STAFF PAPER

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IASB Meeting

Project	**Measuring Quoted Investments in Subsidiaries, Joint Ventures and Associates at Fair Value (Proposed amendments to IFRS 10, IFRS 12, IAS 27, IAS 28 and IAS 36 and Illustrative Examples for IFRS 13)**
Paper topic	Illustrative Example for IFRS 13—Portfolios

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Purpose and structure of this paper

1. This paper starts the redeliberations with the IASB in relation to the Exposure Draft ('ED') *Measuring Quoted Investments in Subsidiaries, Joint Ventures and Associates at Fair Value* (Proposed amendments to IFRS 10, IFRS 12, IAS 27, IAS 28 and IAS 36 and Illustrative Examples for IFRS 13).
2. Specifically, this paper addresses the comments received on question 4 of the ED relating to the inclusion of an illustrative example to IFRS 13 *Fair Value Measurement* to illustrate the application of paragraph 48 of that Standard and asks the IASB whether it agrees with the staff's recommendations.
3. This paper is structured as follows:
   (a) Background to question 4 of the ED (paragraphs 5–8);
   (b) The conclusion of the IASB and basis provided in the ED (paragraphs 9–12);
   (c) Summary of comments received (paragraphs 13–15);
   (d) Analysis of comments received and staff's recommendation (paragraphs 16–33);
   (e) Staff's conclusion (paragraph 34);
   (f) Next steps (paragraph 35) and
   (g) Question for the IASB.

4. This paper also includes the following Appendices:
   (a) Appendix 1—Amendments to the Illustrative Examples for IFRS 13. This appendix includes the proposed illustrative example as published in the ED with proposed drafting amendments based on comments received from respondents; and
   (b) Appendix 2—Submission received requiring clarification of the interaction between the use of Level 1 inputs and the unit of account when applying the portfolio exception in IFRS 13.

Background to Question 4 of the ED

5. In Question 4 of the ED, the IASB proposed to include an illustrative example to IFRS 13 to illustrate the application of paragraph 48 of that Standard to a group of financial assets and financial liabilities whose market risks are *substantially the same and whose fair value measurement is categorised within Level 1* of the fair value hierarchy. The example illustrates that the fair value of an entity's net exposure to market risks arising from such a group of financial assets and financial liabilities is to be measured in accordance with the corresponding Level 1 prices.
6. The IASB's proposal aimed to address a request received by the IFRS Interpretations Committee (the 'Interpretations Committee') (see Appendix 2) to clarify the interaction between the use of Level 1 inputs and the unit of account when applying the portfolio exception set out in IFRS 13. The issue was discussed by the Interpretations Committee in May 2013 and by the IASB in May and December 2013.
7. The submission received requested clarification when applying the portfolio exception in IFRS 13 to a specific circumstance. That circumstance was illustrated by a fact pattern in which an entity had a long position of financial assets and a short position of financial liabilities in a particular market risk[1] and

[1] It is worth noting that the proposed illustrative example in the ED presented the entity's group of financial assets and financial liabilities as having 'market risks that are substantially the same' as this terminology is aligned to the terminology used in IFRS 13.

those financial assets and financial liabilities were categorised within Level 1 of the fair value hierarchy. The submission presented different approaches that the submitter believed an entity could take to measure the fair value of such a group of financial instruments.

8. The IASB noted that the request received to illustrate the portfolio exception for that particular example had similarities with the issue of the interaction between the use of Level 1 inputs and the unit of account that arises when measuring the fair value of investments in subsidiaries, joint ventures and associates that are quoted in an active market. Consequently, the IASB tentatively decided to consider the portfolio exception issue before finalising the ED.

