

IFRS 13 Fair Value Measurement

Background



- ☐ IFRS 13 was first issued in May 2011 with an effective date of 1st January 2013
- ☐ Further amendments were made in 2013

Objective

IFRS 13:

- ☐ defines fair value
- ☐ sets out in a single IFRS a framework for measuring fair value
- ☐ requires disclosures about fair value measurements

Background (Cont'd)



- ❑ IFRS 13 applies when another IFRS requires or permits fair value measurements or disclosures about fair value measurements (and measurements, such as fair value less costs to sell, based on fair value or disclosures about those measurements), except for:
 - ❑ share-based payment transactions within the scope of IFRS 2 Share-based Payment
 - ❑ leasing transactions within the scope of IAS 17 Leases
 - ❑ measurements that have some similarities to fair value but that are not fair value, such as net realisable value in IAS 2 Inventories or value in use in IAS 36 Impairment of Assets

Key Definitions



- ❑ **Fair value:** The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date
- ❑ **Active market:** A market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis
- ❑ **Exit price:** The price that would be received to sell an asset or paid to transfer a liability
- ❑ **Highest and best use:** The use of a non-financial asset by market participants that would maximise the value of the asset or the group of assets and liabilities (e.g. a business) within which the asset would be used
- ❑ **Most advantageous market:** The market that maximises the amount that would be received to sell the asset or minimises the amount that would be paid to transfer the liability, after taking into account transaction costs and transport costs
- ❑ **Principal market:** The market with the greatest volume and level of activity for the asset or liability

Fair Value Hierarchy



- ❑ Basis for the hierarchy
- ❑ FRS 13 seeks to increase consistency and comparability in fair value measurements and related disclosures through a 'fair value hierarchy'. The hierarchy categorises the inputs used in valuation techniques into three levels. The hierarchy gives the highest priority to (unadjusted) quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs
- ❑ If the inputs used to measure fair value are categorised into different levels of the fair value hierarchy, the fair value measurement is categorised in its entirety in the level of the lowest level input that is significant to the entire measurement (based on the application of judgement)

Fair Value Hierarchy (Cont'd)



❑ Level 1 Inputs

- ❑ Level 1 inputs are quoted prices in active markets for identical assets or liabilities that the entity can access at the measurement date. If the inputs used to measure fair value are categorised into different levels of the fair value hierarchy, the fair value measurement is categorised in its entirety in the level of the lowest level input that is significant to the entire measurement (based on the application of judgement).
- ❑ A quoted market price in an active market provides the most reliable evidence of fair value and is used without adjustment to measure fair value whenever available, with limited exceptions.
- ❑ If an entity holds a position in a single asset or liability and the asset or liability is traded in an active market, the fair value of the asset or liability is measured within Level 1 as the product of the quoted price for the individual asset or liability and the quantity held by the entity, even if the 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.

Fair Value Hierarchy (Cont'd)



☐ Level 2 Inputs

- ☐ Level 2 inputs are inputs other than quoted market prices included within Level 1 that are observable for the asset or liability, either directly or indirectly

Level 2 inputs include:

- ☐ quoted prices for similar assets or liabilities in active markets
- ☐ quoted prices for identical or similar assets or liabilities in markets that are not active
- ☐ inputs other than quoted prices that are observable for the asset or liability, for example
 - ☐ interest rates and yield curves observable at commonly quoted intervals
 - ☐ implied volatilities
 - ☐ credit spreads
- ☐ Inputs that are derived principally from or corroborated by observable market data by correlation or other means ('market-corroborated inputs').

Fair Value Hierarchy (Cont'd)



☐ Level 3 Inputs

☐ Level 3 inputs are unobservable inputs for the asset or liability

☐ Unobservable inputs are used to measure fair value to the extent that relevant observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. An entity develops unobservable inputs using the best information available in the circumstances, which might include the entity's own data, taking into account all information about market participant assumptions that is reasonably available

Measurement of Fair Value



Overview of fair value measurement approach

- ☐ The objective of a fair value measurement is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions. A fair value measurement requires an entity to determine all of the following:
 - ☐ the particular asset or liability that is the subject of the measurement (consistently with its unit of account)
 - ☐ for a non-financial asset, the valuation premise that is appropriate for the measurement (consistently with its highest and best use)
 - ☐ the principal (or most advantageous) market for the asset or liability

Measurement of Fair Value (Cont'd)



Overview of fair value measurement approach (Cont'd)

- ❑ the valuation technique(s) appropriate for the measurement, considering the availability of data with which to develop inputs that represent the assumptions that market participants would use when pricing the asset or liability and the level of the fair value hierarchy within which the inputs are categorised.

