

## IFRS Developments

# IASB to clarify interaction between unit of account and fair value measurement requirements

### What you need to know

At their March 2013 meeting, the IASB tentatively decided to issue an exposure draft to clarify that:

- ▶ The unit of account for investments in subsidiaries, joint ventures and associates is the investment as a whole.
- ▶ The requirement to measure fair value using a quoted price in an active market, if available, would override the unit of account for listed subsidiaries, joint ventures, associates and CGUs.

### Highlights

The International Accounting Standards Board (IASB or Board) was asked to address questions about the unit of account for investments in subsidiaries, joint ventures and associates measured at fair value in accordance with IFRS 13 *Fair Value Measurement*. In particular, the Board was asked to consider whether the fair value of such investments should reflect assumptions that are consistent with the investment as a whole, or each individual financial instrument contained within that investment.

At their meeting in March 2013, the IASB tentatively decided the following:

- ▶ The unit of account for investments in subsidiaries, joint ventures and associates is the investment as whole.
- ▶ When a quoted price in an active market is available for the individual financial instruments that comprise the entire investment, the fair value measurement is the product of the quoted price of the financial instrument (P) multiplied by the quantity (Q) of instruments held (i.e., price x quantity,  $P \times Q$ ).
- ▶ When testing cash generating units (CGUs) for impairment, if they correspond to an entity whose financial instruments are quoted in an active market, the fair value measurement is the product of  $P \times Q$ .

## Unit of account for investments in subsidiaries, joint ventures and associates

The identification of what constitutes the asset or liability to be measured is fundamental to determining its fair value. Fair value may need to be measured for either:

- ▶ A stand-alone asset or liability (e.g., a financial instrument)

Or

- ▶ A group of assets, a group of liabilities, or a group of assets and liabilities (e.g., a CGU or a business)

What is measured depends on the unit of account for the asset or liability. Unit of account is an accounting concept that determines the level at which an asset or liability is aggregated or disaggregated for the purposes of applying IFRS 13 and other standards.

Unless specifically addressed in IFRS 13, the appropriate unit of account is determined by the standard that permits or requires the fair value measurement or disclosure.

For investments in subsidiaries, joint ventures and associates, an entity needs to look to IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements*, IAS 27 *Separate Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures* to determine the relevant unit of account. However, these standards do not provide explicit guidance on the relevant unit of account. In addition, the measurement requirements in IFRS 10, IAS 27 and IAS 28 refer to IFRS 9 *Financial Instruments*, permitting or requiring an investment to be accounted for in accordance with that standard in certain circumstances. This has led to questions about the extent to which IFRS 9's requirements apply. Would only the measurement basis specified in IFRS 9 (i.e., fair value through profit or loss) apply or would IFRS 9 also prescribe the unit of account (i.e., the individual financial instrument(s) that comprise the investment as a whole)?

At its March 2013 meeting, the IASB tentatively decided that the unit of account for investments in subsidiaries, joint ventures and associates is the investment as whole, and not the individual financial assets and/or liabilities that constitute the investment.

## Interaction between unit of account and IFRS 13's measurement requirements

### Investments in subsidiaries, joint ventures and associates

When an entity holds a position in a single asset or liability that is traded in an active market (including a position comprising a large number of identical assets or liabilities), IFRS 13 requires an entity to measure fair value using that price, without adjustment.

This requirement is accepted when the asset or liability being measured is a financial instrument in the scope of IFRS 9 or IAS 39 *Financial Instruments: Recognition and Measurement*. However, when an entity holds an investment in a subsidiary, joint venture or associate, some believe the fair value should include an adjustment (e.g., a control premium) to reflect the value of the investor's control, joint control or significant influence over its investment as a whole.

IFRS 13 requires entities to select inputs that are consistent with the characteristics of the asset or liability being measured and would be considered by market participants when pricing the asset or liability. Apart from block discounts (which are specifically prohibited), determining whether a premium or discount applies to a particular fair value measurement requires judgement and depends on specific facts and circumstances.

The IASB plans to clarify that the unit of account is the investment as a whole for subsidiaries, joint ventures and associates

For listed investments and CGUs, the requirement in IFRS 13 to use P x Q would apply even if the unit of account is the entire investment

The standard indicates that premiums or discounts should not be incorporated in fair value measurements unless all of the following conditions are met:

- ▶ The application of the premium or discount reflects the characteristics of the asset or liability being measured
- ▶ Market participants, acting in their 'economic best interest', would consider that premium or discount when pricing the asset or liability
- ▶ The inclusion of the premium or discount is not inconsistent with the unit of account in the IFRS that requires or permits the fair value measurement

If the unit of account is the investment as a whole, it would be appropriate to include a control premium (or similar) when determining fair value provided that market participants take this into consideration when pricing the asset.

However, an issue arises if a quoted price in an active market is available. Would the requirement to use P x Q, without adjustment, to measure fair value override the requirements related to premiums or discounts even in situations where the unit of account is the entire investment? The Board was specifically asked to clarify this for listed investments.

The IASB tentatively decided that for investments comprised of financial instruments, for which a quoted price in an active market is available, the requirement to use P x Q takes precedence. Therefore, for these investments, the fair value measurement is the product of the quoted price multiplied by the quantity held, even when the reporting entity has a controlling interest (or similar) in the investment. This is generally consistent with the current treatment under US GAAP.

In making this tentative decision, the IASB noted that quoted prices in an active market provide the most reliable evidence of fair value.

#### **CGUs that correspond to an entity whose financial instruments are quoted in an active market**

When testing for impairment in accordance with IAS 36, the recoverable amount of a CGU is the higher of its value in use or fair value less costs of disposal. The fair value component of fair value less costs of disposal is required to be measured in accordance with IFRS 13.

When a CGU corresponds to a listed entity, the same issue of whether the requirement to use P x Q, without adjustment, to measure fair value arises.

Consistent with its decision in relation to listed investments in subsidiaries, joint ventures and associates, the IASB has tentatively decided that, if the CGUs correspond to an entity whose financial instruments are quoted in an active market, the requirement to use P x Q will apply.

In making its tentative decision, the Board noted a potential difference between IFRS and US GAAP. US GAAP specifically notes that the fair value of a reporting unit may not necessarily equal its market cap. While a difference would exist, the Board noted that, unlike US GAAP, IAS 36 permits the recoverable amount of a CGU to be determined based on either its fair value less costs of disposal or its value in use.

### How we see it

Many argue that the requirement to use P x Q, without adjustment, to measure the fair value of listed investments in subsidiaries, joint ventures, associates and CGUs already exists in IFRS 13. If IFRS 13 is amended to incorporate the Board's March 2013 tentative decisions, the IASB will provide the additional necessary clarification.

However, this requirement may still seem counterintuitive to many preparers. We encourage constituents to take the opportunity to respond to the Board when it issues the exposure draft.

### Next Steps

The staff intends to prepare an exposure draft of proposed amendments to IFRS 13, which is expected to be issued in late Q2 or early Q3 2013.

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EYG no. AU1574

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