The conclusions of the IASB and the basis provided in the ED

9. In considering the fact pattern included in the submission received, the IASB believed that it was necessary to address which was the appropriate price (P) and the appropriate quantity of financial instruments (Q) that should be used when applying paragraph 48 of IFRS 13 to a group of financial assets and financial liabilities whose market risks are substantially the same and whose fair value measurement is categorised within Level 1 of the fair value hierarchy. This is included in paragraphs BC25 and BC26 of the ED:

> BC25 [...] In relation to P, the IASB believed that the Level 1 prices are the prices to be considered, because of the following principles in IFRS 13:
>
> (a) maximisation of the use of relevant observable inputs and minimisation of the use of unobservable inputs (see paragraph 61 of IFRS 13); and
>
> (b) Level 1 inputs should be used without adjustments whenever they are available (see paragraphs 69, 77 and 80 of IFRS 13).
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> BC26 In relation to Q, the IASB believed that the quantity of financial instruments should reflect the net position because:
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> (a) the market risks of the financial assets and financial liabilities are substantially the same and, as a result, they can be offset; and
>
> (b) the net position reflects how an entity would exit or close out such outstanding risk exposure.

10. Consequently, the IASB concluded that if an entity elects to use the exception in paragraph 48 of IFRS 13, the appropriate fair value measurement of the net risk exposure arising from a group of financial assets and financial liabilities whose

market risks are substantially the same, and whose fair value measurement is categorised within Level 1 of the fair value hierarchy, would be determined by multiplying the financial instruments included in the resulting net position by the corresponding unadjusted Level 1 price. The IASB noted that incorporating adjustments for premiums or discounts to the Level 1 inputs is not permitted in IFRS 13.

11. The IASB's conclusions represented continuity in practice under IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 9 *Financial Instruments*, which the IASB did not intend to change when issuing IFRS 13 (see paragraph BC27 of the ED).

12. The IASB also concluded that amendments to IFRS 13 were not needed to clarify the application of paragraph 48 for the specific case discussed. However, because the existence of different views could impair consistent application of the Standard, the IASB decided to propose including an example to illustrate the application of that paragraph.

Summary of the comments received

13. The majority of the respondents to the ED agreed that the proposed additional illustrative example for IFRS 13 appropriately illustrates the application of paragraph 48 of IFRS 13.

14. Some respondents, however, were of the view that the illustrative example did not address all scenarios and circumstances regarding the application of paragraph 48 of IFRS 13. In particular, these respondents thought that additional guidance should be provided in the following areas:

    (a) examples with portfolios consisting of:

        (i) financial instruments categorised within Level 1 and Level 2 of the fair value hierarchy;

        (ii) financial instruments categorised within Level 2 and Level 3 of the fair value hierarchy; and

        (iii) financial instruments that have different Level 1 prices.

    (b) allocation of the resulting measurement to the individual financial assets and financial liabilities for presentation and disclosure purposes;

(c) interaction between the portfolio exception and the use of mid-market pricing as a practical expedient in accordance with paragraph 71 of IFRS 13 and clarification of the term ‘bid-offer reserve adjustment’ included in paragraph IE47F of the ED.

15. Some respondents did not agree with the proposals in the ED because they were of the view that the fair value of the net risk exposure arising from a group of financial assets and financial liabilities whose market risks are substantially the same should be measured by applying a valuation technique that considers the characteristics of the net risk exposure (ie the net risk exposure should be adjusted for premiums or discounts if those represent its features).

Analysis of comments received and staff’s recommendation

16. For the purposes of framing the analysis of the comments received and providing related recommendations, the staff think that it is worth highlighting that in the development of the additional illustrative example the IASB focused only on the request received and did not intend to broaden the analysis to include other instances or circumstances.

17. The paragraphs below include the main comments received and the staff’s related recommendation.

Need for additional guidance including additional guidance on the allocation of portfolio-level adjustments

18. On the basis of the comments received, the staff note that the comments requesting or suggesting additional guidance to cover circumstances such as examples with portfolios consisting of financial instruments that are also categorised within Level 2 and Level 3 of the fair value hierarchy, or portfolios consisting of financial instruments that have different Level 1 prices, are beyond the initial clarification submitted. The submission *specifically* dealt with the application of paragraph 48 of IFRS 13 to an entity’s long position in financial assets and a short position in financial liabilities in a particular market risk and whose fair value measurement is categorised within Level 1 of the fair value hierarchy.

19. These additional items add a further dimension to the specific fact pattern of the original request for clarification. On the basis of the initial request for clarification as described in paragraph 7 of this paper, the staff is of the view that the proposed illustrative example in the ED appropriately addresses the specific issue submitted for clarification.

