



*Emerging considerations in financial reporting during
uncertain times*

IFRS 13 – Fair Value Measurement

Presentation by:

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AGENDA



- Introduction
- Scope of IFRS 13
- Definition of fair value and key principles
- Measurement
- Application of fair value measurement - Non-financial assets
- Application of fair value measurement - liabilities and an entity's own equity instruments
- Valuation techniques
- Fair value hierarchy
- Disclosures

Introduction



IFRS 13 sets out a framework for measuring fair value in a single IFRS, and answers:

#1:
What is meant by “fair value”?

#2:
How should an entity measure fair value?

#3:
What should be disclosed about fair value measurements?

Scope of IFRS 13



<p>IFRS 3 Business combinations</p>	<ul style="list-style-type: none">• Identifiable assets and liabilities of an acquiree are measured at fair value• Non-controlling interest can be measured at fair value at the date of acquisition• Previously-held equity interest is measured at fair value on a step acquisition
<p>IFRS 5 Non-current assets held for sale ..</p>	<ul style="list-style-type: none">• Non-current assets and/or disposal groups are measured at the lower of carrying amounts and fair value less costs to sell.
<p>IAS 16 Property Plant & Equipment</p>	<ul style="list-style-type: none">• Items that are measured using the revaluation model (i.e., fair value at the date of revaluation less subsequent accumulated depreciation and impairment)
<p>IFRS 15 Revenue from contracts with customers</p>	<ul style="list-style-type: none">• Revenue is measured at the fair value of the consideration received or receivable and recognised when prescribed conditions are met, which depend on the nature of the revenue.

Scope of IFRS 13



IAS 36 Impairment of assets

- When the recoverable amount is determined based on “fair value less costs of disposal”

IAS 38 Intangible assets

- Items that are measured using the revaluation model (i.e., fair value at the date of revaluation less subsequent accumulated depreciation and impairment)

IFRS 9 Financial instruments

- A financial asset or financial liability is measured initially at fair value. Subsequent measurement depends on the category of financial instrument. Some categories are measured at amortised cost, and some at fair value.

Scope of IFRS 13



IAS 40 Investment property

- Investment properties that are measured using the fair value model
- Investment properties that are measured using the cost model – still need to apply IFRS 13 because IAS 40 requires disclosure of fair value

IAS 41 Biological Assets

- Biological assets are measured at fair value on initial recognition and at each reporting date
- Agricultural produce are measured at fair value at the point of harvest

Scope exemptions



Category 1:
Exempt from IFRS 13
measurement and
disclosure
requirements

- Share-based payment transactions within the scope of IFRS 2
- Leasing transactions within the scope of IFRS 16
- Measurements that have similarities to fair value but are not fair value (e.g., net realisable value in IAS 2 or value in use in IAS 36)

Category 2:
Exempt only from IFRS
13 disclosure
requirements

- Plan assets measured at fair value in accordance with IAS 19
- Retirement benefit plan investments measured at fair value in accordance with IAS 26
- Assets for which the recoverable amount is fair value less costs of disposal in accordance with IAS 36

Definition



Asset

The price that would be received to sell the asset

Fair value is an **EXIT PRICE**

In an orderly transaction

Between market participants

At measurement date

Liability

Price that would be paid to transfer the liability

- NOT based on how much the reporting entity has to pay to settle a liability
- Should be based on how much the reporting entity has to pay to a market participant such that the market participant is willing to take over the liability

Measurement - The asset or liability - Characteristics



5.14 A fair value measurement relates to a **particular asset or liability**. It should, therefore, incorporate the asset or liability's **specific characteristics** if market participants consider these characteristics when pricing the asset or liability. These characteristics could include *condition, location and restrictions, if any*, on sale or use as of the measurement date. [IFRS 13 para 11].

How to determine fair value



Unit of account

- What is being measured?
- What is the appropriate **unit of account**? Is it the same as the basis for valuation?

Market

- What is the principal (or if none exists, the most advantageous) market?

Assumptions

- What **assumptions** would market participants in the principal (or the most advantageous) market take into account when pricing the asset or liability?
- What **characteristics** of the asset or liability would market participants take into account?

Inputs and valuation techniques

- What **inputs** are available and could be used in determining the fair value? What is (are) the appropriate **valuation technique(s)**?

Step 1: Unit of account

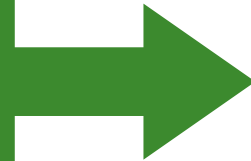


- Whether the asset or liability is a stand-alone asset or liability, a group of assets, a group of liabilities or a group of assets and liabilities for recognition or disclosure purposes depends on its unit of account
- The unit of account for the asset or liability should be determined in accordance with the IFRS that requires or permits the fair value measurement, except as provided in IFRS 13 (e.g., IFRS 13.48, IFRS 13.80).

Step 2: The Market



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



Principal market

(the market with the greatest volume or level activity for the asset or liability)

