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Project	**Post-implementation Review of IFRS 13 *Fair Value Measurement***
Paper topic	Background - Prioritising Level 1 inputs or the unit of account

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Introduction

1. The purpose of this paper is to provide an overview of the International Accounting Standards Board's (the Board) discussions and feedback received relating to the fair value measurement of quoted investments (unit of account issue), both prior to the Post-implementation Review (PIR) of IFRS 13 *Fair Value Measurement* and during the PIR of IFRS 13. This paper will not be discussed in the Board session and is intended to be read as background information.

2. The paper is structured as follows:

   (a) background on issue (paragraphs 3-4);

   (b) the beginning of the unit of account project (paragraphs 5-9);

   (c) information and feedback provided from the 2014 Exposure Draft and other activities completed (paragraphs 10-27); and

   (d) feedback provided from the PIR of IFRS 13 (paragraphs 28-40).

   Appendix 1 of this paper lists the types of instruments and circumstances in which this issue arises.

Background on issue

3. IFRS 13 requires that:

   (a) the fair value measurement of an asset or a liability or a group of assets and/or liabilities takes into consideration the unit of account for the item being measured (for example a financial instrument or a cash-generating unit or a business). The unit of account itself is determined applying other IFRS Standards.[1]

   (b) an entity selects inputs that are consistent with the asset or liability characteristics that market participants would take into account in a transaction for the asset or liability.[2]

   (c) Level 1 inputs should be used without adjustment to measure fair value whenever those inputs are available.[3]

4. After IFRS 13 came into effect, some stakeholders, in particular preparers and auditors, indicated that the measurement of fair value was not clear when Level 1 inputs exist but do not correspond to the unit of account. As a result, these stakeholders asked the Board to clarify whether Level 1 inputs or the unit of account should be prioritised in arriving at the measurement. The staff have summarised fair value measurements affected by this issue in Appendix 1.

The beginning of the unit of account project

5. In February and March 2013, the Board discussed two questions relating to fair value measurement, submitted by a preparer and an auditor.[4] The questions were:

   (a) fair value measurement of investments in subsidiaries, joint ventures and associates, when those investments were quoted in an active market; and

[1] See paragraphs 13 and 14 of IFRS 13.
[2] See paragraph 69 of IFRS 13.
[3] See paragraphs 77 and 80 of IFRS 13.
[4] The Agenda papers with the detailed questions to the Board can be found in Appendix 1 and 2 of the February 2013 papers: http://archive.ifrs.org/Current-Projects/IASB-Projects/FVM-unit-of-account/Pages/papers-1.aspx

(b) the recoverable amount of cash-generating units (CGUs) on the basis of fair value less costs of disposal when the CGUs were entities that were quoted in an active market.

6. In May 2013, the IFRS Interpretations Committee (the Committee) received a submission from an auditor on how an entity should measure the fair value of an entity's net exposure to market risks arising from a group of Level 1 financial assets and financial liabilities whose market risks are substantially the same (ie the application of the portfolio exception in paragraph 48 of IFRS 13 for that specific case).[5] Based on the information presented, the Committee was not able to answer the issue submitted and asked the Board to consider it.

7. Later in May 2013, Board discussed these three issues together as one project. This project was further discussed by the Board in December 2013 and February 2014. As a result of these discussions, the Board decided to propose narrow-scope amendments to:

(a) IFRS 10 *Consolidated Financial Statements*;

(b) IAS 27 *Separate Financial Statements*;

(c) IAS 28 *Investments in Associates and Joint Ventures*; and

(d) IAS 36 *Impairment of Assets*.

The Board also decided to propose a non-authoritative example to illustrate the application of the portfolio exception in IFRS 13. In September 2014, the Board published the Exposure Draft, *Measuring Quoted Investments in Subsidiaries, Joint Ventures and Associates at Fair Value* (the 2014 Exposure Draft).[6]

8. The 2014 Exposure Draft proposed:

(a) that the unit of account for investments within the scope of IFRS 10, IAS 27 and IAS 28 was the investment as a whole rather than the

[5] This submission can be found in Appendix 1 of the May 2013 Committee Agenda paper: http://archive.ifrs.org/Meetings/MeetingDocs/Interpretations%20Committee/2013/May/AP18%20Fair%20Value%20Measurement.pdf

[6] The 2014 Exposure Draft can be found at: http://www.ifrs.org/Current-Projects/IASB-Projects/FVM-unit-of-account/Exposure-Draft-September-2014/Documents/Exposure-Draft-Measuring-Quoted-Investments-September-2014.pdf

individual financial instruments included within that investment. The Board determined that the extent of an entity's control or influence in an investee determines whether that investment in that investee is within the scope of IFRS 10, IAS 27 or IAS 28. As a result, that characteristic (ie the level of control or influence) would highlight that the relevant unit of account in those Standards is the investment to which that key characteristic applies (ie the investment as a whole), instead of the unit of account prescribed in IFRS 9 (ie individual financial instruments that make up the investment).

