ISSUES PAPER
Measuring Quoted Investments in Subsidiaries, Joint Ventures and Associates at Fair Value

Purpose

1 Form tentative views on the measurement proposals in IASB Exposure Draft ED/2014/4 *Measuring Quoted Investments in Subsidiaries, Joint Ventures and Associates at Fair Value* and decide key comments to be raised in the AASB submission to the IASB, subject to any comments received from constituents. Staff will bring the ED back to the Board in December 2014 for discussion of other proposals, including transitional provisions and drafting concerns.

Background

2 In September 2014, the IASB issued IASB ED/2014/4 (incorporated into AASB ED 254 *Measuring Quoted Investments in Subsidiaries, Joint Ventures and Associates at Fair Value*) as part of its Fair Value Measurement: Unit of Account narrow-scope project. The ED addresses questions regarding the unit of account for financial assets that are investments in subsidiaries, joint ventures and associates measured at fair value, and clarify the fair value measurement of such investments and of qualifying portfolios that comprise only Level 1 financial instruments.

3 Investments in subsidiaries, joint ventures and associates are measured/accounted for at fair value (through profit and loss) in accordance with AASB 9 *Financial Instruments* in the following instances:

(a) in consolidated and separate financial statements, when an investment in a subsidiary is held by an investment entity (paragraph 31 of AASB 10 *Consolidated Financial Statements*, paragraph 11A of AASB 127 *Separate Financial Statements*);

(b) in consolidated and separate financial statements, when an investment in an joint venture or associate is held by, or is held indirectly through, an entity that is a venture capital organisation, or a mutual fund, unit trust or a similar entity including an investment-linked insurance fund, as an accounting policy choice (paragraph 11 of AASB 127, paragraphs 18 and 19 of AASB 128 *Investments in Associates and Joint Ventures*);

(c) where (a) and (b) do not apply, in separate financial statements, as an accounting policy choice (paragraph 10 of AASB 127); and

in addition,

(d) disclosure of the fair value of an entity's investment in a joint venture or associate is required where the joint venture or associate has been accounted for using the equity method and there is a quoted market price for the investment (paragraph 21(b) of AASB 12 *Disclosure of Interests in Other Entities*);

(e) the recoverable amount of an asset or cash-generating unit comprising or including financial assets classified as subsidiaries, associates or joint ventures may be determined on the basis of fair value less costs of disposal (paragraphs 4 and 18 of AASB 136 *Impairment of Assets*);

(f) certain investments in subsidiaries, joint ventures and associates that are held for sale are measured at fair value less costs to sell in accordance with AASB 5 *Non-current Assets Held for Sale and Discontinued Operations*; and

(g) in step acquisition activity involving obtaining control of an associate or joint venture, measurement of the fair value of the previously held equity interest is required.

The unit of account for investments in subsidiaries, joint ventures and associates is the investment, not the individual financial instruments making up the investment

4 Question 1 of the ED pertains to the unit of account for investments in subsidiaries, joint ventures and associates, as follows:

> *The IASB concluded that the unit of account for investments within the scope of IFRS 10, IAS 27 and IAS 28 is the investment as a whole rather than the individual financial instruments included within that investment (see paragraphs BC3–BC7). Do you agree with this conclusion? If not, why and what alternative do you propose?*

Preliminary staff view

5 Staff **agree** with the IASB's conclusion in that the unit of account for financial assets that are investments in subsidiaries, joint ventures and associates is the investment as a whole, and not the individual financial instruments that make up that investment. Staff **agree** with the IASB's rationale set out in paragraph BC6 to the ED that the characteristic (being the level of control or influence) of the investment highlights that the relevant unit of account in IFRS 10, IAS 27 and IAS 28 is the investment to which that key characteristic applies, instead of the individual financial instruments that make up the investment.