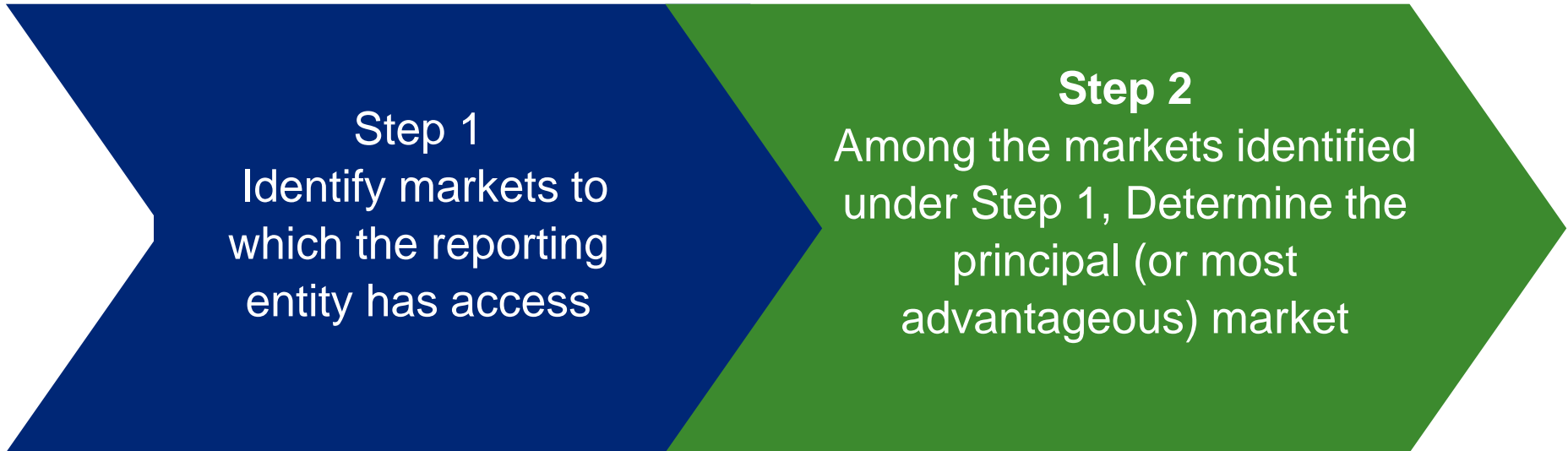


Most advantageous market

(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)

In the absence of the principal market

Identifying a market



Step 1	Step 2
Entity A is engaged in the trading of goods and has access to Markets B, C, D, E and F	Entity A determines that Market B is the principal (or most advantageous) market

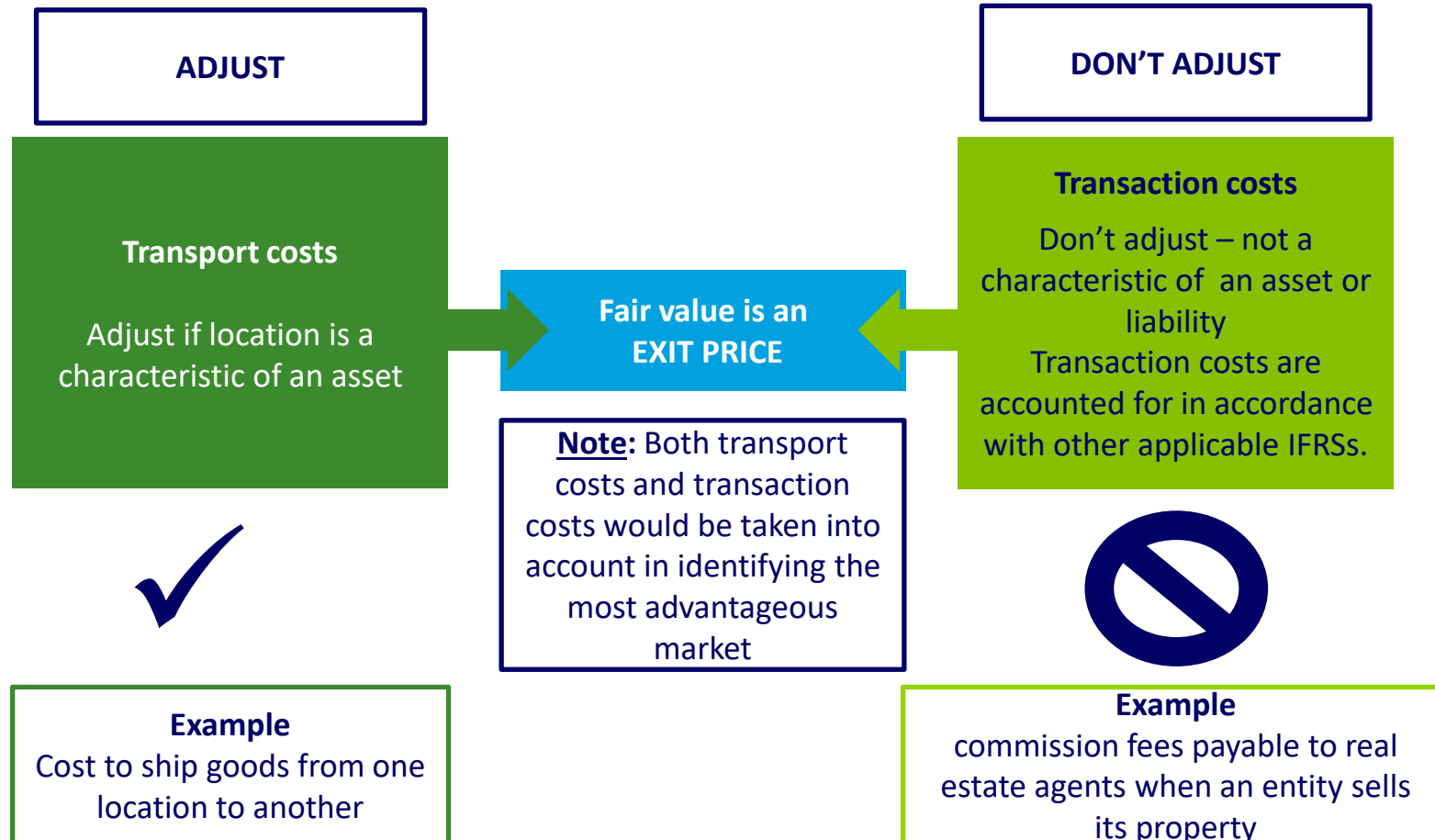
Market participants



5.26 IFRS 13 emphasises that a fair value measurement should be based on the **assumptions of market participants** (that is, it is not an entity-specific measurement). [[IFRS 13 para 22](#)]. Market participants are buyers and sellers in the principal (or most advantageous) market for the asset or liability that are:

- 1. Independent.** The transaction counterparties are not related parties as defined in IAS 24.
- 2. Knowledgeable.** Transaction counterparties have a reasonable understanding about the asset or liability and the transaction using all available information, including information that might be obtained through due diligence efforts that are usual and customary.
- 3. Able to transact** in the asset or liability.
- 4. Willing to transact** in the asset or liability. Transaction counterparties are motivated but not forced or otherwise compelled to transact.

