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

Purpose

1 Form views on the remaining 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. As at 2 December 2014, no submissions on AASB Exposure Draft ED 254 *Measuring Quoted Investments in Subsidiaries, Joint Ventures and Associates at Fair Value* have yet been received. Staff will communicate feedback from subsequent submissions received to the Board at this meeting.

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.

Tentative Board decisions on IASB ED/2014/4

3 At its meeting in October 2014, the Board considered the measurement proposals of IASB ED/2014/4 and formed the tentative decisions noted in paragraphs 4 – 7 below pertaining to IASB Questions 1–4.[1]

4 In respect of the appropriate unit of account, the Board tentatively agreed:

(a) with the IASB's proposal that the unit of account for investments in subsidiaries, joint ventures and associates is the investment as a whole;

(b) there is a conceptual inconsistency between the ED proposals and paragraph 19 of IAS 28 that should be included as part of a general comment in the AASB's submission that the unit of account should be considered at a conceptual level rather than as a standards-level project; and

(c) that the IASB's conclusion as to the appropriate unit of account should be reflected within the affected Standards. The Board asked staff to give consideration to the inconsistency in IAS 28 noted above when drafting this aspect of the submission.

5 However, having concluded that the unit of account is the investment as a whole, the Board expressed concern as to the relevance of using, for quoted investments, the quoted price (P) multiplied by the quantity of financial instruments held (Q)

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1 Link to Agenda Paper 10.2 from the October 2014 AASB meeting: http://www.aasb.gov.au/admin/file/content102/c3/M141_10.2_Issues_Paper_Measuring_Quoted_Investments_in_Subsidiaries_Joint_Ventures_and_Associates_at_Fair_Value.pdf

[i.e. (P x Q)] without adjustments, in measuring the fair value of such investments. The Board tentatively decided that the unadjusted amount of P x Q might not reflect the fair value of an investment held for sale as a whole, as it would not take into account the characteristics that market participants would consider in pricing an investment that provides control or significant influence. The Board, however, acknowledged the objective and verifiable nature of quoted prices as Level 1 inputs, consistent with the AASB 13 *Fair Value Measurement* principle of maximising the use of observable inputs.

6 The Board tentatively disagreed with the proposal that the recoverable amount of a cash-generating unit that corresponds to a quoted entity measured on the basis of fair value less costs of disposal should be measured as P x Q. The Board noted that it would disagree with this proposal regardless of whether the IASB proceeds with its proposal to require P x Q for measuring the fair value for investments in subsidiaries, joint ventures and associates.

7 The Board also considered 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. The Board tentatively agreed with:

(a) the IASB's conclusion to require fair value to be measured by measuring the net risk exposure and considering the number of financial instruments that make up the net position multiplied by the corresponding Level 1 prices; and

(b) the inclusion of an Illustrative Example to IFRS 13 to illustrate the application of paragraph 48 of IFRS 13. The Board tentatively agreed to recommend to the IASB that the Application Guidance to IFRS 13 be amended to ensure clarification is made as part of the mandatory IFRS 13 material.

Question to Board Members

Q1 Do Board members agree to confirm their previous tentative decisions as described in paragraphs 4 – 7 above?

8 In view of the Board's tentative decisions noted in paragraph 5 above, staff wish to identify whether Board members are intending to dissent from an Australian amending standard that introduces a requirement to apply P x Q as the fair value measurement of quoted investments in subsidiaries, joint ventures and associates should the IASB decide, after its redeliberations on the ED, to finalise its proposals in this regard.

Question to Board Members

Q2 Are there any Board member that are intending to dissent from the issue of an Australian amending standard incorporating these proposals, should the IASB proceed with them?

Further IASB ED/2014/4 proposals

Question 2: Location of the proposals

9 At the October 2014 meeting, staff noted two separate aspects relating to Question 2 of the ED for the Board's consideration:

(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 – discussed by the Board at the October 2014 meeting; and

(b) whether Board members agree that amendments be made only to IFRS 10 *Consolidated Financial Statements*, IFRS 12 *Disclosures of Interests in Other Entities*, IAS 27 *Separate Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures* to reflect the IASB's conclusions in this regard – discussed below.

