Measuring the fair value of investments in subsidiaries, JVs and associates

Proposals rule out premiums for quoted investments

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IN THE HEADLINES

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> “Measuring the fair value of an investment based on a quoted price is a straightforward approach – but does it provide the best answer for users of financial statements?”

– Chris Spall
KPMG’s global IFRS financial instruments leader

Diversity in fair value measurement for certain investments

There has been diversity in practice regarding the unit of account used to measure the fair value of investments in subsidiaries, joint ventures (JVs) and associates: the investment as a whole or the individual shares making up the investment.

This issue is important because if the unit of account is an individual share, then it cannot be argued that a premium or discount related to the size of the holding – e.g. a control premium – should be included in the measurement of fair value. However, if the unit of account is the investment as a whole, then it may be appropriate to add a control (or other) premium.

In an attempt to introduce clarity, on 16 September 2014 the IASB published an exposure draft[1] dealing with investments in subsidiaries, JVs and associates that are quoted in an active market – i.e. Level 1 instruments in the fair value hierarchy under IFRS 13 *Fair Value Measurement*.

1 ED/2014/4 *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).*

Fair value of quoted investments would be PxQ

Under the proposals, the unit of account for such investments would be the investment as a whole. However, fair value would still be measured as the product (P×Q) of the quoted price of the financial instrument (P) and the quantity (Q) of instruments held. This guidance would also apply to measuring the fair value less costs of disposal of a cash-generating unit (CGU) that corresponds to a quoted investment in a subsidiary, JV or associate when assessing the CGU for impairment.

The Board’s reasoning is that fair value measurements are more relevant, objective and verifiable when they are based on unadjusted Level 1 inputs. In responding to the proposals, the issue for constituents to consider is whether a PxQ measurement is consistent with identifying the investment as a whole as the unit of account – and whether this is the best information for users of financial statements.

Who and what could be impacted?

Sector	How?
Investment entities, venture capitalists and similar organisations	Fair value measurements in the financial statements
All sectors	• Impairment loss calculations, when recoverable amount is based on fair value less costs of disposal • Fair value measurements in the separate financial statements, if such investments are measured at fair value

The proposals could result in lower fair value measurements, with a consequential impact on profit or loss, if a control or similar premium is disregarded.

Implications for fair value measurements of unquoted investments

The Board’s reasoning that the unit of account for an investment in a subsidiary, JV or associate is the whole investment appears to indicate that, if the investment is not quoted, then fair value would be based on an exit price for the whole investment – i.e. the size of the investment could affect the fair value measurement if a market participant would consider it to be a relevant characteristic in pricing the investment.

Example added for portfolio measurement

If certain conditions are met, then IFRS 13 permits an entity to measure the fair value of a group of financial assets and financial liabilities with offsetting risk positions on the basis of its net exposure (the ‘portfolio measurement exception’). The proposals illustrate the measurement of a group that comprises only financial instruments with offsetting market risks that are all quoted in an active market. In the example, fair value is measured based on the Level 1 prices of the instruments that make up the net risk exposure. Therefore, under the proposals, it would not be acceptable to adjust the fair value of such a portfolio’s net exposure for premiums or discounts.

Next steps

Companies should consider whether the proposals could trigger a potential change in valuation methodology. Comments are due to the IASB by 16 January 2015. For more information, go to the IASB’s press release or speak to your usual KPMG contact.

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