FINANCIAL REPORTING WORKSHOP

IFRS 13- Fair Value Measurement

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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/IFRS 16)
- 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

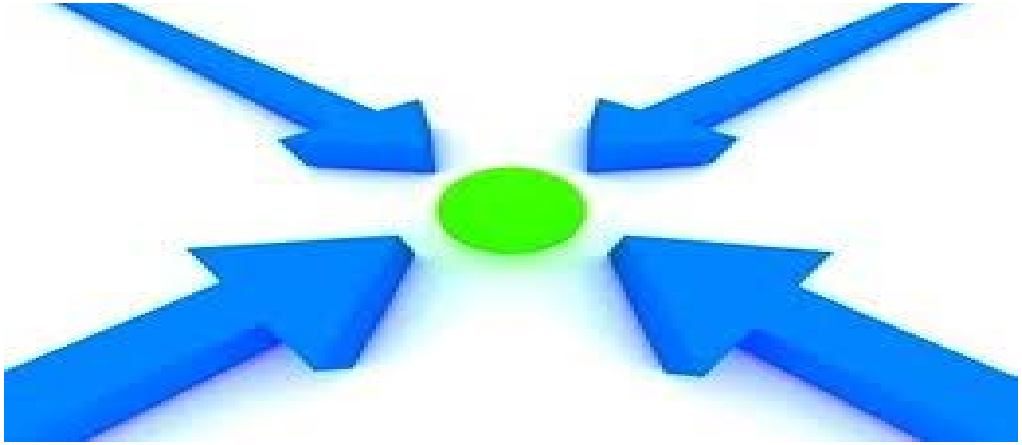
Step 6: Fair value disclosures

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	IFRS 9
Unit of account is entire investment?	Unit of account is generally 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 2014
- X Ltd believes that it would be able to sell its shareholding for a total of KES 200 million at 31 December 2018
- One individual share has been valued at KES 400 at 31 December 2018
- X Ltd carries its investment in subsidiary at fair value in its separate financial statements

What is the fair value at 31 December 2018?

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

Principal market
Highest volume and level of trading activity

No

Most advantageous market
Consider BOTH transaction costs and transport costs – maximizes amount received /paid

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	45	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

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?

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

Use valuation techniques:

- That are appropriate in the circumstances
- Maximise the use of observable inputs
- Minimise the use of unobservable inputs

Valuation techniques include:

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

Valuation technique

Level 1

Unadjusted quoted prices for identical instruments in active market

Examples:

- ✓ Securities NSE.
- ✓ Treasury Bills.
- ✓ Treasury Bonds

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.

Examples:

- ✓ Corporate bonds.
- ✓ Derivatives e.g. interest rate and currency swaps

Level 3

Significant unobservable inputs

Examples:

- ✓ Private equity investments
- ✓ Biological assets valuation –DCF
- ✓ Valuation of PPE

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.

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

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