Preliminary staff view

10 Staff **disagree** with the IASB proposal not to amend IFRS 13 to reflect the IASB's conclusions for an entity to apply P x Q as its fair value measurement of its quoted investments in subsidiaries, joint ventures and associates. Staff consider that IFRS 13 should be amended for this matter as:

(a) amending IFRS 13 is consistent with an objective of IFRS 13 being to "set out in a single IFRS a framework for measuring fair value" (IFRS 13.1(b)); and

(b) the issue giving rise to the ED results from the different interpretations of the requirements in paragraphs 69 and 80 of IFRS 13 – the ambiguity in the application of these paragraphs will remain if the Standard itself is not amended.

11 Staff do not think it is necessary to amend IFRS 10, IFRS 12, IAS 27 and IAS 28 in addition to amending IFRS 13. (However, staff agree with the AASB's tentative decision from its October 2014 meeting to amend IFRS 10, IAS 27 and IAS 28 to reflect 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 views in paragraphs 10 – 11?

Question 5: Transitional proposals

12 Question 5 of the ED pertains to the proposed transitional provisions for the amendments, as follows:

> *The IASB proposes that for the amendments to IFRS 10, IAS 27 and IAS 28, an entity should adjust its opening retained earnings, or other component of equity, as appropriate, to account for any difference between the previous carrying amount of the quoted investment(s) in subsidiaries, joint ventures or associates and the carrying amount of those quoted investment(s) at the beginning of the reporting period in which*

the amendments are applied. The IASB proposes that the amendments to IFRS 12 and IAS 36 should be applied prospectively.

The IASB also proposes disclosure requirements on transition (see paragraphs BC32–BC33) and to permit early application (see paragraph BC35).

Do you agree with the transition methods proposed (see paragraphs BC30–BC35)? If not, why and what alternative do you propose?

Preliminary staff view

13 Staff considered the transitional provisions having regard to if the IASB were to proceed with its amendments as exposed, the Board's tentative decisions on the ED to date, and the other preliminary staff views set out in this paper.

14 With respect to the amendments to IFRS 10, IAS 27 and IAS 28, staff **agree** with the proposed requirement to disclose the effect of the amendments on transition. However, staff **disagree** with the proposed transitional provisions to require adjustment be made to opening retained earnings (or other component of equity, as appropriate) at the beginning of the reporting period in which the amendments are applied, for the following reasons:

(a) to the extent the proposed amendments are a clarification of the most appropriate valuation technique, staff consider the proposed transitional provisions to be inconsistent with paragraphs 65-66 of IFRS 13 (AASB 13)[2], which require revisions to valuation techniques or its application to be accounted for as a change in accounting estimate. Staff also note that the IASB has drawn a similarity between these fair value measurement proposals and changes arising on implementation of IFRS 13 (see BC30 of the ED), and that the transitional provisions of IFRS 13 (AASB 13)[2] do not permit adjustment to be made to opening retained earnings on initial adoption of the Standard;

(b) to the extent the proposed amendments are considered to reflect an entity's error in applying IFRS 13, staff think that full retrospective restatement (limited by the prospective application required on adoption of IFRS 13) of prior periods, rather than the limited retrospective application proposed, should be required, especially in the event IASB proceeds with its measurement proposals as exposed (P x Q).

15 Staff also **disagree** with the proposed transitional provisions to IFRS 12 to apply the amendments to IFRS 12 prospectively (that is, not to restate the fair value disclosed in the comparative period). Staff do not think that the proposed transitional provisions are necessary, as:

(a) to the extent the proposed amendments are a clarification of the most appropriate valuation technique to be treated as a change in accounting estimate, staff think that the disclosures specified by paragraph 97 of IFRS 13 (AASB 13)[2] provide sufficient information to users that the basis of measuring the fair value of an investment in a joint venture or associate has changed from

2 Refer to the Appendix in this paper.

the previous reporting period (however, staff note that these paragraphs do not apply to an Australian entity complying with only Tier 2 reporting requirements);

(b) to the extent the proposed amendments are considered to reflect entity error in application of IFRS 13, staff think that full retrospective restatement (limited by the transitional provisions of IFRS 13) of the prior period disclosure should be required.

16 Staff **agree** with the proposed transitional provisions to IAS 36, should the IASB proceed with its proposed amendments to IAS 36 to require that the fair value less costs of disposal of a cash-generating unit that corresponds to a quoted investment in a subsidiary, joint venture or associate be measured as P x Q less disposal costs.