20. Some respondents also suggested providing additional guidance for entities to perform the allocation of portfolio-level adjustments to the individual financial assets and financial liabilities. With regard to this particular suggestion, the staff observe that paragraph IE47E of the ED is consistent with paragraphs 50[2] and 51[3] of IFRS 13 which refers to the allocation of *portfolio-level adjustments* to individual assets or liabilities that make up the group of financial assets and financial liabilities managed on the basis of the entity's net risk exposure.

21. Paragraph 50 of IFRS 13, in particular, states that the exception in paragraph 48 does not pertain to financial statement presentation (ie in some cases the presentation of financial instruments may differ from the basis of their measurement) and that the allocation of portfolio-level adjustments, if needed, shall be performed on a reasonable and consistent basis using a methodology appropriate in the circumstances.

22. Therefore, the staff are of the view that no additional guidance is required in respect of allocating portfolio-level adjustments to the individual financial assets and financial liabilities as the ED is aligned to the requirements of paragraphs 50 and 51 of IFRS 13. In addition, it would not be appropriate for an illustrative example to go beyond the requirements of a Standard.

23. The staff recommend that the illustrative example deals specifically with the interaction between the use of Level 1 inputs and the unit of account when

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[2] IFRS 31.50

The exception in paragraph 48 does not pertain to financial statement presentation. In some cases the basis for the presentation of financial instruments in the statement of financial position differs from the basis for the measurement of financial instruments, for example, if an IFRS does not require or permit financial instruments to be presented on a net basis. In such cases an entity may need to allocate the portfolio-level adjustments (see paragraphs 53–56) to the individual assets or liabilities that make up the group of financial assets and financial liabilities managed on the basis of the entity's net risk exposure. An entity shall perform such allocations on a reasonable and consistent basis using a methodology appropriate in the circumstances.

[3] IFRS 13.51

An entity shall make an accounting policy decision in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to use the exception in paragraph 48. An entity that uses the exception shall apply that accounting policy, including its policy for allocating bid-ask adjustments (see paragraphs 53–55) and credit adjustments (see paragraph 56), if applicable, consistently from period to period for a particular portfolio.

applying the portfolio exception set out in IFRS 13 for the specific fact pattern included in the initial clarification request. The staff also note that the illustrative example in the ED cannot go beyond the requirements of IFRS 13; developing guidance to cover additional circumstances would represent additional work that was neither initially requested nor foreseen. Having said that, the staff think that the post-implementation review of IFRS 13 would provide the IASB the opportunity to assess the need for further guidance in relation to paragraph 48 of IFRS 13 and if so, the IASB can then decide to undertake further work on this specific area.

Interaction of the illustrative example with the practical expedient of mid-market pricing and clarification of the bid-offer reserve adjustment

24. Some respondents also requested additional guidance regarding the interaction between the portfolio exception and the use of mid-market pricing as a practical expedient in accordance with paragraph 71 of IFRS 13 as well as clarification of the term bid-offer reserve adjustment included in paragraph IE47F of the illustrative example.

25. Paragraph 71 of IFRS 13 states:

> This IFRS does not preclude the use of mid-market pricing or other pricing conventions that are used by market participants as a practical expedient for fair value measurements within a bid-ask spread.

26. The table in paragraph IE47C of the illustrative example includes the most representative exit price for a long position (CU99), the most representative exit price for a short position (CU101) and the mid-price (CU100)[4]. Because the market risks arising from the financial instruments are substantially the same, the measurement of the entity's net exposure to market risks coincides with the measurement of its net long position of 500 financial instruments (see paragraph IE47E). The entity measures such position by considering the most representative exit price for a long position (ie CU99), resulting in a measurement of CU 49,500 (ie 500 × 99).

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4 In this paper, monetary amounts are denominated in 'currency units(CU)'.

27. The staff think that the permission to use mid-market pricing or other pricing conventions as a practical expedient for fair value measurements in paragraph 71 of IFRS 13 does not mean that those prices may not represent the most representative exit prices for the assets or liabilities being measured at fair value (ie those mid-market prices or prices arising from conventions represent indeed the fair value prices of the assets or liabilities being measured). The staff think that this matter is, however, outside the scope of the clarification requested and, consequently, does not recommend to adjust the drafting to the example for this particular matter.