6 However, staff think that this view could be seen as being inconsistent with the IASB's conclusions in paragraph 19 of IAS 28. The paragraph permits an entity to measure the portion of its investment in an associate that is held indirectly through a venture capital organisation (or a mutual fund, unit trust or similar entity) at fair value through profit or loss while applying the equity method to any remaining portion of its investment. The IASB explains its rationale for its conclusions in paragraph 19 of IAS 28 in paragraphs BC20–BC22 of the Basis for Conclusions to IAS 28, which state (emphasis added in bold):

> **Exemptions from applying the equity method: partial use of fair value measurement of associates**
>
> BC20 The Board received a request to clarify whether different measurement bases can be applied to portions of an investment in an associate when part of the investment is not accounted for using the equity method in accordance with paragraph 18 of IAS 28, but it is instead measured at fair value through profit or loss in accordance with IFRS 9. The Board initially deliberated this amendment to IAS 28 as part of the Improvements to IFRSs issued in April 2010; however, at its meeting in February 2010 the Board decided to address this issue within the joint ventures project.

BC21 **The Board noted that two views exist with respect to measurement. The first view identifies all direct and indirect interests held in the associate either by the parent or through any of its subsidiaries, and then applies IAS 28 to the entire investment in the associate. In accordance with this view, there is only one investment in the associate and it should be accounted for as a single unit. The second view identifies all direct and indirect interests held in an associate, but then allows the use of the measurement exemption to portions of an investment in an associate if the portion is held by a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, regardless of whether those entities have significant influence over their portion of the investment in the associate. The Board agreed with the second view and therefore amended IAS 28.** The Board decided that equivalent guidance on the partial use of fair value for the measurement of investments in joint ventures should not be provided because the Board thought that such events would be unlikely in practice.

BC22 The Board also discussed whether the partial use of fair value should be allowed only in the case of venture capital organisations, or mutual funds, unit trusts and similar entities including investment-linked insurance funds, that have designated their portion of the investment in the associate at fair value through profit or loss in their own financial statements. The Board noted that several situations might arise in which those entities do not measure their portion of the investment in the associate at fair value through profit or loss. In those situations, however, from the group's perspective, the appropriate determination of the business purpose would lead to the measurement of this portion of the investment in the associate at fair value through profit or loss in the consolidated financial statements. Consequently, the Board decided that an entity should be able to measure a portion of an investment in an associate held by a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, at fair value through profit or loss regardless of whether this portion of the investment is measured at fair value through profit or loss in those entities' financial statements.

7 Staff think paragraph 19 of IAS 28 may be read as reflecting that there may be more than one unit of account for an investment in a subsidiary, associate or joint arrangement (but not that the unit of account is the individual financial assets making up that investment), as staff do not think it is appropriate for split measurement to be applied to a single unit of account. Staff think the IASB should consider whether its conclusion that the unit of account for an investment in a subsidiary, associate or joint venture is the investment as a whole is consistent with its existing Basis for Conclusions to IAS 28.

8 Staff think this interaction between the IASB's current and previous project is another example reflecting the Board's concern as expressed in the AASB submissions on the IASB Discussion Paper DP/2013/1 *A Review of the Conceptual Framework for Financial Reporting* that issues pertaining to 'unit of account' should not be addressed only at a standards level without conceptual underpinnings to guide those standards-level decisions.

Question to Board Members

Q1 Do Board members agree with the preliminary staff view in paragraph 5 above that the unit of account for financial assets that are investments in subsidiaries, joint ventures and associates is the investment as a whole, and not the individual financial instruments that make up that investment?

Q2 Do Board members agree that there is an inconsistency between the ED's proposals and paragraph 19 of IAS 28 that this should be highlighted as part of the AASB's submission?

9 Staff note that the ED does not propose any amendments to IFRS 10, IAS 27 or IAS 28 to clarify the Standards in this regard (that is, to address the reason the question was initially raised with the IASB). Regardless of whether the Board agrees with the staff view in paragraph 5 above, staff think that the IASB should clarify within each affected Standard its conclusion that the appropriate unit of account for financial assets that are investments in subsidiaries, joint ventures and associates is the investment as a whole.

Question to Board Members

Q3 Do Board members agree with the preliminary staff view in paragraph 9 above that the IASB should amend IFRSs to reflect its conclusion that the appropriate unit of account for financial assets that are investments in subsidiaries, joint ventures and associates is the investment as a whole?

10 Staff intend to raise further drafting concerns with the proposed amendments, including the location of the amendments, with the Board at its December 2014 meeting.

