

STAFF PAPER

November 2015

IASB Meeting

Project	Fair Value Measurement: Unit of Account		
Paper topic	Research of the proposed measurements in the Exposure Draft—Detailed analysis		
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This paper has been prepared for discussion at a public meeting of the IASB and does not represent the views of the IASB or any individual member of the IASB. Comments on the application of IFRSs do not purport to set out acceptable or unacceptable application of IFRSs. Technical decisions are made in public and reported in IASB *Update*.

Introduction

1. Agenda Paper 6A provides a summary of the activities carried out as part of the research work on the measurement proposals in the Exposure Draft ('the 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). This paper provides the IASB with detailed information relating to the activities carried out so far relating to the research work mentioned above.
2. In particular, the work described in this paper includes the assessment of the population that may be affected by the proposed measurement in the ED and the feedback received from accounting firms, valuation specialists, securities regulators, Accounting Standards Advisory Forum (ASAF) and Financial Accounting Standards Board (FASB) staff.¹ We are not asking the IASB to make any decisions at this meeting.

¹ Some of the messages received from different constituents participating in this research coincide. Consequently, the reader of this paper may think this document is somehow reiterative. Even though that may be the case, the staff have reflected the feedback received from the different constituents without eliminating those messages that coincided amongst different types of constituents, prioritising the completeness of the feedback received per type of constituent rather than the style of the document.

3. In a forthcoming meeting, the staff plan to provide information about the academic literature review and feedback received from users of financial statements, Global Preparers Forum (GPF) and preparers.
4. This paper is structured as follows:
 - (a) measurement proposed in the ED (paragraph 5);
 - (b) assessing the population that may be affected by the proposed measurement (paragraphs 6–47);
 - (c) summary of the feedback received:
 - (i) valuation specialists (paragraphs 48–64);
 - (ii) accounting firms (65–82);
 - (iii) securities regulators (paragraphs 83–102);
 - (iv) ASAF (paragraphs 103–117); and
 - (v) FASB staff (paragraphs 118–120); and
 - (d) Appendix A—Description of the types of entities included in the ‘investment firm’ label of the S&P Capital IQ database (see paragraph 15).

Measurement proposed in the ED

5. The ED proposed that:
 - (a) the measurement of investments in subsidiaries, joint ventures and associates at fair value when these investments are quoted in an active market (quoted investments) should be based on the product of the quoted price for the individual financial instruments that make up the investment (P) and the quantity of financial instruments (Q), ie $P \times Q$; and
 - (b) the recoverable amount of CGUs on the basis of fair value less costs of disposal when they correspond to entities that are quoted in an active market (quoted CGUs) should be the product of the quoted price (P) and the quantity of financial instruments held (Q), or $P \times Q$.

Assessing the population that may be affected by the proposed measurement

6. We think that as part of this research exercise, it is relevant to assess the population of entities that may be affected by the proposed measurement in the ED. The ED amended IFRS 10 *Consolidated Financial Statements*, IFRS 12 *Disclosure of Interests in Other Entities*, IAS 28 *Investments in Associates and Joint Ventures*, IAS 27 *Separate Financial Statements* and IAS 36 *Impairment of Assets*.
7. We have carried out an assessment of the entities that may be affected by the proposals in the ED relating to quoted investments (ie entities that have quoted investments in subsidiaries, joint ventures and associates that are required or permitted to measure those investments at fair value).²
8. This assessment mainly entailed conducting database searches by type of entity (ie investment entity and non-investment entity) and by type of investment held (ie quoted investments in subsidiaries, joint ventures and associates). In some instances, some of the results presented below involved carrying consecutive searches that aimed to obtain the information needed, or involved parallel searches that subsequently needed to be interlinked because there was no direct way of accessing specific information.
9. This would not, however, have been the case for the assessment of the population that may be affected by the proposals relating to the measurement of the recoverable amount of quoted CGUs on the basis of fair value less costs of disposal. Such assessment would have required individual inspections of annual reports to identify whether any of the entities' CGUs corresponded to an entity and if so, whether that was a quoted entity. For the purpose of deriving sound conclusions, the number of annual accounts and manual inspections would have represented a

² Paragraph 31 of IFRS 10 states: '[...] an investment entity shall not consolidate its subsidiaries or apply IFRS 3 when it obtains control of another entity. Instead, an investment entity shall measure an investment in a subsidiary at fair value through profit or loss in accordance with IFRS 9.'

Paragraph 18 of IAS 28 states: 'When an investment in an associate or a joint venture is held by, or is held indirectly through, an entity that is a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure investments in those associates and joint ventures at fair value through profit or loss in accordance with IFRS 9.'

Paragraph 10 of IAS 27 states: 'When an entity prepares separate financial statements, it shall account for investment in subsidiaries, joint ventures and associates at either: (a) at cost; (b) in accordance with IFRS 9; or (c) using the equity method as described in IAS 28. [...]'

major exercise. On the basis of the feedback received from valuation specialists (see paragraph 59), accounting firms (see paragraph 75) and securities regulators (see paragraph 93), we understand, however, that the population of entities that would be affected by these proposals would be fairly limited.

10. Similar conclusions about the accuracy of their assessment could be derived when assessing the following items. Some comment letters received in response to the ED pointed out that the proposed measurement would also be applicable in the following situations:
 - (a) *IFRS 3 Business Combinations*. Some respondents to the ED thought that the proposed measurement would also affect the fair value measurement of previously held quoted equity interests in an acquiree and the fair value measurement of non-controlling interests when those are quoted in an active market;
 - (b) *IFRS 5 Non-current Assets Held for Sale and Discontinued Operations*. Some respondents thought that investments within the scope of that Standard would also be affected by the proposals; and
 - (c) *IFRS 10 Consolidated Financial Statements*. Some respondents to the ED thought that the proposed measurement would also affect the fair value measurements of quoted retained interests resulting from an entity losing control of a subsidiary.
11. Assessing the population of entities that would be affected in each of these situations would have also required extensive manual procedures such as individual inspections of annual reports to identify, for example, entities that had acquired a controlling interest and then to verify that that interest was in a quoted entity. In addition, we note that extrapolating any conclusions from the outcomes of an assessment including those situations could also be questionable, because some of these situations are one-time transactions that are influenced, in many cases, by macroeconomic factors.
12. Consequently, the exercise described in the paragraphs below aim to assess the population that would be included in the following situations included in the ED:

- (a) investment entities that would be required, in accordance with IFRS 10, to measure their quoted investments in subsidiaries at fair value by applying $P \times Q$ (see paragraphs 15–21);
 - (b) venture capital organisations, mutual funds, unit trusts and similar entities³ that would be permitted, in accordance with IAS 28, to measure their quoted investments in joint ventures and associates at fair value in its consolidated financial statements, and if so, would be applying $P \times Q$ (see paragraphs 22–28);
 - (c) non-investment entities that may, in accordance with IAS 27, choose to measure their quoted investments in subsidiaries at fair value in their separate financial statements and, when they did so, would be applying $P \times Q$ (see paragraphs 29–37); and
 - (d) non-investment entities that may, in accordance with IAS 27, choose to measure their quoted investments in joint ventures and associates at fair value in its separate financial statements and, when they did so, would be applying $P \times Q$ (see paragraphs 38–47).
13. We have assessed the population of entities falling within the instances discussed in paragraph 12 using the S&P Capital IQ database (‘the database’). The database currently holds information for 5,982,013 entities across 217 jurisdictions around the world. For some of these entities, the database holds audited annual reports. Out of these 5,982,013 entities, we have searched for entities for which the database holds copies of the original audited annual reports filed within the last three years. The outcome of this search was that the database included 88,258 entities that had audited annual reports filed within the last three years. These entities were distributed across 162 jurisdictions. Consequently, we focussed our analysis on that population of entities.
14. For the remaining entities (ie 5,893,755 entities), the database does not have original audited annual reports because they are either not publicly available or the database is unable to source it from third-party providers. For those entities, the

³ For the purposes of this assessment, we have assumed that entities such as venture capital organisations, mutual funds, unit trusts and similar entities would have been included in the label ‘investment firms’ of the database (see paragraph 22).

information included in the database relates to financial information such as pro-forma financial results and securities exchange-related documents.

Investment entities that would be required to measure their quoted investments in subsidiaries at fair value by applying P × Q

15. As mentioned in paragraph 13, we will focus the analysis on the population of 88,258 entities for which the database has original audited accounting annual reports for the last three years.⁴ Out of these 88,258 entities, the database classifies 2,572 entities as ‘investment firms’ (2.91 per cent of the population being analysed). The database includes under the label ‘investment firms’ entities that are additionally classified as: ‘Public Investment Firms’, ‘Private Investment Firms’, ‘Financial Services Investment Arms’ and ‘Corporate Investment Arms’. The detailed descriptions of each of these sub-labels are included in Appendix A to this paper.⁵
16. We have discussed the different sub-labels in which ‘investment firms’ have been classified with the IASB’s Investment Entity project team to ensure that the entities included in those sub-labels could be considered to be generally aligned with the definition of ‘investment entities’ in IFRS 10.⁶
17. On the basis of the brief descriptions of the different sub-labels of entities included within the label of ‘investment firms’, the Investment Entity project team noted that entities in all of those sub-labels could broadly fulfil the definition of ‘investment entities’ in IFRS 10, except the entities included in the sub-label ‘Corporate Investment Arms’. In the case of this sub-label, the description refers to entities that are principally investment firms that are majority-owned by corporations that are not financial services companies or other investment firms

⁴ The data analysed in this assessment correspond to data extracted from the database on 6 October 2015. The database’s population varies over time, with entities being added and removed on an ongoing basis.

