

FINANCIAL REPORTING WORKSHOP

IFRS 13- Fair Value Measurement

Presentation by:

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Agenda



1. Introduction
2. Scope of IFRS 13
3. Definition of Fair Value
4. Valuation Techniques
5. Fair Value Hierarchy
6. Presentation and disclosure

Introduction



- ❑ IFRS 13 was issued in May 2011.
- ❑ Effective for periods beginning on or after 1 January 2013.
- ❑ Establishes a single framework for measuring fair value where that is required by other standards.
- ❑ Applies to both financial and non-financial items measured at fair value.
- ❑ Requires disclosures about fair value measurements

Scope

In scope

- Fair value measurements that are required or permitted by other IFRSs
- Fair value measurements required/permitted to be disclosed by other IFRSs but not included in statement of financial position

Out of scope

- Share-based transactions (IFRS 2)
- Leasing transactions (IAS 17)
- NRV (IAS 2) and Value in use (IAS 36)
- Disclosure for plan assets (IAS 19), Retirement benefit investments (IAS 26) and assets for recoverable amounts is FV less costs of disposal (IAS 36)



Definition of fair value



The price received to **sell** an asset or paid to **transfer** a liability in an **orderly transaction** in the **principal market** (or most advantageous market) **between market participants** at the **measurement date**



Transaction costs

EXIT PRICE

Transport costs



Key considerations



Step 1: What is the unit of account?

Step 2: Is there more than one market for the item?

Step 3: Who are the other market participants?
How would they use the asset/liability?

Step 4: What is the current use of the asset?
Is there a better alternative use for the asset?

Step 5: Calculate the price

Step 6: Fair value disclosures

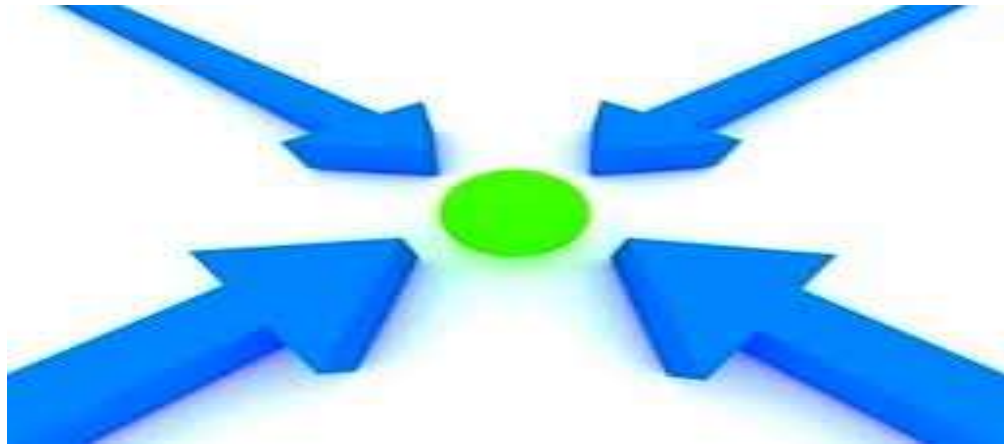
Definition – Unit of Account

The level at which an asset or a liability is aggregated or disaggregated in IFRS for recognition purposes based on the particular IFRS standard



Example – Individual vs group of assets

- Y Ltd has investment property comprising furnished building
- If Y Ltd uses the investment property as a group of assets (each floor is rented as a single asset) – the unit of account is each floor
- If Y Ltd uses the investment property as individual assets (the building is rented as a whole) – the unit of account is the individual asset
- Grouping is based on what market participants will consider



Investments in subsidiary, JV and associate (separate financial statements)

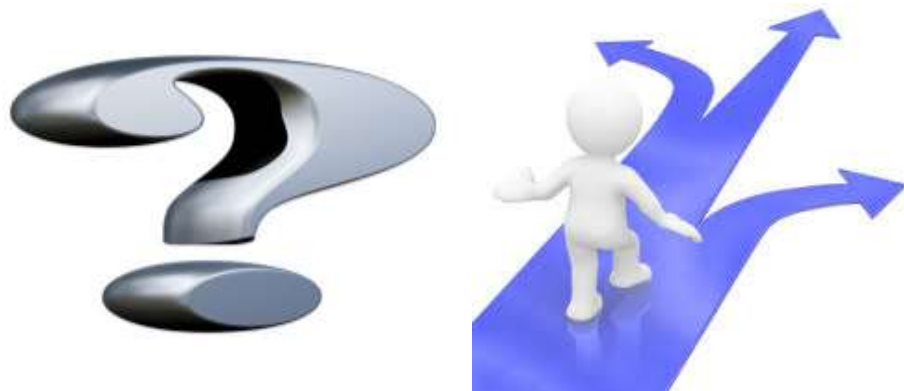
Which standard?