Step 3: Assumptions



The Price: Example 1



- Entity A acquired an investment property for a transaction price of CU100 million
- Entity A paid commission fees to real estate agent of about CU5 million
- Entity A recorded the investment property on initial recognition at CU105 million in accordance with IAS 40.20

- The market value of the investment property remains unchanged at CU100 million
- Assume that if Entity A sold the property on 31 Dec 20X1, it had to incur commission fees of CU5 million

1 Dec 20X1

31 Dec 20X1

Question:

In accordance with IAS 40, at what amount should Entity A record the investment property at 31 December 20X1?

The Price: Example 1



Suggested accounting solution:

- Entity A should record the investment property at CU100 million as at 31 December 20X1
- Commission fees to real estate agents are transaction costs to be incurred when Entity A sells the property
- Fair value should not be adjusted for the transaction costs of CU5 million
- The difference between the carrying amount of CU105 as at 1 Dec 20X1 and the fair value as at 31 Dec 20X1 is recognised in the profit or loss.

The Price: Example 2



Facts:

- Entity A has agricultural produce as defined under IAS 41, which is required to be measured at fair value at the point of harvest.
- The agricultural produce is located in location A.
- It was determined that Entity A's principal market is location B.
- Pricing quote at location B is CU100 per unit of agricultural produce.
- It would cost Entity A transportation costs of CU5 to ship each unit of agricultural produce from location A to location B.

Question:

- What is the fair value of each unit of agricultural produce?

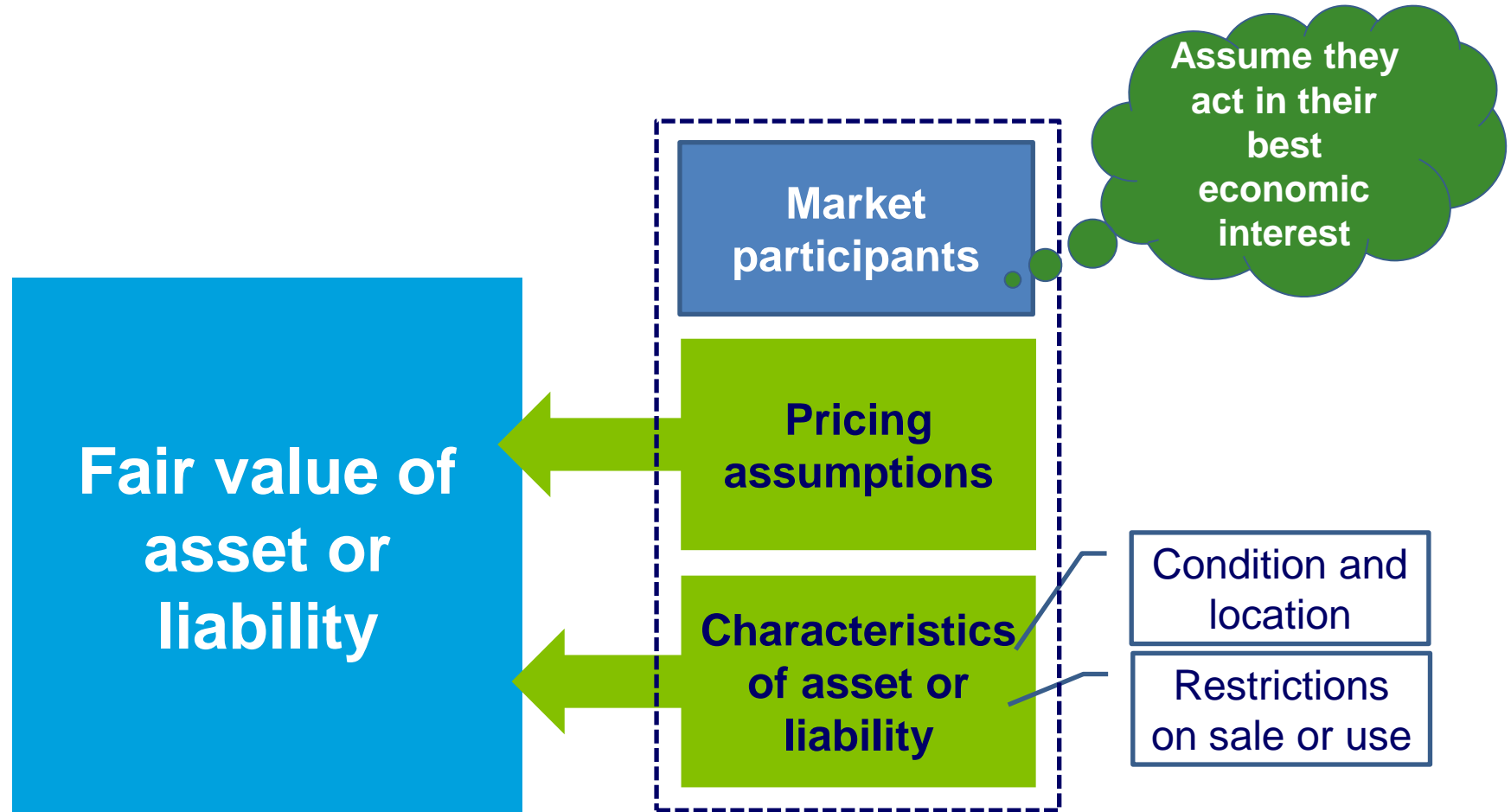
The Price: Example 2



Suggested accounting response:

- Entity A should take into account transportation costs to be incurred to ship agricultural produce from location A to location B in arriving at the fair value of the agricultural produce.
- This is because the location in this example reflects the characteristics of the subject asset.
- Therefore, the fair value of each unit of agricultural produce is CU95.