28. In relation to the comment suggesting clarifying the term bid-offer reserve adjustment included in paragraph IE47F of the ED, this is related to *another* way of arriving at the same measurement for the net exposure to market risks by using the mid-market price (CU100) adjusted by a bid-offer reserve, which would only represent the difference between using the mid-market price and the most representative exit price for that net risk exposure (ie CU100 – CU99 = CU1). The bid-offer reserve adjustment would bring back the measurement as if the net risk exposure had been measured using the most representative exit price (ie CU99) from the very beginning. This alternative methodology was included in the example since it is commonly used in practice.

29. The staff recommend that no further amendments are required to the illustrative example on the basis that using a mid-market price and bid-offer reserve provide another way of arriving at the same measurement of the net risk position. However, given the request for clarification the staff recommend that this be clarified in the Basis for Conclusions of the ED.

Comments opposed to the proposed illustrative example

30. The respondents who did not agree with the proposals in the ED were of the view that the fair value of the net risk exposure arising from a group of financial assets and financial liabilities whose market risks are substantially the same should be measured by applying a valuation technique that considers the characteristics of the net risk exposure (ie the net risk exposure should be adjusted for premiums or discounts if those represent its features).

31. As mentioned in paragraph 10, the IASB concluded that the approach included in the submission in which premiums or discounts should be considered in the measurement of the net risk exposure did not respect key principles in IFRS 13, such as the prohibition of incorporating the use of blockage factors in the fair value measurements.

32. The staff recommend that the IASB continues to hold this conclusion in the final illustrative example since such adjustments to Level 1 prices would not be permitted in accordance with IFRS 13 and would represent a discontinuance of practice under IAS 39 and IFRS 9 which the IASB did not intend to change when issuing IFRS 13 (see paragraph BC27 (a) of the ED).

Comments received on the drafting of the illustrative example

33. A few respondents have provided some drafting suggestions to the illustrative example. The staff has incorporated those suggestions as much as possible in the amended drafting of the illustrative example (see Appendix 1).

Staff's conclusion

34. Based on the analysis of the comments received, the staff recommend that:
    (a) the illustrative example deals with the specific fact pattern submitted (ie the interaction between the use of Level 1 inputs and the unit of account when applying the portfolio exception set out in IFRS 13). The need for additional guidance could be assessed when the IASB undertakes the post-implementation review of IFRS 13;
    (b) no further amendments should be included in the illustrative example to clarify the interaction between the use of mid-market prices and the portfolio exemption as this clarification is outside the scope of the initial request received but instead this be clarified in the Basis for Conclusions. The illustrative example should also not be amended to clarify the term bid-offer reserve used in paragraph IE47F of the ED as this only aim to provide another way of arriving at the measurement of the net risk position; and
    (c) the net exposure to market risks should *not* be adjusted for premiums or discounts because that exposure is composed of financial instruments that

have a Level 1 price available, which should be used without adjustments in accordance with IFRS 13.

Next steps

35. If the Board agrees with the recommendations outlined in paragraph 34, the staff will proceed towards finalising the drafting of the illustrative example. Furthermore, the table below illustrates the forthcoming steps relating to the other aspects of the ED.

Forthcoming steps	**Expected date**
Further research on the use of P x Q	**Q2-Q3 2015**
Redeliberations with the IASB relating to the measurement of quoted investments at fair value and the recoverable amount of quoted CGUs on the basis of fair value less costs of disposal and any transition requirements	**Q2–Q3 2015**

Question for the IASB

Question to the IASB
Does the IASB agree with the staff's analysis and recommendations outlined in paragraph 34 of this Agenda Paper?

Appendix 1—Amendments to the Illustrative Examples for IFRS 13 *Fair Value Measurement*

Application to financial assets and financial liabilities with offsetting positions in market risks or counterparty credit risk

IE47A Example 13A illustrates the application of the exception in paragraph 48 of the IFRS to a group of financial assets and financial liabilities whose market risks are substantially the same and whose fair value measurement is categorised within Level 1 of the fair value hierarchy.