(b) to amend IFRS 10, IFRS 12, IAS 27 and IAS 28 to **clarify** that the fair value measurement of quoted investments in subsidiaries, joint ventures and associates should be the product of the quoted price (P) multiplied by the quantity of financial instruments held (Q), or P × Q, without adjustments. The Board reached this conclusion because it believed that the resulting measurements are more relevant, objective and verifiable when they are based on unadjusted Level 1 inputs.[7]

(c) to align the fair value measurement of a quoted CGU to the fair value measurement of a quoted investment by amending IAS 36 to **clarify** that the recoverable amount of a CGU that corresponds to a quoted entity measured on the basis of fair value less costs of disposal should be the product of the quoted price (P) multiplied by the quantity of financial instruments held (Q), or P × Q, without adjustments. The Board decided that, as is consistent with those requirements for an investment, a quoted CGU should be measured using the quoted prices for the individual financial instruments.

(d) to include an illustrative example in IFRS 13 to illustrate the application of the portfolio exception of that Standard to a group of financial assets and financial liabilities whose market risks are substantially the same and whose fair value measurement is categorised within Level 1 of the fair value hierarchy. The example illustrated that the fair value of an entity's net exposure to market risks arising from such a group of

[7] See paragraph BC168 of IFRS 13.

financial assets and financial liabilities is to be measured in accordance with the corresponding Level 1 prices. The Board decided that an amendment to IFRS 13 was not needed, as the Standard is clear. However, because the submission mentioned in paragraph 6 reflected the existence of different views, the Board decided to provide an example in IFRS 13.

9. One Board member dissented from the 2014 Exposure Draft publication because he disagreed with the fair value measurement on the basis of PxQ when the unit of account is not an individual instrument.

Information and feedback provided from the 2014 Exposure Draft and other activities completed

2014 Exposure Draft feedback

10. The table below shows the feedback received on the main proposals in the 2014 Exposure Draft which was presented to the Board in March 2015:[8]

Proposal in the 2014 Exposure Draft	*Summary of feedback received*
For investments in subsidiaries, joint ventures and associates, the unit of account is the investment as a whole rather than the individual financial instruments included within these investments.	Many respondents supported that proposal.

[8] The Board discussed comment letters received on the 2014 Exposure Draft at its meeting in March 2015. The Agenda Paper discussed at that meeting can be found on the meeting page at: http://www.ifrs.org/Meetings/MeetingDocs/IASB/2015/March/AP06-Fair%20Value.pdf

The fair value measurement of investments in subsidiaries, joint ventures and associates when quoted in an active market should be the product of the quoted price (P) multiplied by the quantity of financial instruments held (Q), or P×Q, without adjustments.	Many respondents disagreed with the proposals, citing views that: (a) there is a lack of alignment between the proposed measurement and the unit of account being the investment as a whole (in their view there is no Level 1 input for that unit of account); (b) the proposed measurement may not provide relevant information because it may not reflect the features of the investment (for example the ability to exercise significant influence); (c) the measurement proposals would lead to inconsistencies between the measurement of quoted and unquoted investments at fair value; and (d) the measurement proposals result in day one gains or losses when the acquisition price includes a premium or discount. However, many of the users of financial statements who provided feedback agreed with the proposals, noting that the measurement should provide information that is objective and verifiable. They thought P×Q met these objectives better than measurement based on a different valuation technique.