IAS 27

IAS 39 / IFRS 9

Unit of account is entire investment?

Unit of account is generally
individual financial instrument



In what circumstances is unit of
account not individual financial
instrument?

Financial instruments

Example 1: Unit of account



- X Ltd is the majority shareholder (65%) of A Ltd holding 400 000 shares
- Previously X Ltd purchased the shares for KES120 million in 2009
- X Ltd believes that it would be able to sell its shareholding for a total of KES 200 million at 31 December 2013
- One individual share has been valued at KES 400 at 31 December 2013
- X Ltd carries its investment in subsidiary at fair value in its separate financial statements

What is the fair value?

1. 200 million
2. 180 million
3. 160 million.



Financial instruments

Example 2: Unit of account

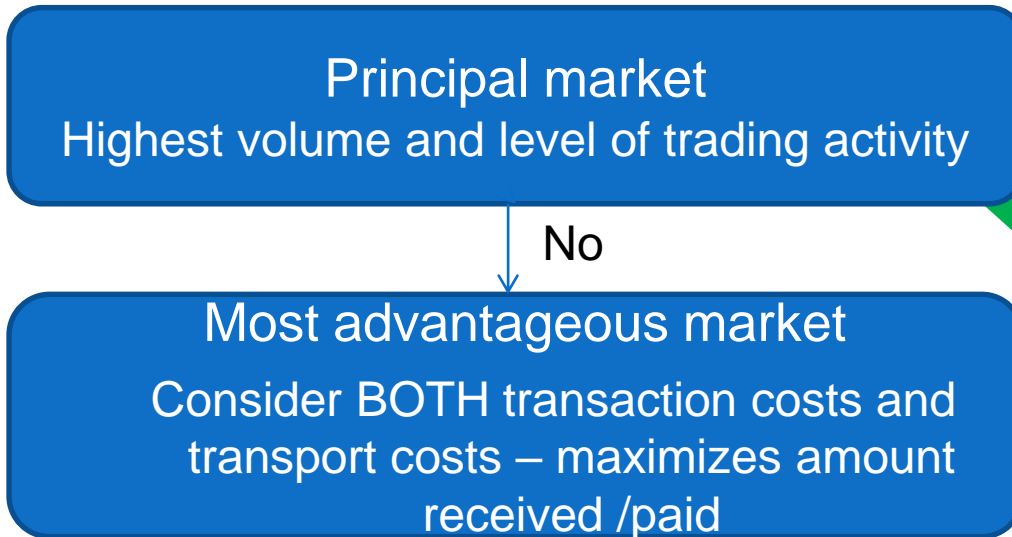


- Assume X Ltd carries the investment at cost (KES120 million) in its separate financial statements
- At 31 December 2014 the share price is KES 200 per share (KES 80 million for entire investment)
- X Ltd plans to sell the entire investment during 2015, therefore it is classified as held for sale
- A number of interested buyers would pay KES110 million for the 65% shareholding
- Transaction costs of KES 500 000 would be incurred by X Ltd to sell the investment

What is the fair value?

A) 120 million, B). 80 million C). 110 million. D). 10.5 million

Possible markets



NB! Must have
access to market

No need to
undertake
exhaustive search

In absence of evidence to the contrary, use
market that the entity usually transacts in



Example 3: Principal market



Company P holds inventory (maize) that is traded in three different markets as below, identify principal and most advantageous market:

Company P

Buys and sells in

Market A

Market B

Market C

Volume (annual)	30 000	12 000	6 000
Trades per month	30	12	10
Price	50	48	53
Transport costs	(3)	(3)	(4)
Possible fair value	47	43	49
Transaction costs	(1)	(2)	(1)
Net Proceeds	46	43	48