Interaction between Level 1 inputs and the unit of account for investments in subsidiaries, joint ventures and associates (P x Q)

11 Question 2 of the ED pertains to the interaction between Level 1 inputs and the unit of account for investments in subsidiaries, joint ventures and associates, as follows:

> *The IASB proposes 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 (see paragraphs BC8–BC14).*
>
> *Do you agree with the proposed amendments? If not, why and what alternative do you propose? Please explain your reasons, including commenting on the usefulness of the information provided to users of financial statements.*

Preliminary staff view

12 Staff think there are two issues here that the Board may wish to consider:

(a) whether Board members agree that P x Q be applied by an entity as its fair value measurement of quoted investments in subsidiaries, joint ventures and associates; and

(b) whether Board members agree that amendments be made to IFRS 10, IFRS 12, IAS 27 and IAS 28. Staff propose to discuss this issue at the Board's meeting in December 2014.

13 In relation to 12(a) and having regard to the investments identified in paragraph 3, staff **conditionally agree** with the IASB's proposal and rationale for determining that P x Q be applied to measure the fair value of an investment in a subsidiary, joint venture or associate that is traded in an active market. In relation to the investments identified in paragraphs 3(a), 3(b), 3(c) and 3(g) above[1], staff **agree** that P x Q is the most objective measure of the fair value of the investment, and that it provides useful information as it is reflective of the underlying economics of the entity's investment in that set of financial statements. (The staff's view is that it is possible that the 'underlying economics of the entity's investment' differs between the consolidated financial statements and separate financial statements.)

14 However, staff are **concerned** that P x Q may not be reflective of an entity's fair value when the investment is held for sale as a whole (e.g. disposal of a subsidiary), or when measuring the fair value of an equity accounted interest for the purposes of disclosure (see paragraphs 3(d) and 3(f) above). In these instances, staff think that, in accordance with paragraph 69 of IFRS 13, the characteristic of the investment asset that market participants would take into account in a transaction to acquire the asset <u>would</u> require application of an adjustment to the quoted price of an individual financial asset within that investment asset. This is because staff think the *nature* of the financial asset to the entity is different (interest in an operation vs interest in shares), and consequently the principal market in these instances should reflect market participants for the acquisition of control/significant influence of an operation/ business, as distinct from market participants such as venture capitalists and investment entities for the acquisition of a share in that operation/ business, for whom the size of the holding does not represent a characteristic of the investment. Staff do not consider P x Q to provide useful information to users of the financial statements in these instances.

15 Staff think departure from using P x Q is justifiable in the instances identified in paragraph 14 above in accordance with paragraph 79(b) of IFRS 13 as the quoted price in the active market does not represent fair value at the measurement date. Staff further consider that it is arguable that there is no active market for the (whole) investment where the relevant principal market and market participants are those entities seeking to acquire an interest in an associate, joint venture or subsidiary for the purposes of obtaining significant influence or control, rather than a marketplace where generic market participants are seeking to acquire an interest in a share of an entity. Accordingly, staff think fair value could be determined other than by reference to the available Level 1 input.

16 On balance, staff preference is for the IASB to clarify that there is no 'one size fits all' measure of fair value for investments in subsidiaries, associates and joint ventures that are quoted in an active market, as the determination of an appropriate fair value depends on the facts and circumstances of the entity. However, should the IASB proceed with its proposals in the ED and where the alternative is no guidance, staff would support the requirement to apply P x Q to the investment forms identified in paragraph 3 above, excepting paragraph 3(e) (relating to recoverable amount of a

1 Investments in subsidiaries, joint ventures or associates measured at fair value, whether as directed by an Accounting Standard (e.g. as held by an investment entity) or as an accounting policy choice.

quoted cash-generating unit), as staff consider that P x Q provides the most objective evidence of the fair value of the investment asset.

> **Question to Board Members**
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> Q4 Do Board members agree with the preliminary staff view in paragraphs 13-16 that P x Q is appropriate for determining the fair value of subsidiaries, associates and joint ventures that are quoted in an active market in only certain instances, and with the staff recommendation in paragraph 16 for the IASB to instead clarify that there is no 'one size fits all' measure of fair value for investments in subsidiaries, associates and joint ventures that are quoted in an active market?
>
> Q5 Do Board members support measuring the fair value of quoted investments in subsidiaries, joint ventures and associates as P x Q without adjustment, should the IASB proceed with the ED's proposals?