For impairment testing, in some cases, the recoverable amount of a CGU is based on fair value less costs of disposal and the CGU is quoted in an active market. The 2014 Exposure Draft proposed that for a quoted CGU, its fair value less costs of disposal should be measured on the basis of P×Q, without adjustments.	Many respondents suggested that the fair value measurement of a quoted CGU should be aligned with the fair value measurement of a quoted investment but did not think that P×Q resulted in the most appropriate measurement because: (a) CGUs do not correspond exactly to, or are rarely identical to, a quoted entity; (b) the proposed measurement would not be aligned with the unit of account (ie the CGU); (c) they believed that it would not be appropriate to recognise an impairment loss based on the value of an individual financial instrument that is qualitatively different from the collective assets of the CGU being assessed for impairment; (d) they believed that the measurement proposals could lead to inconsistencies between quoted and unquoted CGUs when measuring the recoverable amount on the basis of fair value less costs of disposal; and (e) the measurement proposals are inconsistent with ASC 350-*Intangibles, Goodwill and Other* (section 350-20-35) under US generally accepted accounting principles. However, users that were in favour of a measurement resulting from applying P×Q for quoted investments also thought that this measurement should be applied for the purpose of measuring the recoverable amount of quoted CGUs on the basis of fair value less costs of disposal. Neverthless, for a few of these users, the level of comfort provided by measurements resulting from applying P×Q was not as high as in the case of quoted investments. This is because this measurement could result in the impairment of, in many cases, long-lived assets.

11. The 2014 Exposure Draft feedback is from both comment letters and user outreach conducted by staff. The outreach included meetings and conference calls with different users and user groups to discuss the proposed amendments. The staff held **five** meetings, both in person or by telephone call. One of these meetings was a public meeting with the Capital Markets Advisory Group and another was a user panel event organised by European Financial Reporting Advisory Group.

12. The other feedback and research on the proposed illustrative example for IFRS 13 on the portfolio exception and proposed next steps were discussed in April and

July 2015.[9] The Board noted that the proposed illustrative example would be non-authoritative and the comments received did not reveal significant diversity in practice. Accordingly, the Board concluded that it was unnecessary to publish the proposed illustrative example in IFRS 13 as a separate document.

13. In July 2015, the Board discussed potential directions for the project. On the basis of the comments received, the Board decided that further evidence-based research should be undertaken with respect to quoted investments and quoted CGUs. The paragraphs below list the main activities and summarises the findings from the research work.[10]

Research after the 2014 Exposure Draft

Assessment of the population of entities holding quoted investments measured at fair value

14. The objective of this assessment was to identify how many entities would be affected by the proposals in the 2014 Exposure Draft.

15. The assessment focused on:

    (a) investment entities with investments in quoted subsidiaries. These investments are required to be measured at fair value, in accordance with IFRS 10.

    (b) venture capital organisations, mutual funds, unit trusts and similar entities with investments in quoted joint ventures or associates. These investments are permitted to be measured at fair value, in accordance with IAS 28.

    (c) non-investment entities with investments in quoted subsidiaries, joint ventures or associates. These investments are permitted to be measured at fair value in the non-investment entities' separate financial statements, in accordance with IAS 27.

[9] The Agenda papers from the April and July meetings can be found at:
http://archive.ifrs.org/Meetings/MeetingDocs/IASB/2015/April/AP06-Fair%20Value.pdf
http://archive.ifrs.org/Meetings/MeetingDocs/IASB/2015/July/AP06-FVM.pdf

[10] The Board discussed the research work at its meetings in November 2015 and January 2016. The corresponding **seven** Agenda Papers can be found at the meeting pages:
http://www.ifrs.org/Meetings/Pages/IASB-Meeting-November-2015.aspx and
http://www.ifrs.org/Meetings/Pages/IASB-Meeting-January-2016.aspx.

16. That assessment did not consider:

    (a) previously held quoted equity investments in business combinations achieved in stages and quoted non-controlling interests measured in accordance with IFRS 3 *Business Combinations*;

    (b) quoted investments within the scope of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*;

    (c) quoted investments retained after loss of control and accounted for in accordance with IFRS 10; or

    (d) quoted CGUs for which the recoverable amount is measured on the basis of fair value less costs of disposal.

17. The staff did not recommend widening the assessment of the population to situations described in the previous paragraph. In the Agenda papers, the staff stated:[11]

> …this would have entailed a major exercise requiring extensive manual procedures. In addition, extrapolating any conclusions from the outcomes of an assessment of the population in this research would be further complicated by the fact that some of these instances represent one-time transactions (ie a business combination, investments available for immediate sale or instances in which an entity loses control of a subsidiary). However, the impact of such transactions on financial statements when they occur could be significant.