Measurement of Fair Value (Cont'd)



Guidance on Measurement

- ❑ IFRS 13 provides the guidance on the measurement of fair value, including the following:
 - ❑ An entity takes into account the characteristics of the asset or liability being measured that a market participant would take into account when pricing the asset or liability at measurement date (e.g. the condition and location of the asset and any restrictions on the sale and use of the asset)
 - ❑ Fair value measurement assumes an orderly transaction between market participants at the measurement date under current market conditions
 - ❑ Fair value measurement assumes a transaction taking place in 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

Measurement of Fair Value (Cont'd)



Guidance on Measurement (Cont'd)

- ❑ IFRS 13 provides the guidance on the measurement of fair value, including the following:
 - ❑ A fair value measurement of a non-financial asset takes into account its highest and best use
 - ❑ A fair value measurement of a financial or non-financial liability or an entity's own equity instruments assumes it is transferred to a market participant at the measurement date, without settlement, extinguishment, or cancellation at the measurement date
 - ❑ The fair value of a liability reflects non-performance risk (the risk the entity will not fulfil an obligation), including an entity's own credit risk and assuming the same non-performance risk before and after the transfer of the liability
 - ❑ An optional exception applies for certain financial assets and financial liabilities with offsetting positions in market risks or counterparty credit risk, provided conditions are met (additional disclosure is required)

Valuation Techniques



- ❑ An entity uses valuation techniques appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs
- ❑ The objective of using a valuation technique is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants and the measurement date under current market conditions.

Three widely used valuation techniques are:

- ❑ **market approach** – uses prices and other relevant information generated by market transactions involving identical or comparable (similar) assets, liabilities, or a group of assets and liabilities (e.g. a business)

Valuation Techniques (Cont'd)



- ❑ **Cost approach** – reflects the amount that would be required currently to replace the service capacity of an asset (current replacement cost)

- ❑ **Income approach** – converts future amounts (cash flows or income and expenses) to a single current (discounted) amount, reflecting current market expectations about those future amounts.

- ❑ In some cases, a single valuation technique will be appropriate, whereas in others multiple valuation techniques will be appropriate

Example (Land)



- ❑ An entity acquires land in a business combination. The land is currently developed for industrial use as a site for a factory. The current use of land is presumed to be its highest and best use unless market or other factors suggest a different use. Nearby sites have recently been developed for residential use as sites for high-rise apartment buildings. On the basis of that development and recent zoning and other changes to facilitate that development, the entity determines that the land currently used as a site for a factory could be developed as a site for residential use (ie for high-rise apartment buildings) because market participants would take into account the potential to develop the site for residential use when pricing the land

Example (Land) (Cont'd)



- ❑ The highest and best use of the land would be determined by comparing both of the following:
 - ❑ the value of the land as currently developed for industrial use (ie the land would be used in combination with other assets, such as the factory, or with other assets and liabilities)
 - ❑ the value of the land as a vacant site for residential use, taking into account the costs of demolishing the factory and other costs (including the uncertainty about whether the entity would be able to convert the asset to the alternative use) necessary to convert the land to a vacant site (ie the land is to be used by market participants on a stand-alone basis).
- ❑ The highest and best use of the land would be determined on the basis of the higher of those values. In situations involving real estate appraisal, the determination of highest and best use might take into account factors relating to the factory operations, including its assets and liabilities

Example (Research and Development)



❑ An entity acquires a research and development (R&D) project in a business combination. The entity does not intend to complete the project. If completed, the project would compete with one of its own projects (to provide the next generation of the entity's commercialised technology). Instead, the entity intends to hold (ie lock up) the project to prevent its competitors from obtaining access to the technology. In doing this the project is expected to provide defensive value, principally by improving the prospects for the entity's own competing technology. To measure the fair value of the project at initial recognition, the highest and best use of the project would be determined on the basis of its use by market participants

❑ Examples:

Example (Research and Development) (Cont'd)



- ❑ a) The highest and best use of the R&D project would be to continue development if market participants would continue to develop the project and that use would maximise the value of the group of assets or of assets and liabilities in which the project would be used (ie the asset would be used in combination with other assets or with other assets and liabilities). That might be the case if market participants do not have similar technology, either in development or commercialised. The fair value of the project would be measured on the basis of the price that would be received in a current transaction to sell the project, assuming that the R&D would be used with its complementary assets and the associated liabilities and that those assets and liabilities would be available to market participants

Example (Research and Development) (Cont'd)



- ❑ b) The highest and best use of the R&D project would be to cease development if, for competitive reasons, market participants would lock up the project and that use would maximise the value of the group of assets or of assets and liabilities in which the project would be used. That might be the case if market participants have technology in a more advanced stage of development that would compete with the project if completed and the project would be expected to improve the prospects for their own competing technology if locked up. The fair value of the project would be measured on the basis of the price that would be received in a current transaction to sell the project, assuming that the R&D would be used (ie locked up) with its complementary assets and the associated liabilities and that those assets and liabilities would be available to market participants

Example (Research and Development) (Cont'd)



- ❑ b) The highest and best use of the R&D project would be to cease development if, for competitive reasons, market participants would lock up the project and that use would maximise the value of the group of assets or of assets and liabilities in which the project would be used. That might be the case if market participants have technology in a more advanced stage of development that would compete with the project if completed and the project would be expected to improve the prospects for their own competing technology if locked up. The fair value of the project would be measured on the basis of the price that would be received in a current transaction to sell the project, assuming that the R&D would be used (ie locked up) with its complementary assets and the associated liabilities and that those assets and liabilities would be available to market participants

Example (Research and Development) (Cont'd)



- ❑ c) The highest and best use of the R&D project would be to cease development if market participants would discontinue its development. That might be the case if the project is not expected to provide a market rate of return if completed and would not otherwise provide defensive value if locked up. The fair value of the project would be measured on the basis of the price that would be received in a current transaction to sell the project on its own (which might be zero).