Examples of alternative markets



Item	Market
Equity investments	Dual listing (ie listing on the JSE and LSE)
Physical assets	Same asset traded in different locations (ie Frankfurt and Amsterdam)
Commodities futures	Same commodity trades on different markets (ie SAFEX, CBOT, LME, NYMEX)
Other derivatives	Some derivative traded on different derivative markets (ie Certain derivatives only traded on Yield X and others only traded on SAFEX)

Definition

Buyers and sellers in the principal (or most advantageous) market for the asset or liability that have all of the following characteristics:



W

Willing

A

Able

K

Knowledgeable

I

Independent

Orderly transactions



Calculating fair value based on recent transaction

Determine if transaction is orderly

No – little if any weight given to transaction price

Yes – transaction price is considered

Not known to be orderly – transaction price considered but with less weight placed on it compared to orderly transactions

Circumstances where a transaction is not orderly

Inadequate exposure to market to allow usual and customary marketing activities

Asset/liability marketed to single market participant

Seller is near bankruptcy or receivership

Transaction price is outlier



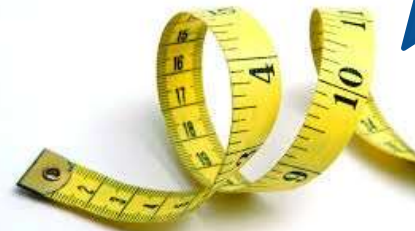
Disorderly Conduct

Measuring fair value

- Use assumptions market participants would use when pricing assets and liabilities
- Assume they act in their economic best interests

Take into account the characteristics of an asset or liability that market participants would consider:

- Condition and location of asset
- Restrictions on the sale or use of the asset



Requirements for determining highest and best use



Non-financial asset



Physically possible



Legally permissible



Financially feasible



Assume current use is highest and best use if no evidence to the contrary

Example 5 – Highest and best use



Luxury hotel in Nairobi that generates rental income

- Independent property valuation experts have valued this hotel at KES 65 million
- X Ltd has signed an agreement with a local bank whereby it cannot make certain modifications to the hotel, reducing the value of the hotel to KES 55 million
- The proximity of the hotel suggests that it could be converted into a super-factory
- Conversion modifications of KES10 million would need to be made to the hotel
- The modified building could then be sold for KES 73 million
- What is the fair value of the property?

Fair value of investment property

Pre IFRS 13

Exclude future capital expenditure (IAS 40.51)

Per IFRS 13

Include the capital expenditure for future improvements in determining fair value of investment property if market participants would consider

Audit teams should evaluate management's assessment of effect of IFRS 13 if future capital expenditure was not considered in the past



Premiums or discounts



Include only if consistent with the unit of account
(individual or portfolio)

Consider if market participants would include it in the
price

Distinguish between:

Characteristic of asset or liability that market participants
take into account for the transaction (liquidity discount) -
include

Characteristic arising from entity's holding of the asset or
liability (blockage factor) - exclude



Transaction price vs fair value

Transaction price normally is the fair value unless:

The transaction is between related parties

The transaction takes place under duress or the seller is forced to accept the price in the transaction

The unit of account represented by the transaction price is different from the unit of account for the asset or liability measured at fair value

The market in which the transaction takes place is different from the principal market (or most advantageous market)



Consider the treatment of day one gains / losses under the relevant IFRS standards.

Entities should consider factors specific to the transaction in order to determine whether the fair value at initial recognition equals transaction price

Valuation technique



Using valuation techniques

- When a quoted price for an identical asset or liability in an active market is not available
- Maximise the use of observable inputs
- Minimise the use of unobservable inputs

Fair value hierarchy

Level 1

Unadjusted
quoted prices
for identical
instruments in
active market

Level 2

- Quoted prices for similar instruments in active market
- Quoted prices for similar/identical instruments in non active market
- Observable inputs and insignificant unobservable inputs

Level 3

Significant
unobservable
inputs

Fair Value Hierarchy (continued)

1. Level 1 inputs

- ✓ Securities on national exchange.
- ✓ Treasury Bills.
- ✓ Certain Treasury Bonds

2. Level 2 inputs

- ✓ Corporate bonds.
- ✓ Derivatives such as interest rate and currency swaps

3. Level 3 inputs

- ✓ Private equity investments
- ✓ Residential and commercial mortgage related assets (including loans, securities and derivatives)

Valuation Techniques

1. Market approach.
2. Income approach.
3. Cost approach.

The technique adopted should maximize the use of relevant observable inputs and minimize the use of unobservable inputs.