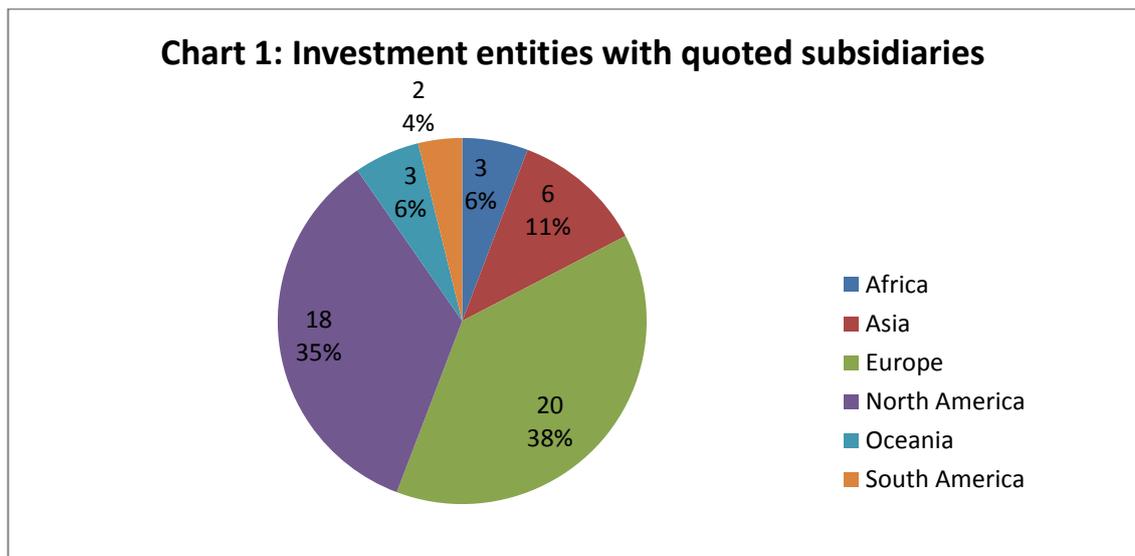
⁵ The database describes the different labels in which it classifies the entities it includes in a document called ‘Criteria Definitions: Company Types’.

⁶ Appendix A of IFRS 10 defines an ‘investment entity’ as an entity that:

- (a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;
- (b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and
- (c) measures and evaluates the performance of substantially all of its investments on a fair value basis.

(see Appendix A). In this regard, it was noted that corporations that own investment firms (ie the investee) may not be investing solely for capital appreciation, investment income, or both and may obtain benefits from the investee that are not available to other parties that are not related to the investee. As a result, the entities that the database included within the sub-label ‘Corporate Investment Arm’ were removed from the population of investment entities subject to our analysis. This resulted in a number of 2,559 entities in the database that could be considered to broadly fulfil the definition of ‘investment entities’ in accordance with IFRS 10.

18. Considering the 2,559 entities that have original audited annual reports in the database that would generally fulfil the definition of ‘investment entity’ in IFRS 10, we noted that only 92 of those entities have investments in quoted subsidiaries (ie 3.60 per cent of the investment entities subject to our analysis). From those 92 investment entities with quoted subsidiaries, 52 entities report in accordance with IFRS (ie 56.52 per cent of the investment entities that have quoted subsidiaries). This only represents 2.03 per cent of the population of investment entities analysed. The remaining 40 investment entities with investments in quoted subsidiaries do not report in accordance with IFRS.
19. The chart below illustrates the geographical distribution of the 52 investment entities with investments in quoted subsidiaries that report in accordance with IFRS.



20. The following table summarises the outcomes obtained when assessing the population of investment entities with investments in quoted subsidiaries:

Summary of the assessment			
Entities with audited annual reports within the last 3 years [A]	88,258		100%
Investment entities [B]	2,559	[B]/[A]	2.90%
Investment entities with investments in quoted subsidiaries [C]	92	[C]/[B]	3.60%
Investment entities with investments in quoted subsidiaries that report under IFRS [D]	52	[D]/[C] [D]/[B]	56.52% 2.03%

Conclusion

21. On the basis of the assessment performed, the 52 investment entities with investments in quoted subsidiaries that report under IFRS represent only 2.03 per cent of the 2,559 investment entities identified in the database. As a result, the number of investment entities that would be required to measure their quoted investments in subsidiaries at fair value by applying P × Q if the proposals became final would be limited.

Venture capital organisations, mutual funds, unit trusts and similar entities that would be allowed to measure their quoted investments in joint ventures and associates at fair value, and, if they did so, would be applying P × Q

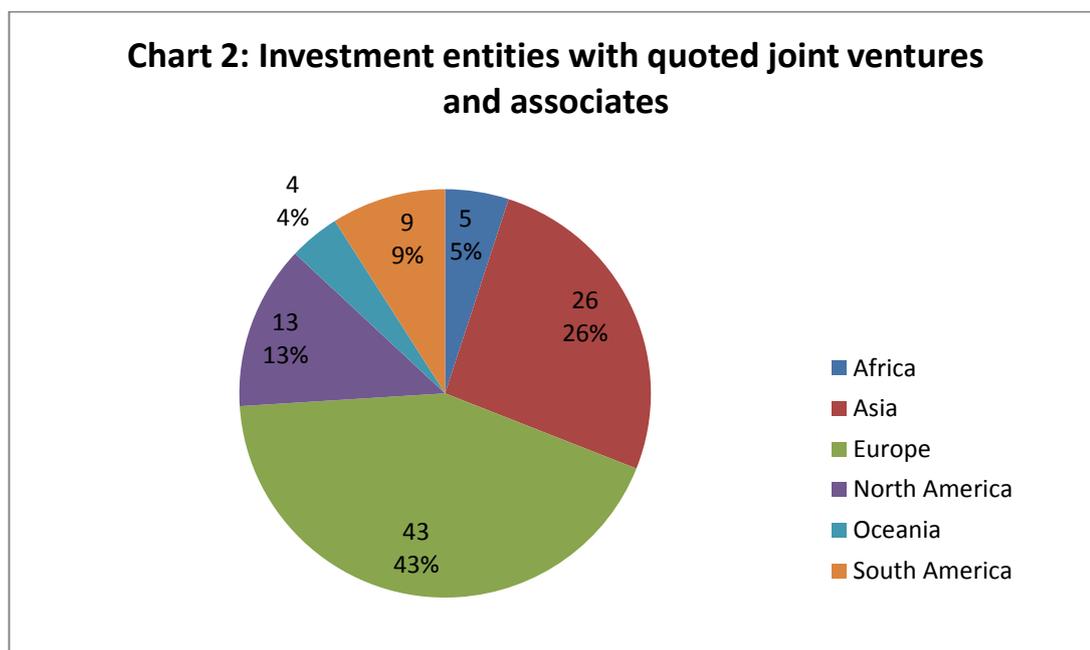
22. IAS 28 permits venture capital organisations, mutual funds, unit trusts and similar entities to measure their investments in joint ventures and associates at fair value. Most of these entities could be thought of as fulfilling the definition of ‘investment entities’ in IFRS 10. Paragraph BC298 of IFRS 10 states that entities that are most likely to be affected by the consolidation exception in IFRS 10 include private equity, venture capital funds, master-feeder or funds-of-funds structures. In addition, paragraph BC299 of IFRS 10 states that ‘some pension funds and sovereign wealth funds may also be affected’ and paragraph BC300 states that ‘Other types of entities may meet the definition of an investment entity, such as

mutual funds and other regulated investment funds, but are less likely to hold controlling investments in other entities'. Consequently, the population of 2,559 entities classified as 'investment firms' by the database is also considered as the starting-point for this assessment.⁷

23. Out of those 2,559 entities, there was no direct way of obtaining the number of entities that had quoted investments in joint ventures and associates. As a result, we had to interlink the following two searches:
 - (a) out of the 2,559 'investment firms', entities that have direct investments in quoted entities with ownership interest ranging between 0 and 50 per cent; and
 - (b) Out of the 2,559 'investment firms', entities that have direct holdings with ownership interest ranging between 20 and 50 per cent.
24. Defining the search between the ownership range of 20 to 50 per cent served as a mean of identifying entities with investments in which they had either significant influence (ie investment in associates) or joint control (ie investments in joint ventures). The outcome of this search are entities with direct holdings ranging from 20 to 50 per cent in both quoted and non-quoted entities.
25. We interlinked those two searches (ie entities with direct investments in quoted entities ranging from 0 per cent–50 per cent and entities with direct holdings with an ownership interest ranging from 20 per cent–50 per cent) and identified 176 investment entities holding investments in quoted entities with ownership interest ranging from 20 to 50 per cent. This results in 6.88 per cent of the population of investment entities having direct holding in quoted entities with an ownership ranging from 20 to 50 per cent.
26. Out of those 176 investment entities, 76 do not report under IFRS, while 100 do report under IFRS. The chart below illustrates the geographical distribution of the 100 entities that have direct holdings in quoted entities with an ownership interest ranging from 20 to 50 per cent (ie interests in joint ventures and associates) that report in accordance with IFRS (ie 56.82 per cent of the investment entities that

⁷ In this section, the terms 'investment firms' or 'investment entities' should be read as meaning 'venture capital organisations, mutual funds, unit trusts and similar entities' in the context of IAS 28.

have quoted investments in joint ventures and associates). This represents 3.91 per cent of the population of 2,559 investment entities analysed.