Disclosure



- ❑ Disclosure Objective
- ❑ IFRS 13 requires an entity to disclose information that helps users of its financial statements assess both of the following:
 - ❑ For assets and liabilities that are measured at fair value on a recurring or non-recurring basis in the statement of financial position after initial recognition, the valuation techniques and inputs used to develop those measurements
 - ❑ for fair value measurements using significant unobservable inputs (Level 3), the effect of the measurements on profit or loss or other comprehensive income for the period.

Disclosure (Cont'd)



☐ Disclosure Exemptions

☐ The disclosure requirements are not required for:

☐ plan assets measured at fair value in accordance with IAS 19 Employee Benefits

☐ retirement benefit plan investments measured at fair value in accordance with IAS 26

Accounting and Reporting by Retirement Benefit Plans

☐ assets for which recoverable amount is fair value less costs of disposal in accordance with IAS 36 Impairment of Assets.

Disclosure (Cont'd)



- ❑ Identification of Classes
- ❑ Where disclosures are required to be provided for each class of asset or liability, an entity determines appropriate classes on the basis of the nature, characteristics and risks of the asset or liability, and the level of the fair value hierarchy within which the fair value measurement is categorised.
- ❑ Determining appropriate classes of assets and liabilities for which disclosures about fair value measurements should be provided requires judgement. A class of assets and liabilities will often require greater disaggregation than the line items presented in the statement of financial position. The number of classes may need to be greater for fair value measurements categorised within Level 3

Disclosure (Cont'd)



- ☐ Identification of Classes
- ☐ Some disclosures are differentiated on whether the measurements are:
 - ☐ Recurring fair value measurements – fair value measurements required or permitted by other IFRSs to be recognised in the statement of financial position at the end of each reporting period
 - ☐ Non-recurring fair value measurements are fair value measurements that are required or permitted by other IFRSs to be measured in the statement of financial position in particular circumstances.

Disclosure (Cont'd)



☐ Specific Disclosures Required

☐ To meet the disclosure objective, the following minimum disclosures are required for each class of assets and liabilities measured at fair value (including measurements based on fair value within the scope of this IFRS) in the statement of financial position after initial recognition (note these are requirements have been summarised and additional disclosure is required where necessary):

- ☐ the fair value measurement at the end of the reporting period
- ☐ for non-recurring fair value measurements, the reasons for the measurement
- ☐ the level of the fair value hierarchy within which the fair value measurements are categorised in their entirety (Level 1, 2 or 3)

Disclosure (Cont'd)



☐ Specific Disclosures Required

- ☐ for assets and liabilities held at the reporting date that are measured at fair value on a recurring basis, the amounts of any transfers between Level 1 and Level 2 of the fair value hierarchy, the reasons for those transfers and the entity's policy for determining when transfers between levels are deemed to have occurred, separately disclosing and discussing transfers into and out of each level
- ☐ for 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, any change in the valuation techniques and the reason(s) for making such change (with some exceptions)

Disclosure (Cont'd)



❑ Specific Disclosures Required

- ❑ for fair value measurements categorised within Level 3 of the fair value hierarchy, quantitative information about the significant unobservable inputs used in the fair value measurement (with some exceptions)
- ❑ for recurring fair value measurements categorised within Level 3 of the fair value hierarchy, a reconciliation from the opening balances to the closing balances, disclosing separately changes during the period attributable to the following:
 - ❑ total gains or losses for the period recognised in profit or loss, and the line item(s) in profit or loss in which those gains or losses are recognised – separately disclosing the amount included in profit or loss that is attributable to the change in unrealised gains or losses relating to those assets and liabilities held at the end of the reporting period, and the line item(s) in profit or loss in which those unrealised gains or losses are recognised

Disclosure (Cont'd)



☐ Specific Disclosures Required

- ☐ for recurring fair value measurements categorised within Level 3 of the fair value hierarchy:
 - ☐ a narrative description of the sensitivity of the fair value measurement to changes in unobservable inputs if a change in those inputs to a different amount might result in a significantly higher or lower fair value measurement. If there are interrelationships between those inputs and other unobservable inputs used in the fair value measurement, the entity also provides a description of those interrelationships and of how they might magnify or mitigate the effect of changes in the unobservable inputs on the fair value measurement
 - ☐ for financial assets and financial liabilities, if changing one or more of the unobservable inputs to reflect reasonably possible alternative assumptions would change fair value significantly, an entity shall state that fact and disclose the effect of those changes. The entity shall disclose how the effect of a change to reflect a reasonably possible alternative assumption was calculated

Disclosure (Cont'd)



☐ Specific Disclosures Required

- ☐ 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

- ☐ Quantitative disclosures are required to be presented in a tabular format unless another format is more appropriate

