IFRS Week 2020
IFRS 13- Fair Value Measurement

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Content

Background

- IFRS 13 was issued in May 2011.
- Effective for periods beginning on or after 1 st 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 of IFRS 13

- 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

Excluded Items

- Share-based transactions (IFRS 2)
- Leasing transactions (IAS 17/IFRS 16)
- Net realizable value (IAS 2)
- Disclosure for plan assets (IAS 19)
- Retirement benefit investments (IAS 26)
- Recoverable amounts - FV less costs of disposal (IAS 36)

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

Fair Value Previous Definition

Amounts for which an asset can be exchanged or a liability be settled between knowledgeable willing parties in an arms length transaction

Limitations

- Is it buying or selling?
- What is settling?
- Unclear whether it is market based
- Did not state when the transaction takes place

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

Principal market

- The market with the greatest volume and level of activity for the asset or liability

Most advantageous market

The market that maximizes the amount that would be received to sell the asset or minimizes the amount that would be paid to transfer the liability

Because there may be buyers and sellers who are willing to pay high prices and deal outside the principal market, the most advantageous market may not be the principal market.

Example 3: Principal market

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

	Market A	Market B	Market C
Volume (annual)	30000	12000	6000
Trades per month	30	12	10
Price	50	40	43
Transport	(3)	(3)	(4)
Transaction costs	(1)	(2)	(1)
Net Proceeds	46	43	48

Examples of alternative markets

Item	Market
Equity investments	Dual listings
Physical assets	Asian market, European market
Commodities futures	Same commodity trades on different markets (eg SAFEX, CBOT, LME, NYMEX)

Fair value based on recent transaction

Where a transaction is not known to be orderly – transaction price considered but with less weight placed on it compared to orderly transactions

Where transaction is orderly the price is considered

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

Fair Value Hierarchy

IFRS 13 seeks to increase consistency and comparability in fair value measurements and related disclosures through a 'fair value hierarchy'. The hierarchy categorizes the inputs used in valuation techniques into three levels.

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.
- 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.

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

Examples of Level 2 Inputs

- 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
- Inputs that are derived principally from or corroborated by observable market

Level 3 inputs

- Level 3 inputs are unobservable inputs for the asset or liability.
- An entity develops unobservable inputs using the best information available in the circumstances, which might include the entity's own data.

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

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 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

Illustration

Investment in a subsidiary, associate, joint venture or joint operation

- Use of IFRS 9
- Use of IAS 27 and IFRS 10
- Use of IAS 28
- Use of IFRS 11

Illustration Continued

Which Standard?

IAS 27 and IFRS 10	IFRS 9
Unit of account is the entire business	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 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?a.200 million b. 180 million c. 160 million.

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

Example Best Use

Consider a 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

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

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 is different from the account for the asset or principal market (or most liability measured at fair advantageous market) value

Valuation technique

An entity uses valuation techniques 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.

Valuation technique

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)

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.

Presentation and disclosure

1. The fair value measurement at the end of the reporting period
2. for non-recurring fair value measurements, the reasons for the measurement
3. the level of the fair value hierarchy within which the fair value measurements are categorized
4. 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

5. 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
6. for fair value measurements categorised within Level 3 of the fair value hierarchy, quantitative information about the significant unobservable inputs used
7. a reconciliation from the opening balances to the closing balances
8. a description of the valuation processes used by the entity
9. if the highest and best use of a non-financial asset differs from its current use, an entity shall disclose that fact and the reason

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

Impact of COVID 19 on Fair Values

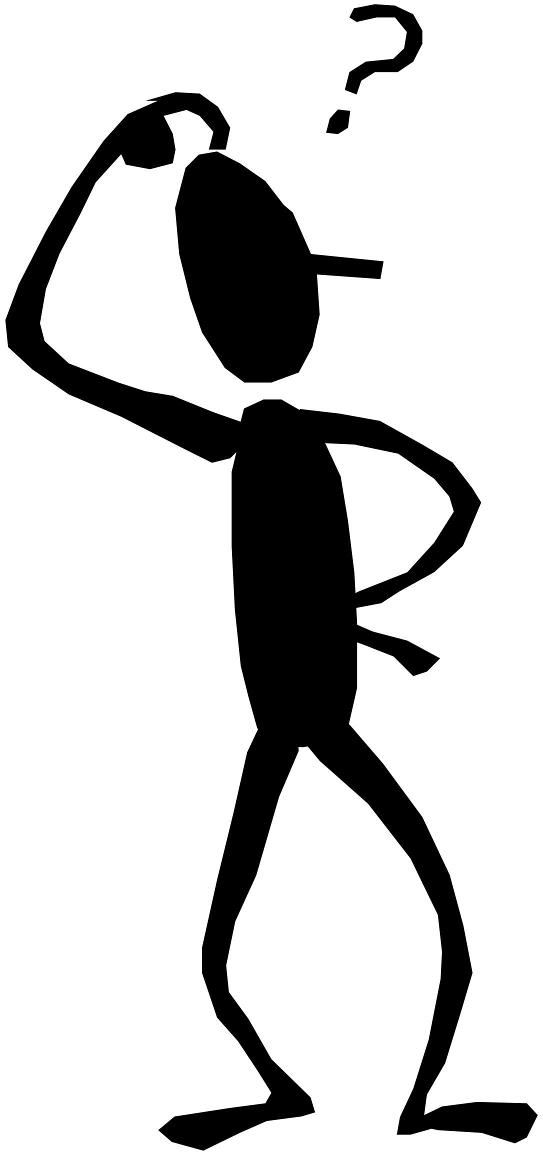
- Decrease in market liquidity;
- Number of quotations decreased since December, particularly for credit instruments;
- Less consistency in pricing feeds from established pricing services;
- Bid/Offer spreads increased in all markets;

- Increase in credit risk;
- Credit spreads for investment grade and non-investment grade entities increased;
- Increase of market volatility and dividend cancellation;
- Equity volatility reached levels of the last financial crisis;
- Interest rates implied volatilities have spiked; and
- Companies have cancelled or postponed dividend payments

Summary of Impact

	Fixed Income	Interest Rate	FX	Equity	Credit
Decrease of Market liquidity	✓	✓	✓		✓
Increase in Credit Risk	✓				✓
Increase of Market volatility	✓	✓	✓	✓	✓
Cancellation of dividends				✓	

Source KPMG International



Questions and discussions

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