27. The following table summarises the outcome obtained for investment entities with investments in quoted joint ventures and associates:

Summary of the assessment			
Entities with audited annual reports in the last 3 years [A]	88,258		100%
Investment entities [B]	2,559	[B]/[A]	2.90%
Investment entities with investments in quoted joint ventures and associates [C]	176	[C]/[B]	6.88%
Investment entities with investments in quoted joint ventures and associates that report in accordance with IFRS [D]	100	[D]/[C]	56.82%
		[D]/[B]	3.91%

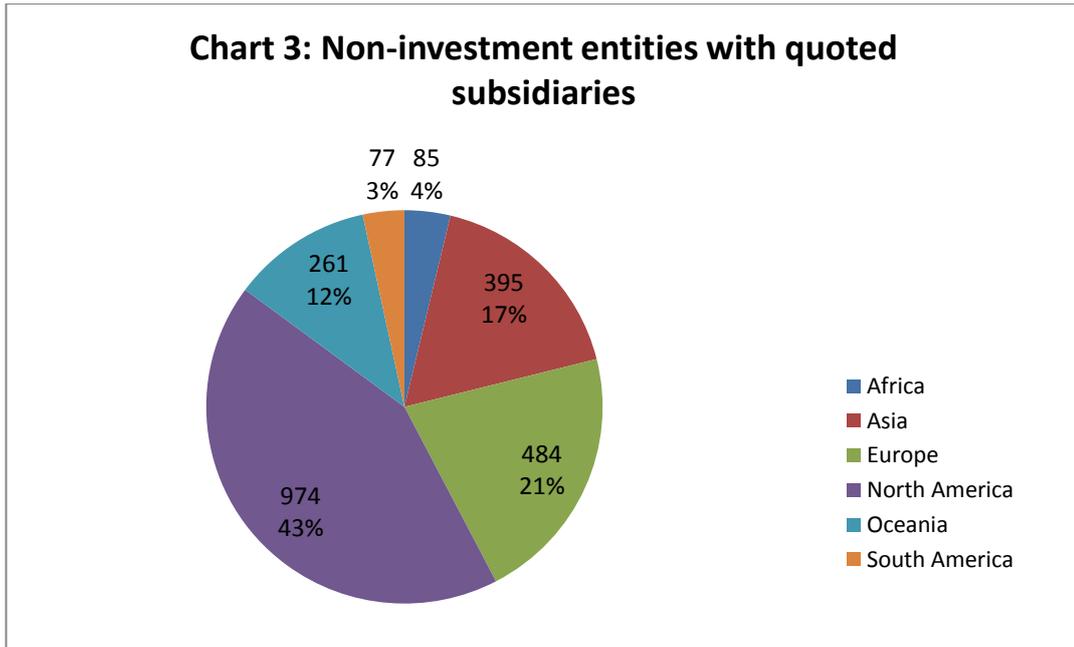
Conclusion

28. On the basis of the assessment performed, the 100 investment entities with investments in quoted joint ventures and associates that report under IFRS represent only 3.91 per cent of the 2,559 investment entities identified in the database. As a result, the number of investment entities that would be allowed to measure their quoted investments in joint ventures and associates at fair value by applying P × Q if the proposals became final would be limited.

Non-investment entities that would be allowed to measure their quoted investments in subsidiaries at fair value, and, if they did so, would be applying P × Q

29. As mentioned in paragraph 13, the database includes 88,258 entities that have original audited annual reports filed during the last three years. Out of these entities, a number of 85,699 are non-investment entities (ie 97.10 per cent of the entire population subject to our analysis).⁸
30. Out of these 85,699 non-investments entities, 5,816 entities (ie 6.79 per cent) have investments in quoted subsidiaries. Out of these 5,816 entities with investments in quoted subsidiaries, 2,817 entities report in accordance with IFRS (ie 48.44 per cent) and 2,999 entities do not report in accordance with IFRS.
31. Of the 2,817 entities that report in accordance with IFRS, 2,276 entities have investments in quoted subsidiaries that are domiciled in jurisdictions that require or permit IFRS in entities' separate financial statements. This represents 80.80 per cent of the total number of non-investment entities that have investments in quoted subsidiaries that report in accordance with IFRS (ie 2,817 entities).
32. The following chart illustrates the geographical distribution of the 2,276 non-investment entities with investments in quoted subsidiaries that report in accordance with IFRS that are domiciled in jurisdictions that require or permit IFRS in entities' separate financial statements.

⁸ The entities classified under the sub-label 'Corporate Investment Arms' have been considered within the group of non-investment entities.



33. Of the 2,276 non-investment entities that have investments in quoted subsidiaries that report in accordance with IFRS in jurisdictions in which IFRS is permitted or required in entities’ separate financial statements, we selected a sample of 25 entities for the purposes of observing whether in that sample a measurement method (either cost, fair value, or the equity method) was most predominantly used.⁹ The 25 entities selected were geographically spread across the jurisdictions represented in Chart 3 above.
34. Of the 25 separate financial statements inspected for these non-investment entities, 25 applied cost when measuring investments in quoted subsidiaries whilst none applied fair value or the equity method.
35. The following table summarises the outcome for non-investment entities with investments in quoted subsidiaries:

⁹ The staff note that allowing the use of the equity method in entities’ separate financial statements was the result of the amendments to IAS 27 *Equity Method in Separate Financial Statements*, issued in August 2014. Entities should apply those amendments for annual periods beginning on or after 1 January 2016 retrospectively with earlier application permitted.

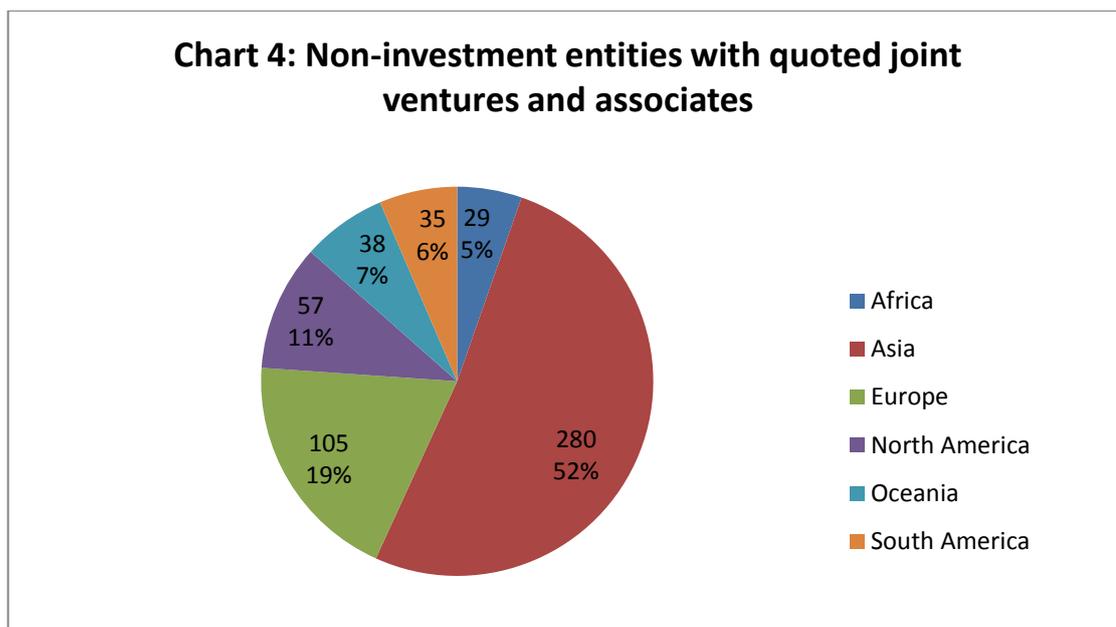
Summary of the assessment			
Entities with audited annual reports in the last 3 years [A]	88,258		100%
Non-investment entities [B]	85,699	[B]/[A]	97.10%
Non-investment entities with investments in quoted subsidiaries [C]	5,816	[C]/[B]	6.79%
Non-investment entities with investments in quoted subsidiaries that report under IFRS [D]	2,817	[D]/[C]	48.44%
Non-investment entities with investments in quoted subsidiaries that are domiciled in jurisdictions that require or permit IFRS in entities' separate financial statements [E]	2,276	[E]/[D]	80.80%
		[E]/[C]	39.13%
		[E]/[B]	2.66%

Conclusion

36. On the basis of the assessment performed, the number of non-investment entities with investments in quoted subsidiaries identified that are domiciled in jurisdictions that require or permit IFRS in entities' separate financial statements represents only 2.66 per cent of the 85,699 non-investment entities identified in the database. In addition, all 25 non-investment entities selected in the sample performed use cost when measuring investments in quoted subsidiaries in their separate financial statements.
37. Consequently, we can infer that the number of non-investment entities to which the proposed amendments would apply when measuring their quoted investments in subsidiaries at fair value in their separate financial statements would be limited.

Non-investment entities that would be allowed to measure their quoted investments in joint ventures and associates at fair value, and, if they did so, would be applying P × Q

38. As mentioned in paragraph 29, out of the 88,258 entities included in the database that have original audited annual reports filed during the last three years, a number of 85,699 are non-investment entities (ie 97.10 per cent).
39. For the purposes of identifying how many of those 85,699 non-investment entities have quoted investments in joint ventures and associates, we undertook the same procedure as described in paragraphs 23–25. We identified that 1,419 non-investment entities hold investments in quoted entities with ownership interest ranging from 20 to 50 per cent (ie investments in quoted associates and joint ventures). This represents 1.66 per cent of the non-investment entities subject to our analysis.
40. Out of those 1,419 entities that hold investments in quoted joint ventures and associates, 659 entities do not report under IFRS, while 760 report in accordance with IFRS (ie 53.56 per cent of the entities that hold investments in quoted entities with ownership interests ranging from 20 to 50 per cent).
41. Of the 760 entities that report in accordance with IFRS, 544 entities having investments in quoted joint ventures and associates are domiciled in jurisdictions that require or permit the application of IFRS in entities' separate financial statements. This represents 71.58 per cent of the 760 non-investment entities that hold investments in quoted joint ventures and associates and that report in accordance with IFRS.
42. The chart below illustrates the geographical distribution of the 544 non-investment entities that have quoted investment in joint ventures and associates that report in accordance with IFRS and for which the application of IFRS is permitted or required in entities' separate financial statements.