Characteristics of the asset or liability



Characteristics of the asset or liability: Example



Facts:

- Entity A has a loan receivable from Entity B (a borrower).

Question:

- Should Entity A consider the credit standing of Entity B in determining the fair value of the loan receivable?

Characteristics of the asset or liability: Example



Suggested accounting response:

- Yes. Entity A should consider Entity B's credit standing in determining the fair value of the loan receivable in accordance with IFRS 13.
- IFRS 13.22 states, in part, “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.”
- Market participants would incorporate the effects of the borrower's credit into the valuation of a loan receivable because this can potentially affect the amount of proceeds they ultimately receive from the borrower.

Fair value vs. transaction price



Fair value

Price that would be received to sell the asset or paid to transfer the liability

EXIT PRICE

VS.

Transaction price

Price paid to acquire the asset or received to assume the liability

ENTRY PRICE

Is transaction price always equal to fair value? If not, how should a 'day 1 gain/loss' be accounted for?

Fair value vs. transaction price



In many cases, the transaction price will equal the fair value (e.g., on the transaction date, the transaction to buy an asset takes place in the market in which the asset would be sold)

IFRS 13 requires us to take into account factors that are specific to the transaction and to the asset or liability.

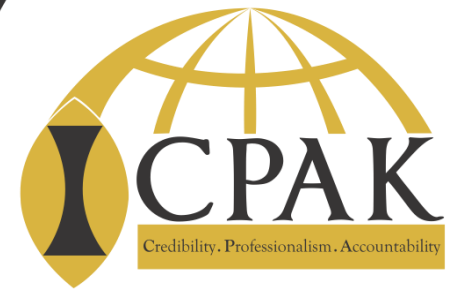
Transaction price might not equal fair value if...

- Transaction is between related parties (i.e., transactions may include capital contribution / distribution element)
- Transaction takes place under duress or the seller is forced to accept the price in the transaction
- Unit of account represented by the transaction price differs from the unit of account for the asset or liability measured at fair value (e.g., a business combination situation)
- The market in which the transaction takes place is different from the principal (or most advantageous) market

Fair value vs. transaction price



Entities should account for the difference between the transaction price and the day 1 fair value as a gain or loss in profit or loss unless the applicable IFRSs specify otherwise



Application of fair value measurement to non-financial assets

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Non-financial assets



A fair value measurement of a non-financial asset should take into account 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

Highest and best use:

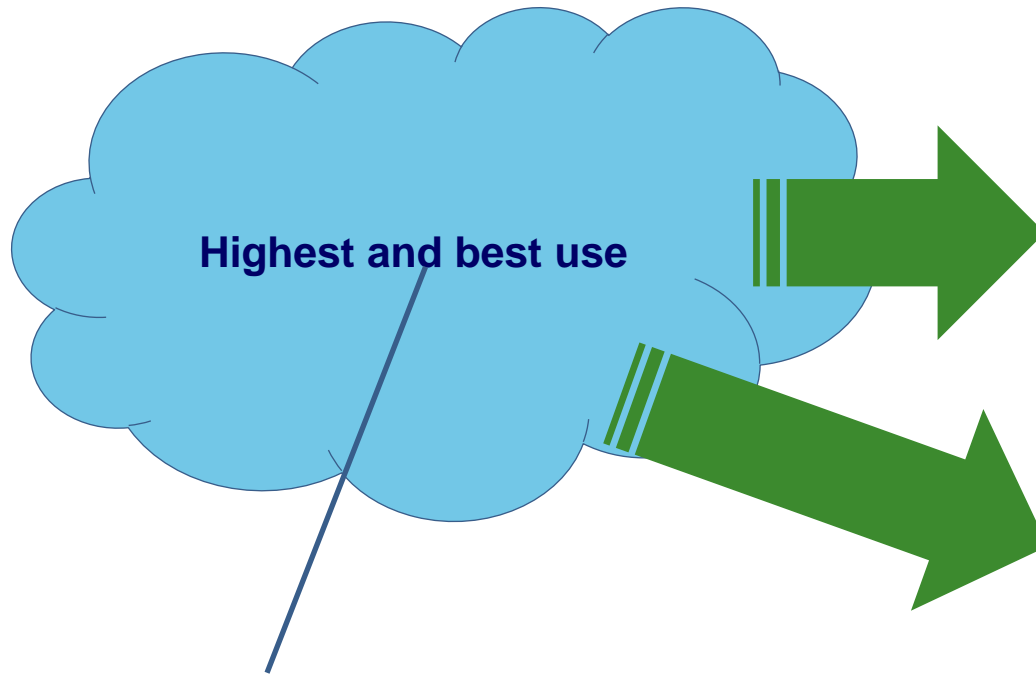
the use by market participants that would maximise the value of the asset or the group of assets and liabilities within which the asset would be used

Physically possible?
(location or size of the asset)

Legally permissible?
(legal restrictions on the use of the asset)

Financially feasible?
(ability to generate adequate income or cash flows to produce an investment return that market participants expect)

Non-financial assets



Highest and best use

Determined from market participant's perspective
(even if reporting entity intends a different use)

Entity's current use presumed to be highest and best use
(unless market or other factors suggest a different use by market participants would maximise the value)

Note: Applies only to non-financial assets

Highest and best use must be supportable

Non-financial assets



Facts:

- Entity A owns a factory property in Country A
- The factory property is comprised of two elements: (a) freehold land and (b) building elements that are accounted for as separate classes of property, plant and equipment and presented separately within the statement of financial position
- Freehold land is not depreciated whilst the building element is depreciated over its estimated useful life
- Entity A accounts for the factory property (freehold land and building elements) using the revaluation model in accordance with IAS 16
- In recent years, nearby sites have been redeveloped as sites for high-rise commercial buildings
- Taking into account all available market and other factors, Entity A determined that the highest and best use of the site is to use it for developing a high-rise commercial building.