Presentation and disclosure

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

1. Carrying amounts and fair values of financial assets and financial liabilities.
2. Their levels in the fair value hierarchy.
3. The valuation techniques.
4. The inputs used to develop those measurements.
5. Level 3, a description of the valuation processes used by the entity.

Example – disclosure

Recurring assets carried at fair value

<i>In thousands of euro</i>	Level 1	Level 2	Level 3	Total
Standing timber	-	-	4,193	4,193
Livestock	-	-	912	912
Total biological assets	-	-	5,105	5,105
Real estate for rental	-	-	2,170	2,170
Total investment property	-	-	2,170	2,170

The entity's policy is to recognise transfers out of Level 3 as of the date of the event or change in circumstances that caused the transfer.

The following table shows a reconciliation from the beginning balances to the ending balances for Level 3 fair value measurements.

<i>In thousands of euro</i>	Standing timber ³	Livestock ³	Investment property
Balance at 1 January 2012	5,942	834	1,050
Acquisitions	294	11	300
Harvested timber transferred to inventories / sales	(2,480)	(127)	-
Reclassification from property, plant and equipment	-	-	800
Gains and losses for the period			
Changes in fair value – Other income – Realised	160	100	-
Changes in fair value – Other income – Unrealised	247	69	20
Net increase due to births and deaths – Other Income – Unrealised	-	11	-
Change in fair value recognised in other comprehensive income			
Effect of movements in exchange rate	30	14	-
Balance at 31 December 2012	4,193	912	2,170

Example – disclosure (cont.)

Valuation techniques and key unobservable inputs used

5. Determination of fair values (continued)

Type	Valuation approach	Key unobservable inputs	Inter-relationship between key unobservable inputs and fair value measurement
Investment property¹ Commercial properties for leasing when prices per square metre for comparable buildings and leases are available	The fair values are determined by applying the market-comparison approach. The valuation model is based on a price per square metre for buildings derived from observable market data, derived from an active and transparent market.	<ul style="list-style-type: none"> Prices per square metre (X to Y). Premium (discount) on the quality of the building and lease terms (-30% to 35%). 	The estimated fair value increases the higher are premiums for higher quality buildings and lease terms.
Commercial properties for leasing when comparable prices per square metre for comparable buildings and leases are not available	In the absence of a price per square metre for similar buildings with comparable lease terms, the fair value is determined by applying the income approach. The valuation models are based on the estimated rental value of the property. A market yield is applied to the estimated rental value to arrive at the gross property valuation. When actual rents differ materially from the estimated rental value, adjustments are made to reflect actual rents. Valuations reflect, when appropriate, the type of tenants actually in occupation or responsible for meeting lease commitments or likely to be in occupation after letting vacant accommodation, the allocation of maintenance and insurance responsibilities between the Group and the lessee, and the remaining economic life of the property.	<ul style="list-style-type: none"> Market rents (A to B). Investment property yields (from 4.8% to 7.9% depending on the location) and discount rates (7.9% to 9.0%; weighted average 8.6%). 	The estimated fair value increases the lower are yields and discount rates.
Commercial properties under construction	The fair value of investment property under construction is determined by estimating the fair value of the completed investment property and then deducting from that amount the estimated costs to complete construction, financing costs and a reasonable profit margin on construction and development. The estimated cost to complete is determined based on the construction cost per square meter in the pertinent area.	<ul style="list-style-type: none"> Construction cost per square meter (€900 to €1,700 depending on the location, weighted average €1,450). Estimated profit margin (14% to 18%, weight average 16.2%). 	The estimated fair value increases the lower are the estimated costs of completion and the lower the required profit on construction and development.

Key points to remember!

- Fair value is the exit price
- Consider assumptions that other market participants would use
- Highest and best use of a non-financial asset should be consistent with a market participant's view
- Use valuation technique that maximises use of observable inputs
- Disclose valuation processes for Level 3



Ask
Answer
Who
Where
What
When
How
Why
Understand
Query
Question
Answers
Apply

Questions