43. Of the 544 non-investment entities that have direct holdings in quoted joint ventures and associates that report in accordance with IFRS in their separate financial statements, we selected a sample of 25 entities for the purposes of observing whether in that sample a measurement method (either cost, fair value or the equity method) was most predominantly used. The 25 entities selected were geographically spread across the jurisdictions represented in Chart 4.
44. Of the 25 separate financial statements inspected, 25 applied cost when accounting for their investments in quoted joint ventures and associates, whilst none applied fair value or the equity method.
45. The following table summarises the outcome obtained for non-investment entities with investments in quoted associates and joint ventures:

Summary of the assessment			
Entities with audited annual reports in the last 3 years [A]	88,258		100%
Non-investment entities [B]	85,699	[B]/[A]	97.10%
Non-investment entities with investments in quoted joint	1, 419	[C]/[B]	1.66%

Summary of the assessment			
ventures and associates [C]			
Non-investment entities with investments in quoted joint ventures and associates that report in accordance with IFRS [D]	760	[D]/[C]	53.56%
Non-investment entities with investments in quoted joint ventures and associates that are domiciled in jurisdictions that require or permit IFRS in entities' separate financial statements [E]	544	[E]/[D] [E]/[C] [E]/[B]	71.58% 38.33% 0.63%

Conclusion

46. On the basis of the assessment performed, the number of non-investment entities with investments in quoted joint ventures and associates identified that are domiciled in jurisdictions that require or permit IFRS in entities' separate financial statements represents 0.63 per cent of the 85,699 non-investment entities identified in the database. In addition, all 25 non-investment entities selected in the sample performed use cost when measuring investments in quoted joint ventures and associates in their separate financial statements.
47. Consequently, we can infer that the number of non-investment entities to which the proposed amendments would apply when measuring their quoted investments in joint ventures and associates at fair value in their separate financial statements would be limited.

Summary of the feedback received

Valuation specialists

Quoted investments

48. When discussing the fair value measurement for quoted investments, we focussed the discussions on the following matters:
- (a) how relevant would the fair value measurement of quoted investments be on the basis of applying $P \times Q$; and
 - (b) what were the most commonly used valuation techniques, main inputs used in deriving the fair value measurement and how relevant or predominant was the inclusion of premiums and/or discounts in those measurements. In instances in which premiums and discounts were included, we considered how they are assessed and measured.

Quoted investments—Relevance of the measurement on the basis of applying $P \times Q$

49. The valuation specialists contacted generally commented that $P \times Q$ is not a relevant fair value measurement for quoted investments, but that there are instances in which $P \times Q$ has been observed to be applied in practice to fulfil the accounting requirements for financial reporting purposes. Their main comments are summarised below:
- (a) $P \times Q$ is not the most relevant fair value measure for quoted investments, because that amount would not be the price a market participant would receive for its entire holding at the measurement date (ie $P \times Q$ would not represent the exit price of an orderly transaction). They noted that the principal market for the sale of a 'block' investment for both investment and non-investment entities would not be the open market but would instead be bespoke markets that would involve private equity or strategic investors.
 - (b) $P \times Q$ may result in overstated measurements in certain markets because share prices are perceived to be typically overvalued. In those markets,

valuation specialists have observed that the fair value measurements for these investments are much lower when a valuation technique is applied compared to the value that would be derived by applying $P \times Q$. On this point, they stated that $P \times Q$ was an accounting rule that resulted in valuations for quoted investments that market participants did not necessarily believe could be realised.

- (c) $P \times Q$ is not the most relevant measure because it does not reflect factors affecting the investment as a whole, such as liquidity and the inability to dispose of an entire shareholding in the market in which the individual shares are traded. In practice, the likelihood of being able to dispose of a 'block' holding at $P \times Q$ was perceived to be low or not probable at all. To reflect the fair value measurement of such a unit of account (ie the investment as a whole), a discount would need to be applied. However, this is not permitted under IFRS 13.¹⁰
- (d) Securities exchanges in many jurisdictions require an entity or individual acquiring an equity interest above a certain threshold in the open market to submit a tender offer for the remaining shares. In this case, the quoted price of these remaining shares on the securities exchange would not represent the (ultimate) exit price for the entire equity interest.
- (e) The measurement obtained by applying $P \times Q$ is often used as a reasonableness check when carrying out the measurement but not necessarily as the final measurement. For example, for quoted investments that are thinly traded, deriving the fair value measurement of a controlling investment on the basis of the quoted price of those traded shares may not result in the most relevant fair value measurement for the controlling investment.
- (f) Applying $P \times Q$ would ignore items such as voting rights, controlling rights, protective rights and information access rights that are conferred to the investor as a result of owning the entire shareholding.

¹⁰ Blockage factors are not permitted in a fair value measurement (see paragraphs 69 and 80 of IFRS 13).

- (g) $P \times Q$ may be appropriate to measure the fair value of quoted investments if there is sufficient liquidity in the market, even though this measurement method may not be aligned with the unit of account and, consequently to the measurement that would be obtained if measuring the investment as a whole. On this point, if there was enough liquidity in a market to support the purchase or sale of a large block of shares, then the measurement that would be obtained by applying $P \times Q$ would reflect fair value for a particular quoted investment.

Quoted investments—Most commonly used valuation techniques and inputs used and consideration of premiums and discounts

50. Some valuation specialists commented that when measuring an item at fair value, they reflect on ‘what is it that needs to be measured at fair value’. They then concentrate on the features of the item so that those can be captured in its fair value measurement. When analysing the features of the investments, valuation specialists would analyse rights and restrictions that are transmitted to the investor and would in some instances reflect those through the inclusions of adjustments. In addition, the consideration of the features and nature of the investment is also important for the purposes of deciding which valuation technique to select. Some valuation specialists commented that, given specific circumstances, one valuation technique might be more appropriate than another. Some of the factors that are considered when selecting a valuation technique are the industry in which the investee operates in, the market conditions in which the investment trades, the nature of the investee’s business, the life cycle of an investee and the investment horizon, and investment type among others.
51. As part of any valuation exercise, valuation specialists typically compare the results from applying multiple valuation techniques for the purposes of understanding the reasons for the differences in valuation. Having said that, many of the valuation specialists mentioned that the discounted cash flow (DCF) method is one of the valuation techniques most frequently used when measuring the fair value of quoted investments. According to them, the DCF method allows them to quantitatively incorporate the manner in which the cash flows generated by the investee will be realised, because it is based on future expected cash flows that are

probability-weighted. The numerator of the DCF includes expected cash flows available to all of the investee's capital providers computed after all operating expenses and corporate taxes (computed using market participants' expectations) have been paid and after any necessary reinvestment requirements such as net working capital have been made.¹¹

52. Even though in the case of quoted investments there is a quoted price for the shares, some valuation specialists mentioned that a comparable company valuation multiples technique may also be used in instances in which the background or details of the observed transactions for comparable companies are known. This valuation technique would allow them to understand whether, for example, a control premium would need to be considered when measuring the fair value of a quoted investment in a subsidiary (ie this technique would allow them to understand whether, for example, the current market price does not reflect such a premium and, consequently, would need to be adjusted).
53. A few valuation specialists mentioned that the adjusted net asset method may also be applied to value a controlling interest in an investee, particularly for entities that derive value from holding assets such as investment entities and property-holding companies.
54. For many of the valuation specialists, the measurement obtained by applying $P \times Q$ is used as a reference to understand how the market is valuing the investment rather than being the primary method used to measure fair value. $P \times Q$ serves as a test of reasonableness when valuation specialists are undertaking the measurement, but it does not necessarily represent the fair value measurement of the investment without considering the features of the investment.
55. Some valuation specialists also commented that, when trying to include in the measurement some of the features of the investment such as control or liquidity, it is sometimes challenging to obtain sound measurements for those items because these adjustments are not easily benchmarked. Nevertheless, measurement of these items in the form of premiums and discounts are undertaken as part of the valuation process when appropriate. Consequently, the adequacy of these

¹¹ Please note that that description would be aligned to a DCF method prepared on the basis of the investee's enterprise value (ie using all free cash flow to the firm).

adjustments relies, inevitably, on the availability of supporting evidence and on their professional judgement.

56. When asked about the most relevant reconciling items between the fair value measurements obtained from valuation techniques and the measurements obtained by applying $P \times Q$, the valuation specialists mentioned the following reconciling items:¹²

- (a) Control premiums—for this item, valuation specialists noted that:
 - (i) Control premiums are often included when measuring the fair value of a controlling interest because this feature of the investment would not always be reflected if the measurement was obtained by applying $P \times Q$. The inclusion of a control premium adjustment when measuring the fair value of a controlling interest may be substantiated to some extent by the controlling investor benefiting from control synergies that imply enhanced cash flows or reduced risks arising from its controlling stake (for example, the ability of a controlling investor to effect operational changes in the investee). These items could be incorporated in a DCF model but would not be necessarily reflected in the individual share price.
 - (ii) Control premiums are often measured by referencing market data pertaining to transactions that involve control of similar entities in similar industries (for example, by using databases that analyse premiums paid in transactions that involve the acquisition of a controlling interest or the use of data from empirical control studies). Another approach to estimating control premiums would be to compare the acquisition price of a comparable company relative to its pre-acquisition quoted price and estimate the control premiums as the difference. The availability of empirical data in emerging markets may be an issue, though.
- (b) Information that is only available to certain investors—often the market in which the individual shares are quoted trades on ‘irrational exuberance’

¹² A few valuation specialists for this section referred us to the AICPA Accounting & Valuation Guide, *Testing Goodwill for Impairment*, paragraphs 4.79–4.83.

while the investor that aims to sell a large stake has information about the investee that is not available to the public at large.

- (c) Liquidity of the market in which the shares are quoted—valuation specialists consider whether the measurement of the investment should include an adjustment for liquidity and in many instances, use option pricing models to measure liquidity adjustments.
- (d) Tax consequences—the fair value of the investment as a whole may be calculated using a taxable basis under a DCF method to reflect additional tax benefits that may not be reflected in the quoted share price.
- (e) Capital structures—a valuation technique such as the DCF method may assume market participants’ assumptions when determining the amount of leverage to develop the cost of capital used in the DCF method. In contrast, the quoted share price may reflect the risk of the investee’s suboptimal leverage and, consequently, differ from the fair value amount obtained from a valuation technique that uses an optimal capital structure.
- (f) Excessive short positions against the shares (when permitted in a particular jurisdiction)—these short positions may cause volatility in the share price that is not taken into account when the fair value of the whole investment has been determined using a valuation technique.

