first allocating impairment loss against goodwill allocated to the CGU and then to the other assets of the CGU.	

3. As shown in Table 1, in Case 1, Entity A has reported an impairment loss of CU20 on 31 December 20X0. In accordance with paragraph 104 of IAS 36 *Impairment of Assets*, Entity A would have allocated the impairment loss first to reduce the carrying amount of any goodwill allocated to the CGU and then to the other assets of the CUG pro rata on the basis of the carrying amount of each asset in the CGU.

4. Continuing with the discussion of Case 1, when applying the proposed amendments retrospectively, Entity A finds that the impairment loss for the year ended 31 December 20X0 would have been only CU5. Consequently, as

[8] This case assumes that the recoverable amount on the basis of fair value less costs of disposal and measured based on P × Q (CU95) is higher than the recoverable amount of CU80 that Entity A obtained by taking the highest of value in use or fair value less costs of disposal measured through a valuation technique.

[9] This case assumes that the recoverable amount on the basis of fair value less costs of disposal and measured based on P × Q (CU95) is lower than the recoverable amount of CU120 that Entity A obtained on the basis of fair value less costs of disposal which was measured through a valuation technique but it is still higher than the value in use obtained for the CGU in the reported period ended 31 December 20X0.

[10] In this paper, currency amounts are denominated in ‘currency units’ (CU).

mentioned in Table 1, Case 1 would lead to a reversal (or partial reversal) of the impairment loss recognised for the other assets of the CGU and could also lead to a reversal (or partial reversal) of the impairment loss recognised for goodwill, if any, in 20X0. Conversely, Case 2 would lead to the recognition of an impairment loss, which would first be allocated to goodwill and then to the other assets of the CGU in accordance with paragraph 104 of IAS 36.

5. We note that both Case 1 and Case 2 illustrate that retrospective application of the proposed amendments would lead to additional implementation costs and/or to the following potential conflicts with current IFRS:
   (a) for example, when considering Case 1, the impairment loss recognised for other assets of the CGU may need to be fully or partially reversed. This would mean that Entity A would need to change the base of the assets it had impaired, by adjusting amortisation charges and the corresponding accumulated amortisation balances; and
   (b) for example, when considering Case 1, any remaining balance of the impairment loss reversal could hypothetically be reversed against any goodwill impairment that Entity A might have recognised in 20X0, which would be inconsistent with paragraph 124 of IAS 36, which prohibits reversing in a subsequent period an impairment loss recognised for goodwill.
6. The fact pattern of this example has been simplified by limiting the retrospective application of the amended requirements to the reporting year before the amendments are effective and having them affect only one CGU. If an entity had more than one CGU and it had to adjust all comparative periods presented retrospectively, this could mean that an entity could end up having to carry out reversals or additional allocations of impairment losses to assets of the CGU and goodwill.
7. We think that the costs of such transitional provisions would overweigh the benefits users would derive. We think that the information provided in the financial statements would be more understandable if:

(a) the proposed amendments to the measurement of the recoverable amount on the basis of fair value less costs of disposal for quoted CGUs affects their impairment tests on a prospective basis; and

(b) entities that incur an impairment loss or an impairment loss reversal during the reporting period in which the proposed amendments are being applied disclose quantitative information about the impact on the impairment loss amount (ie the impairment loss amount, if any, that would have been recognised) in the immediately preceding period presented if the amendments had been applied.

Appendix 2—Transition provision for quoted investments

1. As mentioned in paragraph 13(a), we recommend that, in the case of the measurement of quoted investments at fair value, the proposed transition provision should explicitly state that an entity should adjust its opening retained earnings to account for the effect of the change in measurement as a catch-up adjustment and recognise the change in measurement of the quoted investment during the reporting period in profit or loss for the period in which the amendments are being applied. Figure 1 includes an example to illustrate this.

2. Assume that an entity holds a quoted investment in an associate for which it had reported CU100 in the reporting period preceding the implementation of the proposed amendments (ie the period ending on 31 December 20X0) and that it reports CU115 for the same investment in the period in which it applied the amendments (ie the period ending on 31 December 20X1).

Figure 1—Prospective application

(In CU)	31 Dec 20X0	31 Dec 20X1
Investment in an associate	100	
Applying P × Q	95	115

Statement of financial position (SFP)

	31 Dec 20X0	31 Dec 20X1	Change
Investment in an associate	100	115	15

The CU15 change consists of:

Change in opening retained earnings (1 January 20X1)	-5
Change in the measurement of the investment during the period 20X1	20
Total change as reported in the SFP	**15**

3. For such a case, the following entry reflects the transition provision that the staff recommend:

	Dr	(Cr)
Investment in associate	15	
Retained Earnings (1 January 20X1)	5	
Profit or loss (during 20X1)		20

4. In addition, the entity in Figure 1 would be required to disclose that it had adjusted its opening retained earnings by CU5 for the reporting period in which it applied the proposed amendments.