Question:

- How should Entity A determine the fair value of the property?

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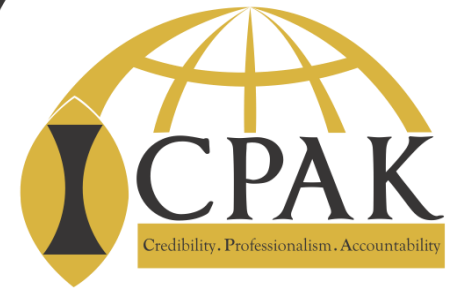
Non-financial assets



Suggested solution:

- The fair value of the property should be determined on the assumption that Entity A disposed of the factory building to market participants at the measurement date and that the market participants would demolish the factory building and use the site to develop a high-rise commercial building.

Fair valuation of Liabilities



Fair value is an
EXIT PRICE

In an orderly transaction

Between market
participants

At measurement date

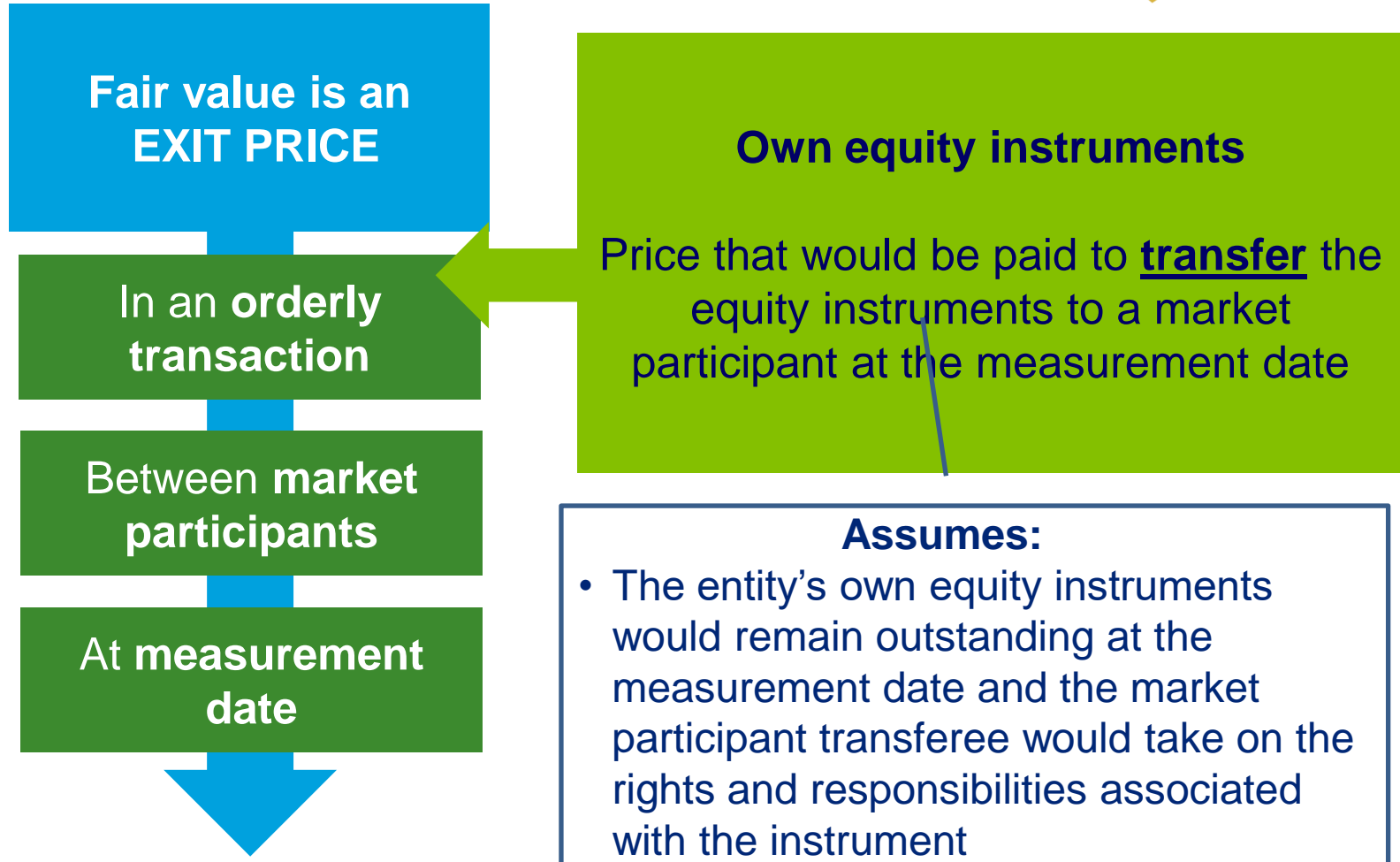
Liability

Price that would be paid to transfer the liability to a market participant at the measurement date