57. A few valuation specialists mentioned that in some instances the difference between the fair value measurement obtained by applying a valuation technique and the measurement obtained by applying $P \times Q$ may also be due to the inappropriateness of some of the inputs used or oversights when carrying out the fair value measurements by using valuation techniques. For example:

- (a) the discount rate used when carrying out the DCF method may have considered inappropriate risk-free rates, which would lead to an inappropriate required equity premium; and
- (b) the estimated cash flows under the DCF method are subject to forecast risk and may not always reflect market participants’ assumptions.

Quoted CGUs

58. The discussions with valuation specialists relating to the measurement of the recoverable amount of quoted CGUs on the basis of fair value less costs of disposal were focussed on the following matters:
- (a) How relevant would the measurement of the recoverable amount of a quoted CGU on the basis of fair value less costs of disposal be when that measurement is based on $P \times Q$?
 - (b) What are the most commonly used valuation techniques for measuring the recoverable amount of quoted CGUs on the basis of fair value less costs of disposal?
 - (c) If an entity was quoted but it had different CGUs, how would the quoted price of the entity be used in the measurement of the recoverable amount of each of the CGUs included in that quoted entity on the basis of fair value less costs of disposal?

Quoted CGUs—Relevance on the measurement by applying $P \times Q$

59. Most valuation specialists commented that measuring the recoverable amount of a quoted CGU on the basis of fair value less costs of disposal by applying $P \times Q$ would not result in a relevant measurement because of the following reasons:
- (a) It is not common that a CGU exactly corresponds to a quoted entity, because the perimeter of a CGU may exclude certain items that are a part of the quoted entity such as, for example, liabilities and tax balances (see paragraph 75). In addition, when performing a purchase price allocation in a business combination, valuation specialists allocate goodwill to the CGUs, which would be another item that would not be included in the quoted entity. One valuation specialist noted that they did observe CGUs that corresponded to a quoted entity in the energy and metal industries, although it was not prevalent.
 - (b) Groups of CGUs can be aggregated for impairment testing purposes and in this scenario the aggregated group of CGUs may not correspond to a single quoted entity.

(c) $P \times Q$ may introduce market volatility into the impairment calculation and this would not correspond to the value of the underlying assets of a CGU.

60. When measuring the recoverable amount of a quoted CGU on the basis of fair value less costs of disposal the valuation specialists commented that $P \times Q$ is used as a sense check to ensure the reasonableness of the measurement.

Quoted CGUs—The most commonly used valuation techniques

61. The valuation specialists commented that the recoverable amount of quoted CGUs on the basis of fair value less costs of disposal was in most cases determined by applying a valuation technique such as a DCF method. They also provided the following comments:

(a) When determining the recoverable amount of quoted CGUs on the basis of fair value less costs of disposal, $P \times Q$ is rarely used as the primary valuation technique. Instead, as previously mentioned, valuation specialists measure the recoverable amount on the basis of fair value less costs of disposal using the DCF method and compare this value to the value derived by applying $P \times Q$ for reasonableness. In some jurisdictions, when there is a quoted price, securities regulators may require a reconciliation between the fair value measurement derived from a valuation technique to the value derived under $P \times Q$.

(b) Measuring the recoverable amount of a quoted CGU on the basis of fair value less costs of disposal using the DCF method allows an entity to take into account market participants' assumptions and capture items such as the effects of future enhancements that may affect the CGU.

62. One valuation specialist based in Asia noted that instead of fair value less costs of disposal, value in use had been observed to be the predominant calculation by which the recoverable amount of a CGU was determined. This valuation specialist noted that value in use was generally seen to yield higher values for the recoverable amount of a CGU compared to fair value less costs of disposal, because value in use generally takes into consideration synergies that might have arisen from having control or significant influence. On this point, this valuation

specialist noted that value in use was more appropriate when determining the recoverable amount for entities with relatively low price-to-book ratios.

63. In the case of quoted CGUs, valuation specialists also noted that they had observed similar reconciling items between the measurement of the recoverable amount on the basis of fair value less costs of disposal when determined using a valuation technique and the value derived from applying $P \times Q$ than the ones described for quoted investments.

Other matters

64. Some of the comment letters submitted in response to the ED asked how the recoverable amount of CGUs should be measured when a quoted entity had more than one CGU. In this regard, valuation specialists provided the following comments:
- (a) For impairment testing purposes, in the case in which a quoted entity consists of more than one CGU, valuation specialists aim to reconcile the fair value measurement of the CGUs of the entity to the fair value measurement of the entire entity. When analysing any differences between these two values, an entity should consider whether these differences may be attributable to a particular CGU being over- or under-valued. In addition, some valuation specialists also noted that the AICPA Accounting & Valuation Guide *Testing Goodwill for Impairment* outlines best practices including performing a reconciliation between the aggregated sum of the fair value measurements of an entity's reporting units (ie CGUs) to the observed market capitalisation of the entity and analyse the implied control premium. As part of this reconciliation, the AICPA Guide outlines possible reconciling items such as control synergies, asymmetric information, tax consequences, and controlling or large block interests.
 - (b) If an entity was quoted but it had different CGUs, the market value of the entire entity could be apportioned to the different CGUs based on factors such as profits, revenues, costs or assets.

Accounting firms

65. We conducted outreach with the global IFRS teams of six large accounting firms that had submitted comment letters in response to the ED. The discussions aimed to:
- (a) provide more insight on the responses included in their comment letters relating to both the proposed measurement for quoted investments and for quoted CGUs;
 - (b) establish with the accounting firms how frequently both investment and non-investment entities have been observed to have quoted investments in subsidiaries, joint ventures and associates that are measured at fair value;
 - (c) confirm whether they had noted any diversity in practice (ie whether entities required or permitted to measure quoted investments in subsidiaries, joint ventures and associates at fair value were measuring that fair value consistently, either by applying a valuation technique or by applying $P \times Q$); and
 - (d) learn their views on the recommendations provided by respondents to the ED in relation to the fair value measurement of quoted investments).
66. The main comments received from these discussions with the accounting firms are outlined in paragraphs 67–82.

Quoted investments

67. All the accounting firms reiterated that the proposed measurement ($P \times Q$) is not a relevant measurement for the unit of account being measured at fair value (ie the investment as a whole). The lack of alignment between the unit of account being measured at fair value and the proposed measurement in the ED is, in their view, evidenced by the following matters:
- (a) there is no Level 1 price for the investment as a whole;
 - (b) $P \times Q$ does not represent an exit price for the investment as a whole that is consistent with a market participant's perspective. The accounting firms commented that when an investor sells, for example, a controlling interest in a quoted subsidiary, the selling price will rarely be equivalent to the

amount represented by $P \times Q$ (ie $P \times Q$ does not reflect the value for which these quoted investments will be realised);

- (c) because the ED concludes that the unit of account is the investment as a whole, the ‘principal market’¹³ for that unit of account would be the market in which such a ‘block’ investment transaction would take place. The accounting firms commented that such transactions do not take place in the open market where the individual shares trade and that the $P \times Q$ measurement would force an entity to measure the fair value of an investment using the price observable in a market (ie the stock exchange markets) that is not in reality the price of the ‘principal market’ where the sale of a ‘block’ investment would take place;
- (d) when entities have a relatively small free-float because, for example, a large percentage is held by a single controlling investor and that controlling interest is unquoted, this could raise doubt as to whether that Level 1 price available for the small free-float is relevant for the measurement of the investor’s controlling interest. In addition, that free-float may consist of shares that may not be traded frequently, which would put pressure on determining whether that Level 1 price represents the quoted price in an ‘active market’;
- (e) one accounting firm did not agree with the rationale used in paragraph BC11 of the ED, which states that investment entities would be prevented from including control premiums when measuring the fair value of their investments in subsidiaries, because paragraphs B85I and BC242 of IFRS 10 state that an investment entity, or other members of the group containing the entity, should not obtain benefits from its investees that would be unavailable to other investors in the investee. According to this accounting firm, control premiums would not only be triggered by the activities included in paragraph B85I of IFRS 10, but could also be a

¹³ Appendix A of IFRS 13 defines ‘principal market’ as ‘The market with the greatest volume and level of activity for the asset or liability’.

function of what market participants would pay in a transaction when acquiring an investee¹⁴; and

- (f) while the measurement obtained by applying $P \times Q$ may be a starting point for valuation professionals, one accounting firm stated that they rarely see valuation professionals concluding with such a measurement unless the accounting firms inform them that the relevant accounting Standards require such a measurement. This accounting firm mentioned that this is particularly noticeable in the investment entity and/or private equity space, because of the frequency with which they are asked to value interests that include some element of control. A member of this accounting firm mentioned that in the United States, the private equity sector considers fair value measurements on the basis of $P \times Q$ as an accounting rule that may not be completely appropriate but is nevertheless applied and, as a result, very little diversity is observed. To illustrate instances in which $P \times Q$ may not be appropriate, an example was provided whereby a private equity firm transacted for a controlling interest in a quoted entity and the price realised did not equate to $P \times Q$ because of factors such as asymmetric information and liquidity.

68. Some of the consequences that the accounting firms perceived from the proposed measurement are as follows:

- (a) the proposed measurement does not respect the **principle** in IFRS 13 to consider the unit of account of the item that is measured at fair value¹⁵;
- (b) the tension with the concept of an ‘**active market**’ would probably increase, requiring a greater degree of judgement when assessing whether shares are traded in an active market, especially because, in their view, it is not

¹⁴ Another accounting firm also noted in its comment letter to the ED that they did not agree with the rationale provided in paragraph BC11 of the ED and stated that ‘[...] the types of activities referred to IFRS 10.B85I and BC242 relate to whether an investment entity, or other members of the group containing the investment entity, obtain benefits which are consistent with acting in some operating or strategic capacity. This is not the same as an enhanced valuation due to the existence of a control premium.’