18. Based on the staff's research it was determined that the proposals in the 2014 Exposure Draft would affect only a **limited** number of entities, and primarily investment entities.[12]

[11] The Agenda paper can be found at: http://archive.ifrs.org/Meetings/MeetingDocs/IASB/2015/November/AP06B-Fair-Value-Measurement.pdf

[12] The detailed analysis of this conclusion can be found in paragraphs in 21, 28, 36-37 and 46-47 of Agenda Paper 6B from the November 2015 meeting: http://archive.ifrs.org/Meetings/MeetingDocs/IASB/2015/November/AP06B-Fair-Value-Measurement.pdf

Outreach

19. The staff undertook outreach with auditors, users, preparers, European Securities and Markets Authority, International Organization of Securities Commissions, valuation firms and the Accounting Standards Advisory Forum.[13] Many stakeholders reiterated the feedback made in response to the 2014 Exposure Draft. The Board also learned:

    (a) valuation specialists typically use P×Q as a reasonableness check when measuring the fair value of quoted investments or the recoverable amount of a quoted CGU on the basis of fair value less costs of disposal. P×Q is not necessarily used as the primary or sole measurement.

    (b) many users of financial statements generally preferred the measurements applying P×Q in respect of quoted investments and quoted CGUs because they considered this measurement to be more verifiable and objective, and **not because they considered it more relevant**. For these users the P×Q measurement was an objective and verifiable starting point from which to derive their conclusions on the fundamental value of the investments.

20. The feedback received during this outreach further corroborated the conclusion from the research assessment that the number of entities effected by the 2014 Exposure Draft would be **limited**. In addition, for the case of quoted CGUs, according to the feedback received by many of the constituents contacted during the research, the population of CGUs that would correspond to quoted entities would also be **limited**.

Academic literature review

21. The objective of the academic literature review (the review)[14] was to understand the extent to which quoted prices are considered by academics to be a good

[13] The Agenda paper summarising this feedback can be found at: http://archive.ifrs.org/Meetings/MeetingDocs/IASB/2016/January/AP06A-FVM.pdf
[14] The Agenda paper on the academic literature review can be found at: http://archive.ifrs.org/Meetings/MeetingDocs/IASB/2016/January/AP06B-FVM.pdf

representation of the value of interests in quoted entities that are within the scope of the 2014 Exposure Draft.

22. In the review, the literature confirmed that the fair value measurements of investments in subsidiaries, joint ventures and associates should be constructed by taking into consideration the prices that market participants would offer to acquire those investments in the corresponding principal markets. In the case of controlling interests, the consensus was that the principal market is the mergers and acquisitions market.

23. The review also found that the business valuation literature is focussed on the measurement of either controlling interests or unquoted minority interests without much focus on the measurements of investments that lie in between, such as investments in joint ventures or associates.

24. The review identified factors to consider when measuring the fair value of a controlling interest on the basis of a listed share price, including whether (the list is not exhaustive):

    (a) the listed price includes a premium for a transfer of control;

    (b) the fair value measurement of such controlling interest should reflect any marketability constraints not captured in the listed price of the shares; and

    (c) the price that market participants would pay in the mergers and acquisitions market would differ from the listed share price.

25. In relation to CGUs, the research suggested that the market capitalisation of a quoted CGU is typically considered to be an external indication of fair value that should be contrasted and reconciled with the fair value measurements obtained (via another valuation technique). Research findings questioned whether the market capitalisation of a quoted CGU should be presented as the conclusive fair value measurement.

Board conclusion

26. The Board discussed this research at its meetings in November 2015 and January 2016. The research findings were **consistent** with the feedback received in the 2014 Exposure Draft. During those meetings, the Board also discussed whether

on the basis of the work performed there was strong evidence that the issue was widespread or that there was divergence in practice that needed to be dealt with by amendments to IFRS 13. The staff paper concluded, based on the research and additional outreach conducted, that there was **not** strong evidence that the issue was widespread or that there was divergence in practice.

27. At the January 2016, the Board decided that the PIR would be a better setting for considering further work on this topic if the PIR identifies this as a critical area in which entities have encountered significant problems when implementing the Standard.

Feedback provided from the PIR of IFRS 13

28. During phase 1 of the PIR of IFRS 13, many stakeholders commented on the work completed by the Board in the project on the unit of account. These stakeholders suggested that the Board further considers this topic in phase 2 of the PIR, because, in their view, IFRS 13 sets out no clear guidance on whether entities should prioritise Level 1 inputs or the unit of account in determining fair value for investments in joint ventures and associates and CGUs.[15]

29. Feedback received during phase 1 of the PIR was **consistent** with the comments received during previous work on this topic.