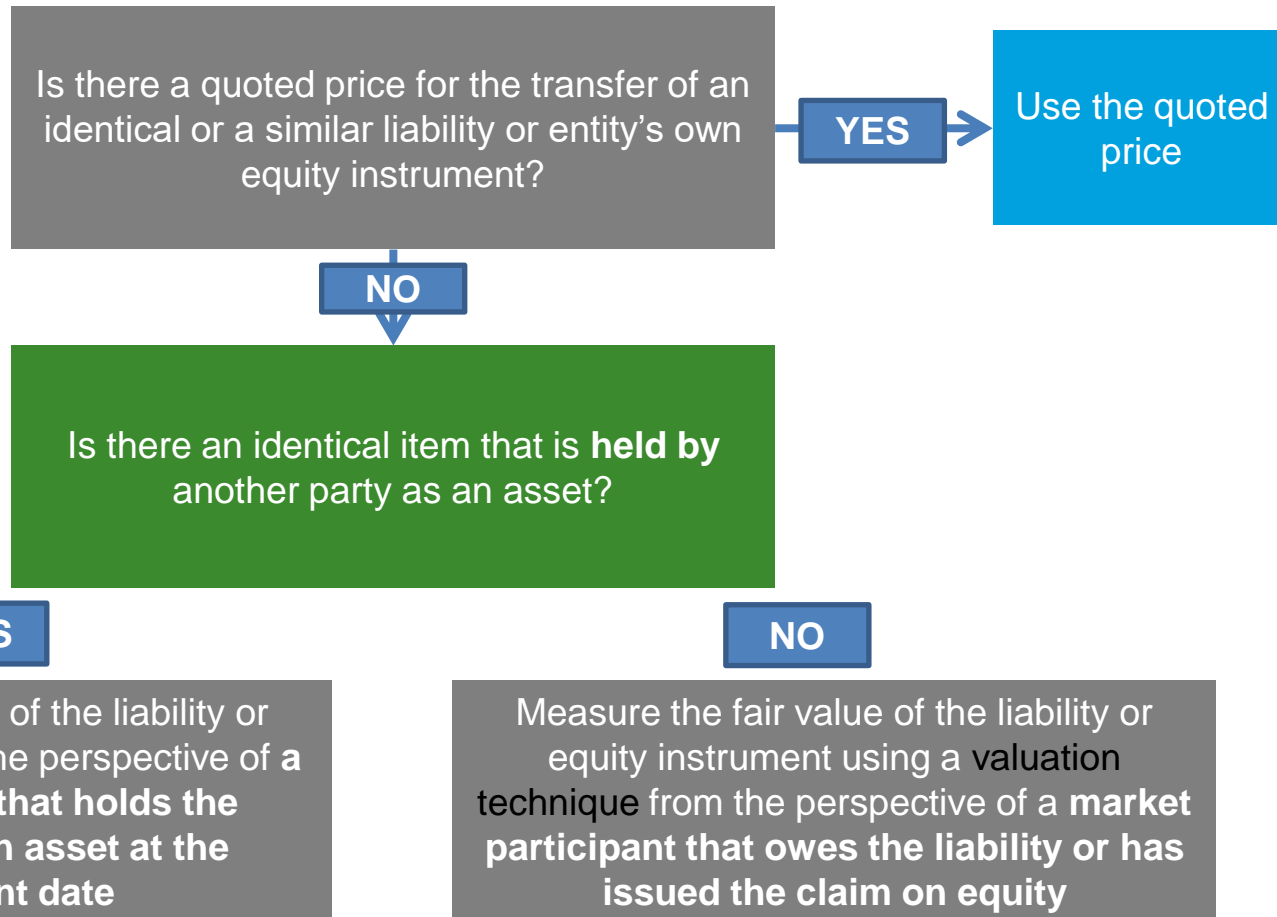
Assumes:

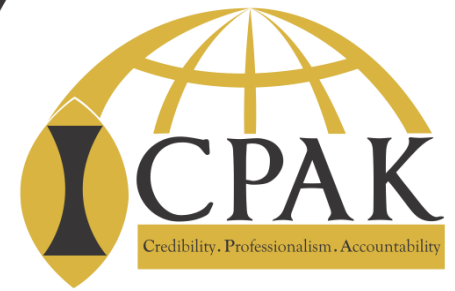
- Liability is transferred to a market participant, **not settled**, at the measurement date
- The liability remains outstanding and the market participant transferee would be required to fulfil the obligation
- Regardless of whether the reporting entity has the ability to transfer its liability to someone else

Fair valuation of Equity



Fair valuation of Equity





Valuation techniques

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Valuation techniques

- No rules as to which valuation technique(s) must be used
- Select the most appropriate technique in the circumstances, for which sufficient data is available
- Apply consistently
- Change in technique = change in accounting estimate (IAS 8)

Inputs

- Maximise use of relevant observable inputs
- Minimise use of unobservable inputs
- Select inputs that are consistent with characteristics of asset or liability (from market participant perspective)
- Consider:
 - Location and condition
 - Restrictions on sale or use

Valuation techniques



Market approach



Prices and other relevant information generated by market transactions involving identical or comparable items

Cost approach



Current replacement cost

Income approach



Convert the future amounts into a single current amount

Cost approach



- The cost approach reflects the amount that would be required currently to replace the service capacity of an asset
- From the perspective of a market participant seller, the price that would be received for the asset is based on the cost to a market participant buyer to acquire or construct a substitute asset of comparable utility, adjusted for obsolescence
- Obsolescence encompasses physical deterioration, functional and economic obsolescence—broader than depreciation for financial reporting purposes
- Commonly used to measure the fair value of tangible assets that are used in combination with other assets or with other assets and liabilities.

Income approach



Future amounts (e.g.,
cash flows or income
and expenses)

**Discount
rate**

Present amount

Valuation techniques include:

- Present value techniques;
- Option pricing models (e.g., the Black-Scholes-Merton formula or a binomial model)
- The multi-period excess earnings method (normally used to measure the fair value of some intangible assets)

Present value techniques



Future amounts (e.g.,
cash flows or income
and expenses)

**Discount
rate**

Present amount

Capture all of the following elements:

- An estimate of future cash flows for the asset or liability being measured
- Expectations about possible variations in the amount and timing of the cash flows representing the uncertainty inherent in the cash flows
- The time value of money (i.e., a risk-free interest rate)
- The price for bearing the uncertainty inherent in the cash flows (i.e., a risk premium)
- Other factors that market participants would take into account in the circumstances
- For a liability, the non-performance risk relating to that liability, including the entity's own credit risk