¹⁵ Paragraph 14 of IFRS 13 states: ‘Whether the asset or liability is a stand-alone asset or liability, a group of assets, a group of liabilities or a group of assets and liabilities for recognition or disclosure purposes depends on its *unit of account*. 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, except as provided in this IFRS.’

unusual for entities to hold investments in entities that are thinly traded. The need for exercising judgement when assessing whether a market, in which transactions for the asset take place, is an 'active market' may be even higher in emerging markets; and

- (c) $P \times Q$ would lead to an **inconsistency** between the measurement of quoted and unquoted investments at fair value. Some accounting firms perceived that this was another factor that would represent additional pressure on the definition of an 'active market', because entities may claim that the market in which the shares of the investments are traded is not active so that the measurements are categorised as Level 2 or Level 3 fair value measurements within the fair value hierarchy, for which premiums or discounts would be allowed.
69. With regard to how frequently investment entities were observed to have quoted investments in subsidiaries or venture capital organisations, mutual funds, unit trusts and similar entities were observed to have quoted investments in joint ventures or associates, the majority of audit firms mentioned that they had not observed many cases. Similarly, on the question of how frequently non-investment entities were observed to have quoted investments in subsidiaries, joint ventures and associates that were measured at fair value in their separate financial statements, the majority of the accounting firms commented that they had generally not observed many cases, although they had noted a few exceptions.
70. In particular, the accounting firms commented that in the case of non-investment entities, it was unlikely that they would elect to measure quoted investments in subsidiaries, joint ventures and associates at fair value in their separate financial statements. In addition, they noted that in many jurisdictions, entities are not required to apply IFRSs in their separate financial statements.
71. Some accounting firms mentioned that the proposed measurement could affect a broader population of entities than what was envisaged in the ED. More specifically, they noted that the proposed measurement could also be applicable in the following situations:

- (a) IFRS 3 *Business Combinations*—the fair value measurement of previously held quoted equity interests in an acquiree and the fair value measurement of non-controlling interests when those are quoted in an active market;
 - (b) IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*—investments within the scope of that Standard could also be affected by the proposals; and
 - (c) IFRS 10 *Consolidated Financial Statements*—the fair value measurements of quoted retained interests resulting from an entity losing control of a subsidiary.
72. With regard to whether the accounting firms had observed any diversity in practice relating to measuring quoted investments at fair value (ie whether entities required or permitted to measure quoted investments in subsidiaries, joint ventures and associates at fair value were measuring that fair value consistently, either by applying a valuation technique or by applying $P \times Q$), the following points were noted:
- (a) one accounting firm stated that they did not observe much diversity in practice on this issue and that their accounting manuals illustrated the fair value measurement by applying $P \times Q$ when investments were composed of financial instruments that had a Level 1 fair value price available;
 - (b) a couple of accounting firms also commented that they had not seen much diversity in practice. In this case, however, they had not observed $P \times Q$ being applied for quoted investments;
 - (c) one accounting firm commented that prior to the publication of the ED, they did not observe significant diversity in practice and that they had generally seen quoted investments being measured at fair value by applying valuation techniques. Subsequent to the publication of the ED, they noted that they had observed quoted investments being measured at fair value by applying $P \times Q$ in certain jurisdictions; and
 - (d) a couple of accounting firms commented that they did not observe significant diversity in practice and that their firm’s guidance illustrates the

application of the requirements by entities having an accounting policy choice when measuring quoted investments at fair value.

Quoted CGUs

73. All the accounting firms reiterated the points raised in their comment letters that the proposed measurement in the ED for the recoverable amount of quoted CGUs on the basis of fair value less costs of disposal by applying $P \times Q$ was not aligned with the unit of account being measured at fair value (ie the CGU as a whole).
74. They also noted that the measurement obtained by applying $P \times Q$ was not consistent with a market participant’s perspective, because the exit price for the group of assets that constitute the CGU would not necessarily be represented by the price of the shares of the entity. In this regard, one accounting firm commented that there is a disconnect between the value of these underlying assets and the quoted price of the shares, because there may be external factors that affect the quoted share price that are unrelated to the value of the group of assets of the CGU.
75. The accounting firms also stated that it was not common for a CGU to exactly correspond to a quoted entity. In particular, they commented that:
- (a) the perimeter of a CGU would typically exclude items such as tax balances and liabilities which would, in contrast, be included in the quoted entity.¹⁶ However, it would be more likely for CGUs to correspond to quoted investments in joint ventures or associates instead of subsidiaries;
 - (b) assets and liabilities that the quoted entity and the CGU do not have in common would need to be factored in as an adjustment to $P \times Q$;
 - (c) when a quoted entity had more than one CGU, it was uncertain how the measurement obtained by applying $P \times Q$ would affect the measurement of the recoverable amount on the basis of fair value less costs of disposal of

¹⁶ Paragraph 76 of IAS 36 states that: ‘The carrying amount of a cash-generating unit: (a) includes the carrying amount of only those assets that can be attributed directly, or allocated on a reasonable and consistent basis, to the cash-generating unit and will generate the future cash inflows used in determining the cash-generating unit’s value in use; and (b) does not include the carrying amount of any recognised liability, unless the recoverable amount of the cash-generating unit cannot be determined without consideration of this liability. This is because fair value less costs of disposal and value in use of a cash-generating unit are determined excluding cash flows that relate to assets that are not part of the cash-generating unit and liabilities that have been recognised [...]’.

each of the CGUs and how $P \times Q$ might apply to situations in which the sum of the recoverable amounts of each of the CGUs exceed the fair value of the entity as a whole, measured by applying $P \times Q$; and

- (d) if the proposals in the ED only applied to quoted entities consisting of a single CGU, one accounting firm anticipated that entities could be motivated to identify more than one CGU so that the requirements did not apply to them.

76. A few accounting firms mentioned that the measurement obtained from $P \times Q$ could be used as an indicator of impairment or as a reference to check how reasonable the resulting measurement was when measuring the recoverable amount of the CGU when performing the impairment test, but they did not think that the $P \times Q$ measurement itself was necessarily relevant for the purposes of measuring the recoverable amount of quoted CGUs.

77. For the measurement of the recoverable amount of quoted CGUs when these CGUs coincide with an investment in an associate, we received mixed feedback. One accounting firm commented that they had observed an entity in the financial services industry that measured the recoverable amount of its quoted CGU (ie an associate) on the basis of fair value less costs of disposal by directly applying $P \times Q$ when measuring the recoverable amount of that CGU. Another accounting firm commented, however, that for CGUs that corresponded to quoted associates, they have observed that entities often measure the recoverable amount of these quoted CGUs on the basis of value in use. On this point, they pointed out that the value in use measurement of the recoverable amount of associates has its own challenges based on the impairment testing requirements of paragraph 42 of IAS 28 which involves an entity estimating:¹⁷

- (a) its share of the present value of the estimated future cash flows expected to be generated by the associate, including the cash flows from the operations of the associate and the proceeds from the ultimate disposal of the investment; or

¹⁷ The same requirements apply when determining the value in use of the net investment in a joint venture (see paragraph 42 of IAS 28).

(b) the present value of the estimated future cash flows expected to arise from dividends to be received from the investment and from its ultimate disposal.

78. Another accounting firm commented that the ED proposals relating to quoted CGUs would result in a lack of alignment with existing guidance under US GAAP. The relevant US GAAP requirements are reproduced below (**emphasis added**):

Determining the Fair Value of a Reporting Unit (ASC Sections 350-20-35-22 and 35-23)

35-22 [The fair value of a reporting unit refers to the price that would be received to sell the unit as a whole in an orderly transaction between market participants at the measurement date. Quoted market prices in active markets are the best evidence of fair value and shall be used as the basis for the measurement, if available. **However, the market price of an individual equity security (and thus the market capitalization of a reporting unit with publicly traded equity securities) may not be representative of the fair value of the reporting unit as a whole.** [FAS 142, paragraph 23]]

35-23 [Substantial value may arise from the ability to take advantage of synergies and other benefits that flow from control over another entity. Consequently, **measuring the fair value of a collection of assets and liabilities that operate together in a controlled entity is different from measuring the fair value of that entity's individual equity securities.** An acquiring entity often is willing to pay more for equity securities that give it a controlling interest than an investor would pay for a number of equity securities representing less than a controlling interest. **That control premium may cause the fair value of a reporting unit to exceed its market capitalization.** The quoted market price of an individual equity security, therefore, **need not be the sole measurement basis** of the fair value of a reporting unit. [FAS 142, paragraph 23]]

Accounting firms' views on the recommendations received from the comment letters to the ED

79. The staff asked accounting firms for their views regarding the recommendations provided by respondents to the ED in relation to the fair value measurement of quoted investments. The recommendations received were the following:
- (a) Recommendation 1—setting up a rebuttable presumption so that $P \times Q$ is presumed to be the measurement that best represents the fair value of quoted investments unless an entity can identify a measurement that more faithfully represents fair value; and

- (b) Recommendation 2—measuring the fair value of the quoted investments using either a valuation technique or adjusted Level 1 inputs, disclose the measurement resulting from $P \times Q$ and provide a reconciliation to explain the difference between the two measurements.
80. The accounting firms did not support having a rebuttable presumption that $P \times Q$ is the measurement that most faithfully represents fair value (ie Recommendation 1). They were of the view that entities may rebut the presumption in almost all instances by asserting that a measurement derived by applying a valuation technique or adjusted Level 1 inputs is a more faithful representation of fair value. One accounting firm stated that the IASB should make a decision rather than introducing a rebuttable presumption, because this would reduce comparability and might result in diversity in practice. Another accounting firm noted that regulators would force entities to apply $P \times Q$ if they were aware that $P \times Q$ was the measurement that was being rebutted.
81. Accounting firms generally supported measuring quoted investments using a valuation technique or adjusted Level 1 inputs together with disclosing the measurement obtained by applying $P \times Q$ (ie Recommendation 2). However, one accounting firm was concerned that a reconciliation between an entity's fair value measurement of its quoted investments and the measurements obtained from applying $P \times Q$ together, with an explanation of the difference, would not be very meaningful. This was because they believed that entities would simply attribute any difference to control premiums or synergies without any further detailed analyses. Another accounting firm noted that a reconciliation would be challenging and might be meaningless, unhelpful and costly to prepare.
82. One accounting firm suggested that both measurements (ie the measurement obtained by applying a valuation technique and the measurement obtained by applying $P \times Q$) should be disclosed over a period of time rather than only at the reporting date. Another accounting firm noted that there were already existing disclosure requirements in IFRS 12 that require entities with quoted investments in joint ventures or associates accounted for using the equity method to disclose 'the fair value' of such investments. The staff note that such an expression in IFRS 12

(ie ‘the fair value of the investment’)¹⁸ was carried forward from IAS 28 to IFRS 12 when the former was amended and the latter issued in May 2011.