Measuring the fair value of a cash-generating unit that corresponds to a quoted entity

17 Question 3 of the ED pertains to the measurement of the fair value of a CGU that corresponds to a quoted entity, as follows:

> *The IASB proposes to align the fair value measurement of a quoted CGU to the fair value measurement of a quoted investment. It proposes to amend 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 (see paragraphs BC15–BC19). To determine fair value less costs of disposal, disposal costs are deducted from the fair value amount measured on this basis.*
>
> *Do you agree with the proposed amendments? If not, why and what alternative do you propose?*

Preliminary staff view

18 Staff **disagree** with the proposed amendment. Staff think that for recoverable amount assessment purposes, the unit of account is identified by IAS 36 and may differ from that identified in accordance with other IFRSs.

19 Staff **agree** that in separate financial statements, the appropriate unit of account identified by IAS 36 in respect of a parent's investment in a subsidiary, associate or joint venture measured on the cost basis[2] is the investment asset (comprising a number of identical quoted financial instruments) as a whole. In this instance, staff consider that it would be appropriate that the fair value less costs of disposal of the investment be measured at P x Q less costs of disposal, consistent with the staff view noted in paragraph 13 above that, for that set of financial statements, P x Q is the most objective measure of the fair value of the investment and provides useful information as it is reflective of the underlying economics of the entity's investment. Staff note that measurement at P x Q may require an entity to recognise an impairment of a recently acquired investment in a subsidiary, associate or joint venture, where the

2 An investment in a subsidiary, associate or joint venture measured at fair value in accordance with IFRS 10, IAS 27 or IAS 28 is outside the scope of IAS 36.

transaction price (which may include a premium to market) is not the same as the fair value of the quoted financial asset (P x Q).

20 In contrast, staff think that in respect of a subsidiary that is consolidated (regardless whether quoted in an active market) and that is itself a stand-alone CGU, the appropriate unit of account identified by IAS 36 is the cash-generating unit as represented by the group of assets and liabilities operating together to generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets. Staff **disagree** with the view implicit in P x Q that the cash-generating unit is the investment as represented by a number of identical quoted financial instruments.

21 Accordingly, staff think it is **inappropriate** for fair value less costs of disposal of a quoted CGU to be determined as P x Q as the 'investment asset' itself does not exist for the purposes of the consolidated financial statements. Further, staff think that requiring P x Q in this instance:

(a) creates further complexities in determining the recoverable amount of a CGU, for example, where a division of a listed subsidiary is a separate CGU to the consolidated entity; and

(b) will result in impairment (where recoverable amount is determined on the basis of fair value less costs of disposal) of a recently acquired subsidiary acquired at a premium to market price.

Staff think the fair value of a quoted CGU should be determined in a manner consistent with that described in paragraphs 14-15 above in respect of the investments identified in paragraphs 3(d) and 3(f) above.

22 In respect of an investment in an associate or joint venture that applies the equity method of accounting, staff think that, as in separate financial statements, the appropriate unit of account identified by IAS 36 is the equity accounted investment (comprising a number of identical quoted financial instruments) as a whole. In these instances, staff think fair value (less costs of disposal) should be measured in a consistent manner to that proposed in paragraphs 14-15 above.

Question to Board Members

Q6 Do Board members agree with the preliminary staff view in paragraphs 18-22 that P x Q is appropriate for determining the fair value less costs of disposal of subsidiaries, associates and joint ventures that are quoted in an active market in only certain instances?

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

23 The IASB ED also addresses whether the portfolio exception in paragraph 48 of IFRS 13 can be applied where an entity holds a portfolio of listed financial instruments categorised within Level 1 of the fair value hierarchy, and how fair value should be determined in respect of the financial instruments making up that portfolio. Question 4 of the ED pertains to the measurement of the fair value of a portfolio of listed financial instruments when the portfolio exception is applied, as follows:

> *The IASB proposes to include an illustrative example to IFRS 13 to illustrate the application of paragraph 48 of that Standard to a group of financial assets and financial liabilities whose market risks are substantially the same and whose fair value measurement is categorised within Level 1 of the fair value hierarchy. The example illustrates that the fair value of an entity's net exposure to market risks arising from such a group of financial assets and financial liabilities is to be measured in accordance with the corresponding Level 1 prices.*
>
> *Do you think that the proposed additional illustrative example for IFRS 13 illustrates the application of paragraph 48 of IFRS 13? If not, why and what alternative do you propose?*