Example 13A—Applying the exception in paragraph 48 of the IFRS to a group of financial assets and financial liabilities whose market risks are substantially the same and whose fair value measurement is categorised within Level 1 of the fair value hierarchy

IE47B Entity A holds a group of financial assets and financial liabilities consisting of a long position of 10,000 financial assets and a short position of 9,500 financial liabilities whose market risks are substantially the same. Entity A manages that group of financial assets and financial liabilities on the basis of its net exposure to market risks. The fair value measurement of all financial instruments in the group is categorised within Level 1 of the fair value hierarchy.

IE47C The bid-ask spread is CU98–CU102, with the mid-price being CU100. ~~and t~~The most representative bid and ask price are as follows:

CU	Bid	~~Mid~~	Ask
Most representative exit price	99	~~100~~	101

IE47D Entity A applies the exception in paragraph 48 of the IFRS that permits Entity A to measure the fair value of the group of financial assets and financial liabilities on the basis of the price that would be received to sell, in this particular case, a net long position (ie an asset) for the exposure to market risks in an orderly transaction between market participants at the measurement date under current market conditions.

IE47E ~~Accordingly, Entity A measures the net long risk position (500 financial assets) in accordance with the corresponding Level 1 prices.~~ Since the market risks arising from the financial instruments are substantially the same, the measurement of the ~~net position~~ net exposure to market risks arising from the group of financial assets and financial liabilities coincides with the measurement of the net long position (500 financial assets) ~~exposure arising from the group of financial assets and financial liabilities~~. Consequently, Entity A measures the group of financial assets and financial liabilities on the basis of the price that it would receive if it would exit its outstanding net exposure to market risks as follows:

CU	Quantity held (Q)	Level 1 price (CU) (P)	(CU) P × Q
Net exposure to market risks, which in this case coincides with the measurement of the net long position	**500**	**99**	**49,500**

IE47F Entity A would also have achieved the same measurement of CU49,500 by measuring the net exposure to market risks ~~long position~~ at the mid-price (ie CU100 × 500 = CU50,000) adjusted by a bid-offer reserve (CU1 × 500 = CU500).

IE47G Since the basis for the presentation of the financial instruments in the statement of financial position differs from the basis for their measurement, Entity A subsequently allocates the portfolio-level adjustments ~~resulting measurement~~ (ie CU49,500) to the individual (10,000) financial assets and (9,500) financial liabilities. In accordance with paragraphs 50 and 51 of the IFRS, Entity A performs this allocation on a reasonable basis that is consistent with previous allocations of that nature using a methodology appropriate to the circumstances.

Appendix 2—Submission received

IFRIC potential agenda item request

This letter describes two related issues that we believe should be added to the IFRIC's agenda. We have included a summary of the issues, a range of possible views and an assessment of the issues against the IFRIC's agenda criteria.

There is currently no established practice because IFRS 13 *Fair Value Measurement* is not yet in effect. However, we believe that these issues are likely to establish themselves as practice issues once entities begin to apply the standard. We believe that the IFRIC should consider the issues because the potential outcomes could have a significant effect on the measurement of fair value, and consistency in this area is desirable.

Issue 1: The unit of account for financial assets that are investments in a subsidiary, joint venture or associate and related retained or pre-existing interests

IFRS 13 explicitly introduces the concept of the 'unit of account', which is determined in accordance with the relevant IFRS that requires or permits the fair value measurement. In many cases the unit of account can be inferred, e.g. a cash-generating unit in IAS 36 *Impairment of Assets*; however, for a financial asset that is an investment in a subsidiary, joint venture or associate it is not clear because the investment held by the entity comprises a number of individual shares.

The following are examples:

1. An investment in a subsidiary, joint venture or associate accounted for in accordance with IAS 39 *Financial Instruments: Recognition and Measurement* / IFRS 9 *Financial Instruments* in separate financial statements. [IAS 27.10(b)]
2. An investment in a joint venture or associate accounted for in accordance with IAS 39 / IFRS 9 by a venture capital or similar organisation. [IAS 28.18]
3. An investment in a subsidiary, joint venture or associate measured at fair value in accordance with IAS 39 / IFRS 9 by an investment entity. [Forthcoming amendment to IFRS 10 and IAS 28]
4. Shares in a subsidiary, joint venture or associate distributed to owners. [IFRC 17.11]
5. A previously held equity interest in an acquiree in accounting for a business combination achieved in stages. [IFRS 3.42]
6. A retained interest following a loss of control, joint control or significant influence. [IFRS 10.25(b), IAS 28.22(b)]

For all of the above items, the issue is whether the unit of account is an individual share or the entire holding. This interpretation makes a difference in applying IFRS 13. For example, if the unit of account is an individual share, then there is no possibility of arguing, for example, that a premium related to the size of the holding should be included in the measurement of fair value.