Securities regulators

83. The staff conducted outreach with a European securities regulator and an international securities regulator that had both submitted comment letters in response to the ED. During the outreach meetings, the staff discussed their views on the measurement of both quoted investments and quoted CGUs.

European securities regulator—quoted investments

84. For quoted investments, the securities regulator commented that from an enforcement point of view, $P \times Q$ is the preferred measurement method, because it is considered to result in the most verifiable measurement. The European securities regulator also noted that even though the ED clarifies that the unit of account for quoted investments is the investment as a whole, $P \times Q$ is still the preferred measurement because, in comparison to other alternatives such as valuation techniques, $P \times Q$, as previously mentioned, is considered to be the most reliable and objective measurement.
85. The European securities regulator was of the view that control premiums are, in some cases, applied as adjustments to an available Level 1 price. However, they noted that control premiums cannot, in many instances, be reliably measured. In relation to this matter, the staff also note an observation made in a speech given by the Securities and Exchange Commission (SEC) staff in 2004 at the 32nd AICPA National Conference on Current SEC and PCAOB Developments.¹⁹ In that speech, the SEC staff commented on the appropriateness of discounts observed in the valuation of private enterprise equity given as compensation to employees. In the valuation of privately held company equity securities, the SEC staff highlighted that discounts for a lack of control could not always be demonstrated by management providing ‘objective and reliable information that the controlling shareholders received greater returns than the minority shareholders [...]’. In that speech, the SEC staff further mentioned that ‘if

¹⁸ Paragraph 21(b)(iii) of IFRS 12 states that ‘[...]if the joint venture or associate is accounted for using the equity method, the fair value of its investment in the joint venture or associate, if there is a quoted market price for the investment’.

¹⁹ The speech can be found at the following link: <http://www.sec.gov/news/speech/spch120604teh.htm>. The link is valid as of 4 November 2015.

management cannot support with objective and reliable information that there is a disproportionate return to certain shareholders, either through the enterprise value cash flows or the equity rights, we do not believe that a lack of control discount is appropriate’.

86. The European securities regulator also commented that when fair value measurements are carried out by using a valuation technique, even though IFRS 13 requires disclosures such as the inputs used in the fair value measurement (including quantitative information about the significant unobservable inputs used) and because of the sensitivity of the fair value measurement to changes in unobservable inputs, this information is not as verifiable and transparent as showing quoted investments measured on the basis of applying $P \times Q$ on the statement of financial position.
87. The European securities regulator also thought that clarity about the interaction between the unit of account being the investment as a whole and the requirements in paragraph 69 of IFRS 13 was necessary.²⁰ In particular, the European securities regulator thought that further clarification was warranted for the following requirements in paragraph 69 of IFRS 13:
- (a) ‘[...] a fair value measurement shall not incorporate **a premium or discount that is inconsistent with the unit or account [...]**’ (**emphasis added**). In the case when the unit of account is the investment as whole, the European securities regulator considers that then premiums (for example, control premiums) and discounts are consistent with the unit of account (ie the investment as a whole) and, consequently, would be appropriate their consideration in all cases; and

²⁰ 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 (see paragraphs 11 and 12). 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 (see paragraphs 13 and 14). 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.’

- (b) ‘[...] 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 [...]’. Considering that ‘the asset’ is the investment as a whole, there is no Level 1 price for ‘the asset’.

European securities regulator—other comments relating to quoted investments

88. Responding to our question about the prominence of investment entities measuring investments in quoted subsidiaries at fair value by applying $P \times Q$, the European securities regulator commented that there is only a relatively small number of issuers qualifying for the investment entities exception but that, for the cases that had been observed, the fair value measurement of the investments in quoted subsidiaries has been obtained by applying $P \times Q$.
89. In the case of non-investment entities, the measurement basis for quoted investments in subsidiaries, joint ventures and associates in their separate financial statements is, in most cases, cost. They noted that given an accounting policy choice between cost and fair value, entities would choose cost because of the possible tax implications and volatility in profit or loss that might arise by applying a fair value measurement.
90. Regarding the recommendations provided by respondents to the ED (see paragraph 79), the European securities regulator noted that if a valuation technique was to be applied to measure quoted investments, it was imperative that the measurement derived by applying $P \times Q$ should also be disclosed. They further noted that explanations for any differences between the fair value measurement obtained from applying a valuation technique and the measurement obtained from applying $P \times Q$ should also be provided, even though this may be challenging, because it was important for users of financial statements to understand these differences.
91. The European securities regulator also commented that the impact of the measurement proposals in the ED on other Standards should be considered, especially in terms of the interaction between the unit of account and the application of a measurement on the basis of $P \times Q$, in particular, for the fair value measurement of:
- (a) quoted investments held for sale in accordance with IFRS 5;
 - (b) quoted non-controlling interests under IFRS 3; and

- (c) a retained interest in a former quoted subsidiary in the case of loss of control in accordance with IFRS 10.

European securities regulator—quoted CGUs

92. The European securities regulator was also of the view that $P \times Q$ was an appropriate measurement for the recoverable amount of quoted CGUs on the basis of fair value less costs of disposal because of its verifiability. In addition, the European securities regulator was of the view that the fair value measurement of quoted investments should be aligned with the measurement of the recoverable amount of quoted CGUs on the basis of fair value less costs of disposal.
93. The European securities regulator also noted that CGUs that correspond exactly to a quoted entity were not very common, because a quoted entity could have items such as liabilities and tax balances that were typically not included in a CGU. It was noted that an investment in an associate could more frequently correspond to a CGU.
94. With regard to the impairment test, the European securities regulator noted that they did not think that $P \times Q$ would have any negative implications. In particular, the European securities regulator stated that entities in cyclical industries such as those that operate in the mining and resource sectors, and that correspond to a CGU, may have a market capitalisation that is less than the CGU's carrying amount. When performing the impairment test, considering a recoverable amount for such a CGU measured on the basis of fair value less costs of disposal by applying $P \times Q$ would not result in a counterintuitive outcome, because the recoverable amount of a CGU under IAS 36 is the higher of the CGU's recoverable amount measured either on the basis of fair value less costs of disposal or value in use. Hence, this 'higher of' requirement should alleviate concerns of entities for which the recoverable amount of a CGU on the basis of fair value less costs of disposal by applying $P \times Q$ was found to be lower than the carrying amount of the quoted CGU.
95. The European securities regulator also noted that entities should assess any significant differences between the amounts derived from measuring the recoverable amount of quoted CGUs on the basis of value in use and on the basis of fair value less costs of disposal by applying $P \times Q$ although such an assessment does not have to be quantitative.

International securities regulator—quoted investments

96. For quoted investments, the international securities regulator noted that its members could be split in two groups on the basis of the two main views that they shared regarding the measurement proposals for quoted investments in the ED.
97. On the one hand, a group of members were of the view that $P \times Q$ was the most appropriate method because it was based on an available quoted price in an active market and, as result, was the most objective and verifiable measure of fair value. One of the members of that group generally supporting $P \times Q$ commented that they would support adjustments to the Level 1 prices for items such as control premiums if these adjustments can be supported with objective evidence.
98. On the other hand, another group of members were of view that if the unit of account is the investment as a whole, then applying $P \times Q$ would not be appropriate because this fair value measurement would not consider certain characteristics of the investment such as, for example, the investor having control or significant influence over the investee. These features would, however, be considered by a market participant when transacting for those investments. A member within this group noted that even though they did not think that $P \times Q$ was appropriate, they were against of applying a valuation technique if there was a Level 1 price available. They would prefer entities to use adjusted Level 1 inputs instead.

International securities regulator—other comments

99. When members were asked about whether they had observed the fair value measurements of quoted investments being measured by applying a valuation technique or by applying $P \times Q$, the responses were mixed. One member noted that they had observed some diversity in practice. Another member mentioned that before the ED was published they had observed both practices. Because of this they allow an entity making an accounting policy choice and require the entity to provide disclosures and that it applies that method consistently.
100. With regard to the recommendations provided by respondents to the ED (see paragraph 79), a few members commented that they would prefer the second recommendation in which entities would measure their quoted investments at fair

value by using a valuation technique or adjusted Level 1 inputs and would disclose the measurement obtained by applying $P \times Q$ and would provide a reconciliation to explain the difference between the two measurements.

International securities regulator—quoted CGUS

101. The international securities regulator noted that the views of its members for the measurement of the recoverable amount of quoted CGUs could also be split in two groups. Typically, the members that had supported a fair value measurement by applying $P \times Q$ for quoted investments would also support that same measurement in the case of the measurement of the recoverable amount of quoted CGUs on the basis of fair value less costs of disposal and, conversely, the members that had supported a fair value measurement on the basis of a valuation technique or adjusted Level 1 prices would also support that same measurement in the case of quoted CGUs.
102. There is the instance, however, of a member that would support the fair value measurement of quoted investments to be carried out on the basis of $P \times Q$ but that would allow consideration of, for example, control premiums when measuring the recoverable amount of a quoted CGU.