Fair value hierarchy



Level 1

Quoted prices in active market for identical assets or liabilities

Level 2

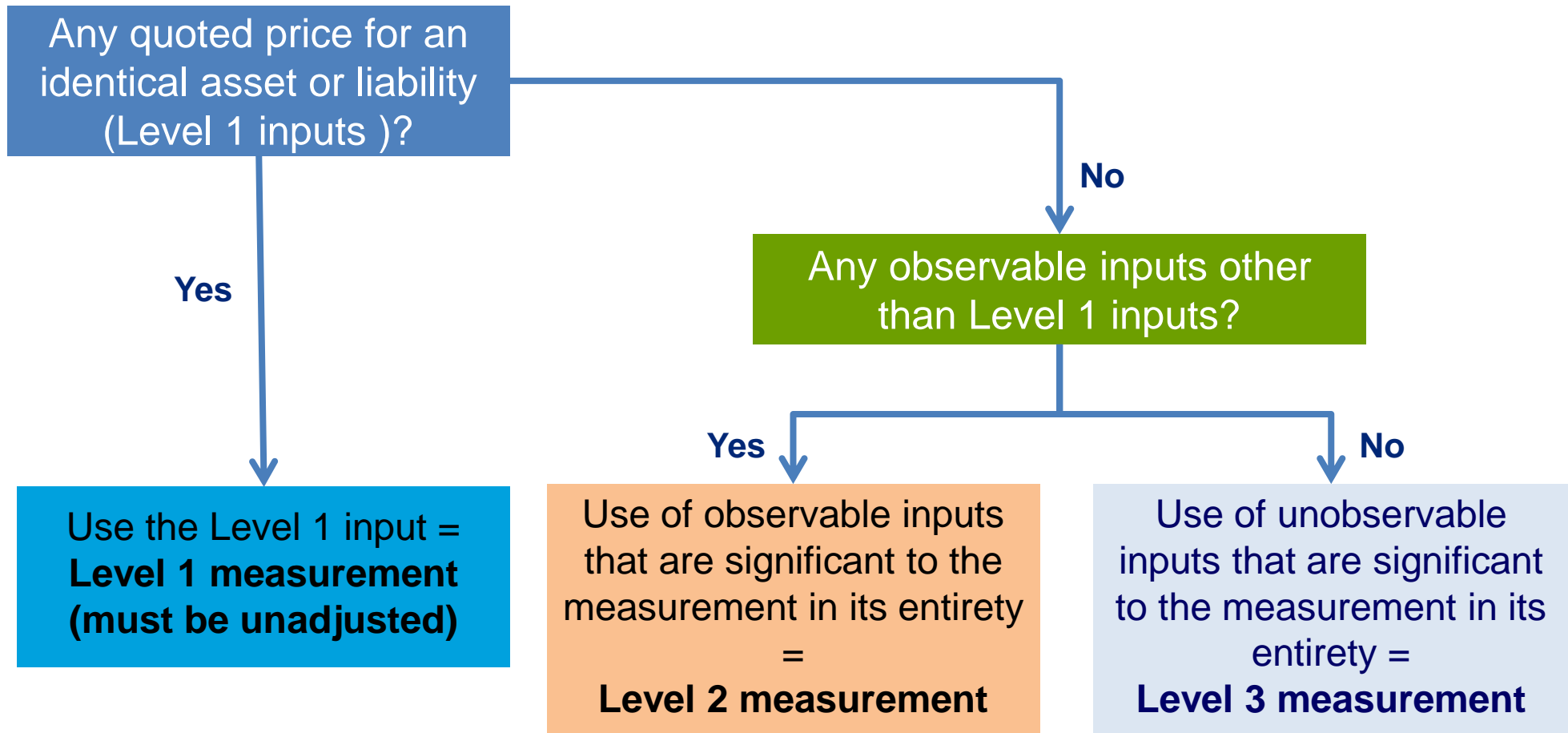
Observable inputs other than quoted prices in level 1, either directly or indirectly

Level 3

Unobservable inputs

- The fair value hierarchy is applicable to both financial and non-financial items that are within the scope of IFRS 13
- The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets and liabilities and the lowest priority to unobservable inputs
- The fair value measurement is categorised in its entirety based on the lowest level of significant input
- Fair value hierarchy depends on the inputs, not valuation techniques.

Fair value hierarchy



Fair value hierarchy



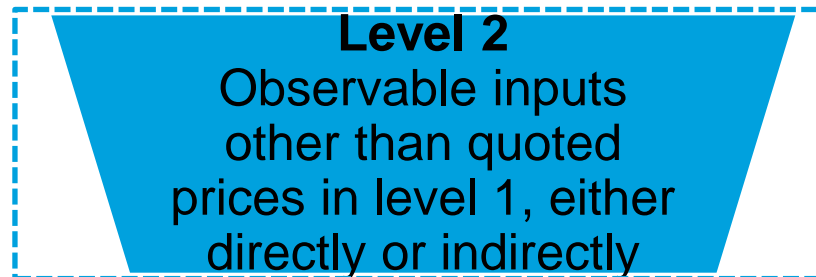
Level 1

Quoted prices in active market for identical assets or liabilities

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

Fair value hierarchy

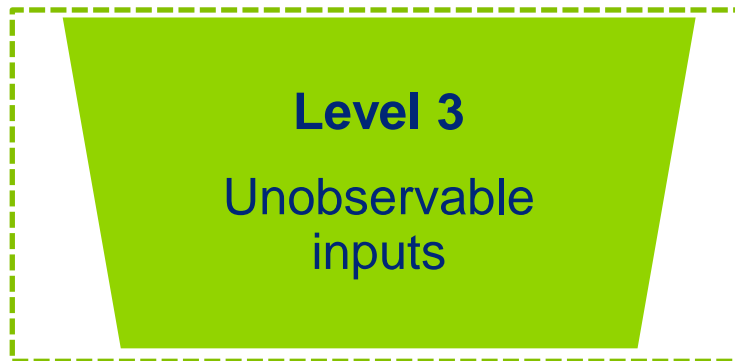


- If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for **substantially** the full term of the asset or liability
- Level 2 inputs include the following:
 - Quoted prices for similar assets or liabilities in active markets
 - Inputs other than quoted prices that are observable for the asset or liability (e.g., observable interest rates and yield curves).