The following are the different approaches that we believe an entity could take once IFRS 13 becomes effective.

View 1: Unit of account is the entire investment

Notwithstanding that the investment comprises a number of individual shares, the unit of account is the investment as a whole. This is on the basis that the accounting in the underlying IFRS (or Interpretation) is premised on the item as a whole, and not on it being a collection of smaller items.

View 2: Unit of account is the individual share

For financial assets, even if outside the scope of IAS 39 / IFRS 9, the unit of account is the individual share, which is consistent with the approach generally taken under IAS 39 / IFRS 9. This is consistent with IFRS 13.BC47, which states that the unit of account under IAS 39 / IFRS 9 is generally an individual financial instrument.

View 3: Mixed approach depending on the financial asset

Views 1 and 2 represent the two extremes, but in between there are more nuanced approaches that seek to distinguish between the types of investments / references within the standards. The following are two examples of which we are aware:

- *Investments in subsidiaries, joint ventures and associates vs 'other items'*

  Under this approach, the unit of account for investments in subsidiaries, joint ventures and associates is the entire investment. While the investment comprises a number of individual shares and therefore it might be argued that the unit of account should be the same as if the general approach under IAS 39 / IFRS 9 is applied, the accounting models for such investments acknowledge that control, joint control and significant influence have a special significance and that the accounting relates to the investment (relationship) as a whole.

  However, investments that do not confer control, joint control or significant influence are no different from other financial assets within the scope of IAS 39 / IFRS 9, and therefore the unit of account should be the individual share.

- *Investments whose accounting is 'in accordance with' IAS 39 or IFRS 9 vs 'other items'*

  Under this approach, the unit of account for the investment is the individual share when the relevant IFRS specifically refers to accounting 'in accordance with' IAS 39 / IFRS 9, or when IAS 39 / IFRS 9 applies subsequently. This would apply to the first three examples raised at the start of this letter, plus the sixth example (loss of control) in many cases.

  In all other cases, the unit of account would be the entire investment.

Issue 2: Interaction between guidance on use of Level 1 inputs and the unit of account

Having established the unit of account, it is then necessary to determine the 'unit of valuation'. Although this term is not defined in IFRS, it is used in this letter to indicate the level at which an asset or a liability is aggregated or disaggregated for the purpose of measuring fair value.

As a general principle, the unit of valuation is based on the unit of account for the asset or liability determined in accordance with the IFRS that requires or permits the fair value measurement, subject to the exceptions in IFRS 13, e.g. in paragraph 48. However, the standard is unclear on the interaction between the unit of account/valuation guidance in paragraph 14 and the requirement to use unadjusted Level 1 prices, when available, in paragraphs 69, 77 and 80.

Possible approaches

The following are the different approaches that we believe an entity could take once IFRS 13 becomes effective.

View 1: Level 1 price required only if available for the unit of account

A Level 1 price is applied without adjustment only if it exists for the unit of valuation established under the relevant IFRS that requires or permits the fair value measurement or by another requirement in IFRS 13. If that unit of valuation is an aggregation of assets or liabilities and a Level 1 price is unavailable at that level, then it is not required that the Level 1 price for an individual asset or liability be used without adjustment to value the aggregate holding.

View 2: Level 1 price takes precedence as a matter of principle

Even if the unit of valuation would otherwise be an aggregate holding, the fair value of an aggregate position that comprises items that are quoted in an active market to which the entity has access at the measurement date must be measured as the product of the Level 1 price for the individual item and the quantity held by the entity.