ASAF

103. As part of our work, the staff reached the Accounting Standards Advisory Forum (ASAF) members for the purposes of gathering their views on different aspects of the proposed measurement included in the ED.
104. The paragraphs below summarise their feedback relating to quoted investments and to quoted CGUs.²¹

Quoted investments

105. For the purpose of obtaining feedback from the ASAF members, the staff asked them questions that aimed to assess the population of entities in their jurisdiction

²¹ The minutes of this meeting can be found at the following link:
<http://www.ifrs.org/Meetings/MeetingDocs/ASAF/2015/October/201510-ASAF-Summary-notes-Oct-2015.pdf>

that may be affected by the proposed measurement and the relevance of the measurement proposed in the ED.

Quoted investments—assessment of the population

106. The staff asked the ASAF members how frequently do investment entities have investments in subsidiaries that are quoted. The majority of the ASAF members commented that it was rare for investment entities to have quoted investments in subsidiaries. One ASAF member mentioned that a possible example of an investment entity having an investment in a quoted subsidiary could be when an investment entity takes a public company private and keeps a small percentage of the shareholding outstanding as part of a structuring opportunity. Another ASAF member mentioned that in the instances in which those investments are quoted, the impact of the proposals in the fair value measurement could be significant.
107. The staff also asked the ASAF members how frequently they had observed venture capital organisations, mutual funds, unit trusts and similar entities having quoted investments in joint ventures and associates for which the investors have chosen to measure them at fair value in its consolidated financial statements and, consequently, are also required to measure them at fair value in their separate financial statements. A few ASAF members commented that this circumstance was also rare.
108. In the case of non-investment entities, some ASAF members commented that it is even less frequent that an investor would measure quoted investments in subsidiaries, joint ventures and associates at fair value in their separate financial statements, because those investments are typically measured at cost in the investors' separate financial statements. One ASAF member mentioned that in their jurisdiction IFRS-compliant financial reports are only required for consolidated financial statements and not for separate financial statements.

Quoted investments—relevance of the measurement proposed

109. In relation to the question on how relevant the fair value measurement of quoted investments would be on the basis of $P \times Q$, the main comments received were:

- (a) Some ASAF members mentioned that the proposed measurement was not a relevant measurement. A few members mentioned that $P \times Q$ was quite reliable, highly irrelevant and not consistent with the definition of fair value. The lack of relevance was mainly backed up by the perceived inconsistency of the proposed measurement with the unit of account being the investment as a whole (ie the price of one share cannot be used to measure a large shareholding). One ASAF member found $P \times Q$ to be an objective measurement but only for one day (ie it is a measurement that represents only a point-in-time measurement). In addition, it was also noted that especially in emerging markets, quoted prices will not always be considered to be a Level 1 price as there will not always be enough liquidity in those markets.
- (b) One ASAF member mentioned that the proposed measurement was relevant for quoted investments because they are generally not transferred to a third party on an aggregated basis; however, in instances in which quoted investments are disposed of as a block, the fair value measurement should be determined by applying a valuation technique or by adjusting Level 1 prices. Another ASAF member mentioned that the relevance of $P \times Q$ depended on the size of the control premium, ie if the control premium was relatively small then $P \times Q$ as a measurement for the investment would be more relevant.
- (c) One ASAF member mentioned that investors in their jurisdiction with whom they had conducted outreach clearly supported $P \times Q$. This support was not because $P \times Q$ was perceived as a relevant measurement but because investors had difficulty in relying on a different measurement.

Quoted investments—valuation techniques and main inputs used

- 110. The staff also asked the ASAF members for feedback on the use of valuation techniques and the inclusion of premiums and discounts in the fair value measurements of the investments.
- 111. It was noted that it is difficult to assign a specific valuation technique, because the measurement methodology is driven by the nature of the investment and the

jurisdiction in which the transactions for that investment occurs. In that respect one ASAF member noted that a discounted cash flow method was applied in their jurisdiction for quoted investments to reflect rights and restrictions associated with the shareholding. They noted that for regulatory purposes, the quoted price is required to be disclosed.

112. One ASAF member also noted that valuation techniques typically include adjustments to capture rights being conveyed to the holder. This member noted that the fair value measurements did not only factored in control premiums, but that other items such as blockage rights, additional information rights and voting rights were also considered. In that respect, some ASAF members noted that control premiums are highly relevant but that the manner in which they are derived is very subjective.
113. Another ASAF member noted that the measurements resulting from applying $P \times Q$ without adjustments were also used because of cost-benefit considerations (ie the calculation could be performed quickly with ease).

Quoted CGUs

114. In relation to quoted CGUs and how relevant $P \times Q$ would be for the purposes of measuring the recoverable amount on the basis of fair value less costs of disposal, one ASAF member commented that the relevance of such a measurement would depend on the closeness of the alignment between the CGU and the quoted entity. This ASAF member also noted that the proposed measurement would result in a lack of alignment between the measurement of the recoverable amount on the basis of fair value less costs of disposal for quoted and unquoted CGUs.
115. Another ASAF member noted that one implication of the proposed measurement could be an increase in impairments. This ASAF member commented that entities would be motivated to obtain a higher recoverable amount (through value in use) if $P \times Q$ could translate into an impairment being recorded. Another ASAF member commented that $P \times Q$ would introduce market volatility into the impairment calculation.

Recommendations received

116. During the comment letter period, respondents to the ED suggested a few recommendations for possible solutions that the IASB could consider:
- (a) set up a rebuttable presumption so that $P \times Q$ is presumed to be the measurement that best represents the fair value of quoted investments unless an entity can identify a measurement that more faithfully represents fair value; and
 - (b) both the recognised fair value of the investment (measured using either a valuation technique or adjusted Level 1 inputs) and the measurement resulting from $P \times Q$ should be disclosed together with a reconciliation to explain the difference between the two measurements.
117. The staff asked the ASAF members for their views on the recommendations received, which can be summarised as follows:
- (a) There was little support for the recommendation that suggested using a rebuttable presumption. Some ASAF members thought that, entities would, in most cases, rebut the $P \times Q$ presumption and assert that a measurement derived using a valuation technique would more faithfully represent fair value.
 - (b) Some ASAF members supported a recommendation to measure the fair value of the quoted investments by applying a valuation technique and disclosing the measurement derived by applying $P \times Q$ together with a reconciliation between the two measurements. A few ASAF members further noted that the disclosures in IFRS 13 relating to Level 3 fair value measurements should be sufficient. However, one member also noted that $P \times Q$ would be a viable solution from a cost-benefit perspective.

Discussions with FASB staff

118. The requirements in US GAAP and IFRS for determining fair value measurements are largely converged as a result of the publication of IFRS 13 and amendments to Topic 820 *Fair Value Measurement* (the fair value Standard) in 2011.^{22, 23}
119. Consequently, as part of this work, we contacted the FASB staff to understand whether:
- (a) the measurement of quoted investments or quoted CGUs had been identified as a significant issue in the Post-implementation Review on the fair value standard that the Financial Accounting Foundation finalised in 2014²⁴; and
 - (b) the FASB had received any request to clarify the fair value measurement of quoted investments and quoted CGUs.
120. According to the FASB staff, the Post-implementation Review did not identify the fair value measurement of quoted investments and quoted CGUs as an area in which entities faced difficulties when implementing the fair value Standard. In addition, the FASB staff are not aware of any requests for clarification about the fair value measurement of quoted investments and quoted CGUs.

²² Topic 820 codified FASB Statement of Financial Accounting Standards No. 157 *Fair Value Measurements* in the FASB *Accounting Standards Codification*®.

²³ It is worth noting that there are different requirements in IFRSs and US GAAP for measuring the fair value of investments in investment entities. Topic 820 provides a practical expedient that allows an entity with an investment in an investment company to use as a measure of fair value in specific circumstances the reported net asset value without adjustment. In IFRS this practical expedient is not allowed because there are different practices for calculating net asset values in jurisdictions around the world (see paragraph BC238 of IFRS 13).

²⁴ The Post-Implementation Review Report on FASB Statement No. 157, *Fair Value Measurements* can be found at the following link: http://www.accountingfoundation.org/cs/ContentServer?c=Document_C&pagename=Foundation%2FDocument_C%2FFAFDocumentPage&cid=1176163848391. This link is valid as of 4 November 2015.

Appendix A—Description of the types of entities included in the ‘investment firm’ label of the S&P Capital IQ database

- A1. The entities that the database classifies as ‘investment firms’ are further classified under the following labels:
- (c) *Public Investment Firm*: a publicly listed firm that makes investments in the form of purchase and sale of public and private equity or debt and other securities, as well as real estate assets. Public Investment Firms may be institutional asset managers, mutual or hedge fund sponsors, pension fund managers, private equity sponsors, or real estate investment firms.
 - (d) *Private Investment Firm*: a privately held firm that makes investments in the form of purchase and sale of public or private equity or debt and other securities, as well as real estate assets. Private Investment Firms may be institutional asset managers, mutual or hedge fund sponsors, pension fund managers, private equity sponsors, or real estate investment firms.
 - (e) *Financial Service Investment Arm*: principal investment firm that is majority-owned by a financial services company, such as a bank. Includes all firms making direct private equity investments and all private equity fund-of-funds that are over 50 per cent owned by a financial services company. Does *not* include any other investment firm type, such as hedge fund sponsors, mutual funds or pension funds. Does *not* include firms whose parent company is also an investment firm; these companies are classified as Private Investment Firms, and they are linked to the parent company as an Operating Subsidiary.
 - (f) *Corporate Investment Arm*: a principal investment firm that is majority-owned by any corporation other than a financial service company or another investment firm. Includes all privately held firms making direct private equity investments and all private equity fund-of-funds that are over 50% owned by another company. Does *not* include any other investment firm type, such as hedge fund sponsors, mutual funds or pension funds, or any publicly traded firms, which are always classified as Public Investment Firms.