

IFRS 13- Fair Value Measurement Financial Reporting-Nyanza

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Agenda



- ☐ Overview
- ☐ Objective
- ☐ Scope and exceptions
- ☐ Measurement
- ☐ Disclosures
- ☐ Risks

Overview of IFRS 13



In 2011 the IASB finalized IFRS 13 and issued it for adoption with effect from 1st January 2013.

IFRS 13 provides a common framework for measuring fair value when required or permitted by another IFRS

The IASB is currently undergoing a post-implementation review of IFRS 13. A first phase of this review was conducted between September and December 2016 and aimed at identifying any major issues that issuers have encountered in implementing the Standard.

In January 2017, the IASB decided to proceed with phase 2 of the review by Publishing a Request for Information(RFI)to seek input from stakeholders on their experiences with IFRS 13.

Overview of IFRS 13



IFRS 13 defines fair value as '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.

The **key principle** is that **fair value** is the exit price from the perspective of market participants who hold the asset or owe the liability at the measurement date. It is based on the perspective of **market participants** rather than the entity itself, so fair value is not affected by an **entity's intentions towards the asset, liability or equity item** that is being fair valued.

The standard has been amended in line with IFRS 9 & IFRS 16 (Leases) on paragraphs 52 and 6 respectively.

Overview of IFRS 13



A fair value measurement requires management to determine four things:

- a. the particular asset or liability that is the subject of the measurement (consistent with its unit of account);
- b. the highest and best use for a non-financial asset;
- c. the principal (or most advantageous) market;
- d. and the valuation technique.

IFRS 13 addresses how to measure fair value but does not stipulate when fair value can or should be used.

Consequently, the entity's intention to hold an asset or to settle or otherwise fulfill a liability is not relevant when measuring fair value.

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;

Level 1 inputs – quoted (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date;

Level 2 inputs – inputs other than quoted prices included within level 1 that are observable for the asset or liability either directly or indirectly;

Level 3 inputs – unobservable inputs for the asset or liability;

Definitions



Principal market – the market with the greatest volume and level of activity for the asset or liability.

A fair value measurement assumes that the transaction to sell the asset or to transfer the liability takes place in the principal market for the asset or liability.

Most advantageous market – the market that maximizes the amount that would be received to sell the asset or minimize the amount that would be paid to transfer the liability.

In the absence of a principal market, the transaction is assumed to take place in the most advantageous market for the asset or liability.

Objective of IFRS 13



1. This IFRS seeks to:
 - (a) defines fair value;
 - (b) sets out in a single IFRS a framework for measuring fair value; and
 - (c) requires disclosures about fair value measurements.

2. Fair value is a **market-based** measurement, **not an entity-specific** measurement. For some assets and liabilities, observable market transactions or market information might be available while for others it may not be possible.
However, the **objective of a fair value measurement in both cases is the same**—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.

Objective of IFRS 13



3. When a price for an identical asset or liability is not **observable**, an entity measures fair value using another valuation technique that **maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs**.

It is instructive to note that an entity's intention to **hold an asset** or to **settle** or otherwise fulfill a liability is not relevant when measuring fair value.

4. The definition of **fair value** focuses on **assets and liabilities** because they are a **primary subject of accounting measurement**. In addition, this IFRS shall be applied to an entity's own equity instruments measured at fair value.

Scope and exceptions



Scope

This IFRS applies when another IFRS requires or permits fair value measurements or disclosures about fair value measurements except as below:-

The measurement and disclosure requirements of this IFRS do not apply to the following:

(a) share-based payment transactions within the scope of IFRS 2

Share-based Payment;

(b) leasing transactions accounted for in accordance with IFRS 16

Leases; and IFRS 13

(c) measurements that have some similarities to fair value but are not fair value, such as net realizable value in IAS 2 Inventories or value in use in IAS 36 Impairment of Assets.

Scope and exceptions



Exceptions on disclosure:

The disclosures required by this IFRS are not required for the following:

- (a) **plan assets** measured at fair value in accordance with IAS 19 Employee Benefits;
- (b) retirement benefit **plan investments** measured at fair value in accordance with IAS 26 Accounting and Reporting by Retirement Benefit Plans;
- (c) assets for which recoverable amount is fair value less costs of disposal in accordance with IAS 36.(impairment of assets)

The fair value measurement framework described in this IFRS applies to both initial and subsequent measurement if fair value is required or permitted by other IFRSs.

Measurement



Definition of Fair Value

IFRS 13 defines fair value as **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.

The Asset or Liability

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.**

Measurement-(Contd)...



The Asset and Liability~contd

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. 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).

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**.

Measurement-(Contd)



The transaction

A fair value measurement assumes that the asset or liability is exchanged in an orderly transaction between market participants to sell the asset or transfer the liability at the measurement date under current market conditions.

A fair value measurement assumes that the transaction to sell the asset or transfer the liability takes place either:

- (a) in the principal market for the asset or liability; or
- (b) in the absence of a principal market, in the most advantageous Market for the asset or liability.