View 3: Level 1 price takes precedence as a matter of reliability

The guidance on Level 1 inputs that is provided in IFRS 13.77 requires an entity to use, if available, a quoted price in an active market because it provides the most reliable evidence of fair value. Therefore, based on its observability, a Level 1 price for constituent assets and / or liabilities takes precedence over a Level 2 or Level 3 price for the unit of valuation.

Although Views 2 and 3 are different, they both result in a fair value measurement for an aggregated position based on the price of an individual constituent asset or liability times the number of assets or liabilities held.

Examples

The following examples illustrate the effect of the above views.

Cash-generating unit that corresponds to a listed entity

The unit of account for impairment testing under IAS 36 is not an individual share but the cash-generating unit (CGU) as a whole comprising its underlying operating assets and liabilities.

Under View 1, because a price is not available in an active market for the whole CGU, neither IFRS 13.69 nor 80 apply. Accordingly, if a market participant would include a premium for control in valuing the CGU, then the fair value of the CGU includes a control premium. Although the Level 1 price for an individual share would be a very important input in determining fair value, it would not necessarily be determinative in valuing the CGU as a whole.

The following are additional arguments in favour of this view for a CGU:

- IFRS 13.69 specifically discusses the application of a control premium to value a controlling interest. The ability to consider a control premium to measure the fair value of a holding in a CGU whose shares are not publicly traded, but not when a CGU's shares are publicly traded, would result in the inconsistent treatment of similar interests.

- If an entity paid a premium to acquire control of a CGU but was subsequently required to measure the CGU using a share price that excluded a control premium, impairment could result, even if there had been no underlying decline in the economic value of the CGU.

- US GAAP allows the inclusion of a control premium when valuing a reporting unit for impairment testing, even when a Level 1 price for the underlying shares is available.[5]

- The carrying amount of a CGU is generally based on operating assets and liabilities and excludes items such as financing items. However, a share price will reflect all of the assets and liabilities of the legal entity that issued the shares, including non-operating assets and liabilities. Therefore, an issue is practice may be whether the market capitalisation based on the share price is a like-for-like comparison with the items included in the carrying amount of the CGU.

Under View 2, the unit of valuation differs from the unit of account through the application of IFRS 13.69 and 80, and is an individual share because a Level 1 price is available at that level. Therefore, no control premium would be considered in valuing the CGU, even if market participants would consider such a premium in valuing a controlling stake in the CGU; this is because a control premium does not attach to an individual share.

Under View 3, the unit of valuation is the CGU, consistent with the general principles in IFRS 13.13-14. However, the Level 1 price is seen as the most reliable measure of fair value to be used in all circumstances. Under this view, the fair value of the CGU would be determined as the Level 1 price times the quantity held as this will provide the most verifiable evidence of fair value.

The logic of the three views outlined above applies equally to other examples, such as the fair value of an investment in a subsidiary, joint venture or associate when the unit of account is the entire investment (see Issue 1).

Portfolio exception for financial assets and financial liabilities

The unit of account for financial assets and financial liabilities subject to the portfolio exception is the individual financial instrument in accordance with IAS 39 / IFRS 9.

Under View 1, the unit of valuation is the net risk exposure in accordance with IFRS 13.48. A Level 1 input for an individual financial instrument is not a Level 1 input for the net risk exposure; therefore, neither IFRS 13.69 nor 77 apply. Consequently, it is irrelevant whether there is a Level 1 input available for an individual financial instrument as the fair value measurement should be based on the characteristics of the

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[5] ASC paragraphs 350-20-35-22 through 35-24

net risk exposure. This leads to consistent application of the portfolio exception regardless of the categorisation of the constituent financial assets' or financial liabilities' fair value measurements in the fair value hierarchy. This is consistent with the fact that IFRS 13 does not restrict the portfolio exception only to portfolios that contain solely financial assets and financial liabilities that would be categorised within Levels 2 or 3.