30. The Board sought additional information through the RFI to supplement the work already performed in this area. The RFI included the following questions relating to unit of account:

Question 3—Prioritising Level 1 inputs or the unit of account

(a) Please share your experience to help us assess:

(i) how common it is for quoted investments in subsidiaries, joint ventures and associates, and quoted cash-generating units to be measured at fair value (please support your comments with examples).

(ii) whether there are material differences between fair value amounts measured on the basis of P×Q alone (when P is the quoted price for an individual instrument and Q is the quantity of financial instruments held) and fair value amounts measured using other valuation techniques. Please provide any

[15] The Agenda paper summarising this feedback can be found at: http://www.ifrs.org/-/media/feature/meetings/2017/january/iasb/pir-ifrs-13/ap7c-phase-1-outreach-feedback.pdf

examples, including quantitative information about the differences and reasons for the differences.

(iii) if there are material differences between different measurements, which techniques are used in practice and why.

Please note whether your experience is specific to a jurisdiction, a region or a type of investment.

(b) The Board has undertaken work on this area in the past (see Appendix 3 [of the RFI]). Is there anything else relating to this area that you think the Board should consider?

Summary of RFI feedback on unit of account

31. Most respondents to the RFI answered the questions relating to the unit of account.[16] A majority of them said the unit of account issue as described in the RFI was not applicable to them because either:

    (a) there are no level 1 inputs that could be used in the measurement (for example shares of subsidiaries tested for impairment as a single or a part of cash-generating unit are usually not quoted in an active market); or

    (b) the investments, even if quoted, are not measured at fair value (for example investments in associates and joint ventures were measured using the equity method).

32. However, many respondents said that although the issue does not occur frequently, it can have a material effect when it occurs.

33. Some respondents provided further comments, and mostly:

    (a) referred to the Board's 2014 Exposure Draft on this issue and their comment letters;

    (b) stated that the measurement should be for the investment as a whole, adjusting PxQ for the value of control, value of synergies, market liquidity as applicable; and

[16] The detailed Agenda paper summarising this feedback can be found at: http://www.ifrs.org/-/media/feature/meetings/2018/january/iasb/ap7f-ifrs-13-detailed-analysis-of-feedback-received.pdf

(c) urged the Board to clarify the Standard in this regard and provide application guidance to ensure consistency of application.

34. This feedback differs from the feedback the staff received in outreach with users of financial statements, most of whom supported measurement on the basis of PxQ, because it is verifiable and in the view of some, better represents fair value of the investment in question.

35. A few users said during outreach meetings that they were supportive of measuring the fair value for the unit of account as a whole, provided an explanation is given of any difference between the resulting measurement and the amount based on PxQ.

Feedback from the RFI – How commonly does this occur?

36. Most respondents, from all stakeholder groups except users, said measuring these instruments at fair value was not common, but does occur.

37. Most respondents noted that fair value measurement of investments held by **investment entities** is common, because IFRS Standards require investment entities to measure their investments at fair value.

38. Some respondents also said fair value measurement takes place during **impairment testing** of cash generating units, when they are or include listed subsidiaries, or in impairment testing of listed associates accounted for under the equity method.

39. A few respondents mentioned other situations where the unit of account issue may be applicable, including when:

(a) a **business combination** is achieved **in stages**, in which case IFRS Standards require previously held interest to be measured at fair value;

(b) sale of ownership interest results in **loss of control** and recognition of new ownership interest (e.g. associates) measured at fair value; or

(c) a subsidiary or investments in joint ventures and associates are classified as **held for sale** in accordance with IFRS 5.

40. The frequency of the fair value measurements mentioned above also depends on business practices and laws in a particular jurisdiction.

Appendix 1–Fair value measurements affected by unit of account issue

Standard applied	Type of instrument being measured	Frequency of fair value measurement		Requirements for fair value measurement		IFRS 13 disclosure requirements apply
		Recurring	Non-recurring	Required	Permitted	
IFRS 10	Investment entities with investments in quoted subsidiaries	✓		✓		✓
IFRS 5	Quoted investments held for sale		✓	✓		✓
IAS 28	Venture capital organisations, mutual funds, unit trusts and similar entities with investments in quoted joint ventures or associates	✓			✓	✓
IAS 27	Non-investment entities with investments in quoted subsidiaries, joint ventures and associates	✓			✓	
IFRS 3	Quoted non-controlling interest in acquiree per		✓		✓	
IFRS 3/ IFRS 10	Quoted investments held after loss of control in subsidiary, and previously held investments in step up acquisitions		✓	✓		
IAS 36	Impairment of quoted CGU when recoverable amount is fair value less cost of sale		✓		✓	