Measurement-(Contd)



Market participants

An entity shall measure the fair value of an asset or a liability using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

In developing those assumptions, an entity need not identify specific market participants. Rather, the entity shall identify characteristics that distinguish market participants generally, considering factors specific to all the following:

- (a) the asset or liability;
- (b) the principal (or most advantageous) market for the asset or liability; and
- (c) market participants with whom the entity would enter into a transaction in that market.

Measurement-(Contd)



The Price

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions (ie an exit price) regardless of whether that price is directly observable or estimated using another valuation technique.

The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs.

Transaction costs do not include transport costs. If location is a characteristic of the asset (as might be the case, for example, for a commodity), the price in the principal (or most advantageous) market shall be adjusted for the costs, if any, that would be incurred to transport the asset from its current location to that market.

Transaction costs shall be accounted for in accordance with other IFRSs.

Measurement-(Contd)



Application to Non-Financial Assets

A fair value measurement of a non-financial asset considers a market participant's ability to generate economic benefits by using the asset in its **highest and best use** or by selling it to another market participant that would use the asset in its **highest and best use**.

The highest and best use of a non-financial asset takes into account

- (a) A use that is **physically** possible
- (b) A use that is **legally** permissible
- (c) A use that is **financially** feasible

Measurement-(Contd)



Application to Liabilities & Entity's own equity instruments

A fair value measurement assumes that a financial or non-financial liability or an entity's own equity instrument is transferred to a market participant at the measurement date. The transfer of a liability or an entity's own equity instrument assumes the following:

- (a) A liability would remain outstanding and the market participant transferee would be required to fulfill the obligation. The liability would not be settled with the counterparty or otherwise extinguished on the measurement date.
- (b) An entity's own equity instrument would remain outstanding & the market participant transferee would take on the rights & responsibilities associated with the instrument. The instrument would not be cancelled or otherwise extinguished on the measurement date.

Measurement-(Contd)



Application to Financial Assets & Financial Liabilities with offsetting positions in the market risks or counter party risks.

An entity shall measure the fair value of the group of financial assets and financial liabilities consistently with how market participants would price the net risk exposure at the measurement date.

Fair value at initial recognition

When an asset is acquired or a liability is assumed in an exchange transaction for that asset or liability, the transaction price is the price paid to acquire the asset or received to assume the liability (**an entry price**).

In contrast, the fair value of the asset or liability is the price that would be received to sell the asset or paid to transfer the liability (**an exit price**).

Measurement-(Contd)



Valuation Techniques

An entity shall use valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.

Three widely used valuation techniques are:-

The market approach,

A valuation technique that uses prices and other relevant information generated by market transactions involving identical or comparable (ie similar) assets, liabilities or a group of assets and liabilities, such as a business

Measurement-(Contd)



Valuation Techniques (contd)...

The cost approach

A valuation technique that reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost).

The income approach

Valuation techniques that convert future amounts (eg cash flows or income and expenses) to a single current (ie discounted) amount.

The fair value measurement is determined on the basis of the value indicated by current market expectations about those future amounts.

Measurement-(Contd)



Inputs to valuation techniques

Valuation techniques used to measure fair value shall **maximize** the use of relevant **observable** inputs and **minimize** the use of **unobservable inputs**.

Fair value hierarchy

To increase consistency and comparability in fair value measurements and related disclosures, this IFRS establishes a fair value hierarchy that categorizes into three levels ,the inputs to valuation techniques used to measure fair value.

The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1 inputs) and the lowest priority to unobservable inputs (Level 3 inputs)

Measurement-(Contd)



Level 1 inputs

Are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.

Level 2 inputs

Are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 inputs

Are unobservable inputs for the asset or liability.

Unobservable inputs shall be 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.

Disclosure Requirements



An entity shall disclose information that helps users of its financial statements assess both of the following:

- (a) 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.**
- (b) for recurring 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 Requirements



To meet the disclosure objectives above, an entity shall consider all the following:

- (a) the level of detail necessary to satisfy the disclosure requirements;
- (b) how much emphasis to place on each of the various requirements;
- (c) how much aggregation or disaggregation to undertake; and
- (d) whether users of financial statements need additional information to evaluate the quantitative information disclosed.

If the disclosures provided in accordance with this IFRS and other IFRSs are insufficient to meet the objectives, an entity shall disclose additional information necessary to meet those objectives.

Disclosure Requirements



Other disclosures

- for recurring and non-recurring fair value measurements, the fair value measurement at the end of the reporting period, and for non-recurring fair value measurements, the reasons for the measurement.
- for recurring and non-recurring fair value measurements, the level of the fair value hierarchy within which the fair value measurements are categorized in their entirety (Level 1, 2 or 3).
- 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.
- An entity shall present the quantitative disclosures required by this IFRS in a tabular format unless another format is more appropriate.

Risks



An entity that holds a group of financial assets and financial liabilities is exposed to **market risks** (as defined in IFRS 7) and to the **credit risk** (as defined in IFRS 7) of each of the counterparties.

Market risk is the risk that the fair value or cash flows of a financial instrument will fluctuate due to changes in market prices. Market risk reflects interest rate risk, currency risk and other price risks

Credit risk is the risk that one party to a financial instrument will cause a loss for the other party by failing to pay for its obligation.

End...



Questions and feedback!

Conclusion



Have a good afternoon