Preliminary staff view

24 Staff support the application of the exception in paragraph 48 of IFRS 13 to a group of financial assets and financial liabilities whose market risks are substantially the same and whose fair value measurement is categorised within Level 1 of the fair value hierarchy. Staff **agree** with the IASB's conclusion to require fair value be measured by measuring the net risk exposure by considering the number of financial instruments that make up the net position multiplied by the corresponding Level 1 prices.

25 Staff also **agree** with the inclusion of an Illustrative Example to IFRS 13 (note: the Illustrative Examples to IFRS 13 are not incorporated into AASB 13) and consider that it illustrates the application of paragraph 48 of IFRS 13. Staff note that the Illustrative Example also reflects the application of paragraph 50 of IFRS 13 that the basis of presentation may differ from the basis of measurement.

26 However, staff think the AASB submission should also include a recommendation that the Application Guidance to IFRS 13 also be amended to ensure clarification is made as part of the mandatory IFRS 13 material.

Question to Board Members

Q7 Do Board members agree with the preliminary staff views in paragraphs 24-26 above?

APPENDIX: Relevant extracts from Accounting Standards

IFRS 13 *Fair Value Measurement* (and AASB 13 of the same name)

11 A fair value measurement is for a particular asset or liability. Therefore, when measuring fair value an entity shall take into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Such characteristics include, for example, the following:

(a) the condition and location of the asset; and
(b) restrictions, if any, on the sale or use of the asset.

12 The effect on the measurement arising from a particular characteristic will differ depending on how that characteristic would be taken into account by market participants.

13 The asset or liability measured at fair value might be either of the following:
(a) a stand-alone asset or liability (eg a financial instrument or a non-financial asset); or
(b) a group of assets, a group of liabilities or a group of assets and liabilities (eg a cash-generating unit or a business).

14 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.

69 An entity shall select inputs that are consistent with the characteristics of the asset or liability that market participants would take into account in a transaction for the asset or liability (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.

Level 1 inputs

76 Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.

77 A quoted price in an active market provides the most reliable evidence of fair value and shall be used without adjustment to measure fair value whenever available, except as specified in paragraph 79.

78 A Level 1 input will be available for many financial assets and financial liabilities, some of which might be exchanged in multiple active markets (eg on different exchanges). Therefore, the emphasis within Level 1 is on determining both of the following:

(a) the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability; and

(b) whether the entity can enter into a transaction for the asset or liability at the price in that market at the measurement date.

79 An entity shall not make an adjustment to a Level 1 input except in the following circumstances:

(a) when an entity holds a large number of similar (but not identical) assets or liabilities (eg debt securities) that are measured at fair value and a quoted price in an active market is available but not readily accessible for each of those assets or liabilities individually (ie given the large number of similar assets or liabilities held by the entity, it would be difficult to obtain pricing information for each individual asset or liability at the measurement date). In that case, as a practical expedient, an entity may measure fair value using an alternative pricing method that does not rely exclusively on quoted prices (eg matrix pricing). However, the use of an alternative pricing method results in a fair value measurement categorised within a lower level of the fair value hierarchy.

(b) when a quoted price in an active market does not represent fair value at the measurement date. That might be the case if, for example, significant events (such as transactions in a principal-to-principal market, trades in a brokered market or announcements) take place after the close of a market but before the measurement date. An entity shall establish and consistently apply a policy for identifying those events that might affect fair value measurements. However, if the quoted price is adjusted for new information, the adjustment results in a fair value measurement categorised within a lower level of the fair value hierarchy.

(c) when measuring the fair value of a liability or an entity's own equity instrument using the quoted price for the identical item traded as an asset in an active market and that price needs to be adjusted for factors specific to the item or the asset (see paragraph 39). If no adjustment to the quoted price of the asset is required, the result is a fair value measurement categorised within Level 1 of the fair value hierarchy. However, any adjustment to the quoted price of the asset results in a fair value measurement categorised within a lower level of the fair value hierarchy.

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