17 Staff **support** allowing earlier application of the amendments, when finalised. Staff note that any early application would have to be in the context of IFRS 13 also having been adopted for that earlier period.

Question to Board Members

Q4 Do Board members agree with the preliminary staff views in paragraphs 14 – 17?

Other matters

18 Staff think it is unclear from paragraph BC14 of the ED whether the IASB intends for its conclusions on fair value measurement to also apply, or not to apply, to the fair value measurement of non-controlling interests or previously held equity investments quoted in an active market. Regardless of whether amendment is made to IFRS 3, staff think that it would be inconsistent for the fair value measurement of such interests to be treated differently to the measurement of investments in subsidiaries, joint ventures and associates. Similarly, staff think that it would be inconsistent if the same rules did not apply to investments in subsidiaries, joint ventures or associates classified as held for sale and measured at fair value less costs to sell.

19 The ED proposes to add footnotes (or add to existing footnotes) to the Basis for Conclusions to IFRS 10, IAS 27, IAS 28 and IAS 36 to reflect its proposed amendments. Staff think that these amendments are unnecessary as the footnotes largely repeat, without adding to, the proposed amendments. Staff are also unclear as to the IASB's rationale for proposing amendments to the respective Basis for Conclusions as the IASB's conclusions in this regard have not affected its previous conclusions when making these Standards.

Question to Board Members

Q5 Do Board members agree with the preliminary staff views in paragraphs 18 – 19?

APPENDIX: Relevant Extracts from AASB 13

1 This Standard:

(a) defines *fair value*;

(b) sets out in a single Standard a framework for measuring fair value; and

(c) requires disclosures about fair value measurements.

65 Valuation techniques used to measure fair value shall be applied consistently. However, a change in a valuation technique or its application (eg a change in its weighting when multiple valuation techniques are used or a change in an adjustment applied to a valuation technique) is appropriate if the change results in a measurement that is equally or more representative of fair value in the circumstances. That might be the case if, for example, any of the following events take place:

(a) new markets develop;

(b) new information becomes available;

(c) information previously used is no longer available;

(d) valuation techniques improve; or

(e) market conditions change.

66 Revisions resulting from a change in the valuation technique or its application shall be accounted for as a change in accounting estimate in accordance with AASB 108. However, the disclosures in AASB 108 for a change in accounting estimate are not required for revisions resulting from a change in a valuation technique or its application.

93 To meet the objectives in paragraph 91, an entity shall disclose, at a minimum, the following information for each class of assets and liabilities (see paragraph 94 for information on determining appropriate classes of assets and liabilities) measured at fair value (including measurements based on fair value within the scope of this Standard) in the statement of financial position after initial recognition:

(a) …

(b) for recurring and non-recurring fair value measurements, the level of the fair value hierarchy within which the fair value measurements are categorised in their entirety (Level 1, 2 or 3).

(c) …

(d) for recurring and non-recurring fair value measurements categorised within Level 2 and Level 3 of the fair value hierarchy, a description of the valuation technique(s) and the inputs used in the fair value measurement. If there has been a change in valuation technique (eg changing from a market approach to an income approach or the use of an additional valuation technique), the entity

shall disclose that change and the reason(s) for making it. For fair value measurements categorised within Level 3 of the fair value hierarchy, an entity shall provide quantitative information about the significant unobservable inputs used in the fair value measurement. An entity is not required to create quantitative information to comply with this disclosure requirement if quantitative unobservable inputs are not developed by the entity when measuring fair value (eg when an entity uses prices from prior transactions or third-party pricing information without adjustment). However, when providing this disclosure an entity cannot ignore quantitative unobservable inputs that are significant to the fair value measurement and are reasonably available to the entity.

(e) …

(i) for recurring and non-recurring fair value measurements, if the highest and best use of a non-financial asset differs from its current use, an entity shall disclose that fact and why the non-financial asset is being used in a manner that differs from its highest and best use.

97 For each class of assets and liabilities not measured at fair value in the statement of financial position but for which the fair value is disclosed, an entity shall disclose the information required by paragraph 93(b), (d) and (i). However, an entity is not required to provide the quantitative disclosures about significant unobservable inputs used in fair value measurements categorised within Level 3 of the fair value hierarchy required by paragraph 93(d). For such assets and liabilities, an entity does not need to provide the other disclosures required by this Standard.

C2 This Standard shall be applied prospectively as of the beginning of the annual reporting period in which it is initially applied.