Fair value hierarchy



- The fair value measurement objective remains the same—exit price
- Entities should try to select the most reliable among unobservable inputs
- The Level 3 measurement inputs should include risk inherent in the particular valuation technique and the risk inherent in the inputs to the valuation technique
- Examples of Level 3 inputs
 - Labour quotes for a particular job in determining the fair value of a decommissioning liability in a business combination
 - Profit/cash flow forecast used in determining the fair value of a cash-generating unit (e.g., cash flows or profit or loss forecast).



Fair value hierarchy



Facts:

- Entity A owns an investment property that is accounted for using the fair value model in accordance with IAS 40
- According to the valuation report, the fair value of the investment property is determined based on the fair values of comparable properties in the similar location.

Question:

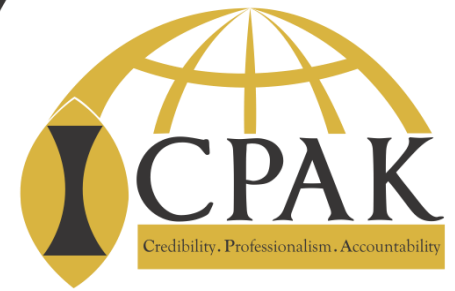
- How should Entity A categorise the fair value measurement (i.e., Level 1, 2 or 3)?

Fair value hierarchy



Suggested solution:

- Level 2
- This is because the fair value is determined based on market observable inputs that are significant to the fair value measurement (i.e., the market prices of comparable properties in similar location). There were no unobservable inputs or adjustments made that would have a significant impact.



Disclosures

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Disclosure objective



Entities should disclose information that helps users assess the following:

- the valuation techniques and inputs used to develop those measurements (for assets and liabilities that are measured at fair value on a recurring or non-recurring basis)
- 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

Recurring vs. Non-recurring basis



Recurring basis

Recurring fair value measurements of assets or liabilities are those that other IFRSs require or permit in the statement of financial position at the end of each reporting period

Examples

- Investment properties measured using the fair value model under IAS 40
- Financial assets at fair value through profit or loss under IFRS 9
- Property, plant and equipment/intangible assets measured using the revaluation model under IAS 16/IAS 38
- Biological assets under IAS 41

Recurring vs. Non-recurring basis



Non-recurring basis

Non-recurring fair value measurements of assets or liabilities are those that other IFRSs require or permit in the statement of financial position particular circumstances

Examples

- Assets classified as held for sale measured at lower of fair value less costs to sell and carrying amounts under IFRS 5

The disclosure requirements are more comprehensive for fair value measurement for recurring assets and liabilities than for non-recurring assets and liabilities.

Illustration – Investment Property



Focus areas:

- Segregation into classes
- Classes of assets and liabilities
- Recurring fair value measurements
- Gains and losses
- Valuation techniques

Illustration – Investment Property



Step 1 – Understand the inputs to the fair value measurement (e.g. the properties) will have to be segregated into classes, not only based on the level of fair value hierarchy, but also whether they are different with regard to nature, characteristics and risk.

These factors might require additional segregation into classes.

Ensure that these classes can be reconciled to the balance sheet.

Illustration – Investment Property



Segregation into classes

KES' millions	31 December 2020	Level 1	Level 2	Level 3
Kenya		-	10	-
Uganda			21	-
Total			31	-

Illustration – Investment Property



For recurring FV measurement categorized within level 3 of the fair value hierarchy, IFRS 13:93(e) and (f) requires reconciliation from the opening balances and closing balances for each class of assets and liabilities. Any transfers between the fair value hierarchy should also be disclosed.

Illustration – Investment Property



KES' millions	Kenya	Uganda	Total
Opening balance	19	4	23
Total gains through profit or loss	3	1	4
Purchases	4	-	4
Closing balance	26	5	31
Changes in unrealized gains for the period included in PL for assets held at the end of the reporting period	3	1	4

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Illustration – Investment Property



Gains and losses included in profit or loss for the period are presented in financial income and non-financial income as shown. (IFRS 13:93(e))

KES' millions		Financial income	Non-financial income
Total gains for the period included in profit or loss		(20)	1
Changes in unrealized gains for the period included in PL for assets held at the end of the reporting period		(18)	4

Illustration – Investment Property



For fair value measurement categorized within level 2 and level 3, (IFRS 13:93(d) requires an entity to disclose a description of the valuation techniques and the input (quantitative information if the input is a level 3 input used in the fair value measurement.

Illustration – Investment Property



KES' millions	Fair value at 31 December 2020	Valuation technique	Unobservable input	Range (weighted average)
Kenya	10	Discounted cash flow Market comparable approach	Long term net operating income margin Rate per square foot	18%-32% (20%) 120 – 150 (130)
Uganda	21	Discounted cash flow Market comparable approach	Long term net operating income margin Rate per square foot	20%-38% (25%) 140 – 160 (150)

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Other disclosure considerations



Entities should provide additional information that will help users of the financial statements to evaluate quantitative information disclosed. (IFRS 13:92)

See list of examples set out in illustrative examples set out in IFRS 13:IE64.

Other disclosure considerations



For level 3 measurements, disclosure of description of the valuation process [IFRS 13:93(g)]

- The reporting procedure;
- Frequency and method of calibration;
- Back testing and other testing procedures of pricing models;
- The process for analyzing changes in FV measurements from one period to another;
- The process for determining the use of third-party information; and
- The methods used to develop and substantiate the unobservable inputs.

Other disclosure considerations



Narrative description of the sensitivity of the fair value measurement to changes in significant unobservable inputs and a description of any interrelationships between those unobservable inputs.[IFRS 13:93(h) and (i)]

Questions and comments