Under Views 2 and 3, the portfolio exception cannot be applied to portfolios containing financial assets and financial liabilities for which a Level 1 price exists. The portfolio exception is designed for portfolios containing financial assets and financial liabilities that are categorised within Levels 2 or 3 of the fair value hierarchy. The restrictions on the adjustment of Level 1 inputs prohibit application of the portfolio exception to portfolios that contain financial assets and financial liabilities for which a Level 1 input exists. Application of the portfolio exception would lead in this case to measurements that are not in accordance with IFRS 13. For example, any portfolio level adjustment based on a portfolio containing financial assets and financial liabilities for which a Level 1 price is available implies an adjustment of the quoted price for these individual assets and liabilities, regardless of the methodology for allocating the portfolio level adjustments. This would be inconsistent with IFRS 13.69, 77 and 80. Alternatively, allocation of the total portfolio level adjustment to only the individual financial assets and financial liabilities that are categorised in Level 2 or 3 leads to measurement of these financial assets and financial liabilities in a manner that is not representative of their respective exit prices.

Under an additional View 4 that is relevant in relation to the portfolio exception, the portfolio exception could be applied only if it maximises value. It is expected that entities that qualify for the portfolio measurement exception would choose to apply the portfolio exception because management of the net risk exposure maximises value to the entity. This is in line with IFRS 13.22, which explains that a fair value measurement is based on assumptions used by market participants, who act in their economic best interest. In addition, as stated in IFRS 13.BC67, a fair value measurement assumes that market participants seek to maximise the fair value of a financial asset or to minimise the fair value of a financial liability and such a transaction might involve grouping assets and liabilities in a way in which market participants would enter into a transaction, if the unit of account in other IFRSs does not prohibit that grouping. Accordingly, the portfolio exception may not be applied so as to change the unit of valuation in a manner that leads to less favourable fair value measurements than arise from valuing the individual financial instruments within the portfolio on a stand-alone basis. The guidance in IFRS 13.69, 77 and 80 generally requires the use of unadjusted Level 1 inputs for the individual constituent financial assets and financial liabilities for which Level 1 inputs are available. This guidance on Level 1 inputs precludes an application of the portfolio exception that results in less favourable fair value measurements than without its application.

For example assume the following fact pattern:

- Long position of 10,000 individual financial assets and short position of 9,500 individual financial liabilities in a particular market risk.
- Bid price is CU 98; mid price is CU 100; ask price is CU 102.
- The most representative exit price within the bid-ask spread of an individual financial asset is CU 99, and of an individual financial liability is CU 101.
- The most representative exit price for a net position of 500 financial assets is CU 45,000.
- All financial assets and financial liabilities are categorised in Level 1 of the fair value hierarchy.

Without application of the portfolio exception, the fair value measurements of the financial assets and financial liabilities would be based on their individual fair values. As such, a fair value measurement of the portfolio would be CU 30,500 (CU 10,000 × CU 99 - CU 9,500 × CU 101). In this example, a fair value measurement based on the net risk exposure amounting to CU 45,000 maximises value to the entity. Under View 4, the fair value measurement of the group of financial assets and financial liabilities is based on the fair value of the net risk exposure, although the fair value measurement cannot be lower than the fair value using the Level 1 inputs of the constituent financial assets and financial liabilities amounting to CU 30,500. Therefore, based on View 4, in this specific fact pattern an entity would be allowed to apply the portfolio exception to value the net risk exposure as a single item.

Reasons for the IFRIC to address the issue

a) ***Is the issue widespread and practical?*** Yes. The determination of fair value is integral to the application of IFRS.

b) ***Does the issue involve significantly divergent interpretations?*** Yes. Depending on the interpretation applied, the different approaches to the measurement of fair value (e.g. whether to include a control premium) could have a significant effect on an entity's financial position and financial performance.

c) ***Would financial reporting be improved through elimination of the diversity?*** Yes. The comparability of financial statements will be improved if entities determine fair value on the same basis.

d) ***Is the issue sufficiently narrow…?*** Yes. Regarding Issue 1, we believe that the issue is capable of interpretation within the confines of IFRS 13 to the extent that standards are already issued; in the future, the issue can be dealt with by the Board in the context of each new standard or amendment. Regarding Issue 2, we believe that the issue is capable of interpretation within the confines of IFRS 13. Both issues related to specific concepts introduced by IFRS 13.

e) ***If the issue relates to a current or planned IASB project, is there a pressing need for guidance sooner than would be expected from the IASB project?*** The issue does not relate to a current or planned IASB project.