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IFRS 13 - Fair Value Measurement

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Agenda

Background

- IASB added the fair value project to its agenda in September 2005
- In November 2006, IASB published a discussion paper *Fair Value Measurements* using US SFAS 157 *Fair Value Measurements* as the basis for its preliminary views
- In October 2008, the IASB's Expert Advisory Panel published a report Measuring and disclosing the fair value of financial instruments in markets that are no longer active (Expert Advisory Panel Report)
- In May 2009, IASB published ED *Fair Value Measurement*
- In June 2010, FASB published an ED to amend ASC Topic 820 (formerly US SFAS 157 *Fair Value Measurements)*. IASB also published a limited re-exposure of certain proposed disclosure requirements
- In May 2011, IASB published IFRS 13 *Fair Value Measurement* and FASB amended ASC Topic 820 to align with IFRS 13.

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Background

Overview of standard

Scope

Fair value measurement principles

Fair value at initial recognition

Valuation techniques, inputs and fair value hierarchy

Fair value in markets that are not active

Disclosures

Comparison with US GAAP

Effective date and transition

Overview of standard

- Fair value defined as an exit price
- Comprehensive framework for measuring fair value when such measurement is required or permitted under other IFRSs
- Additional disclosures required about fair value measurements, including for nonfinancial assets and liabilities
- IFRS 13 provides guidance on ‘how’ to measure fair value rather then ‘when’ to measure fair value; does not require additional fair value measurements

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- Background
- Overview of standard
- Scope
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- Comparison with US GAAP
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Scope

- IFRS 13 applies to other IFRSs that require or permit fair value for measurement or disclosure purposes, such as:
  - Financial instruments
  - Most assets and liabilities acquired in a business combination
  - Non-current assets held for sale in accordance with IFRS 5
  - Investment property/intangibles/PP&E held at fair value
  - Biological assets

Out of scope – measurement & disclosures
- IFRS 2
- IAS 17

Out of scope – disclosures
- IAS 19
- IAS 26
- IAS 36

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Definition of 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"

- Current exit price
- Market participant focus
- Orderly transaction
- Measurement date

The asset or liability

- Fair value measurement considers those characteristics of the asset or liability (e.g. condition and location) that market participants would consider in determining price at the measurement date
- With limited exceptions, IFRS 13 does not prescribe the unit of account for fair value measurement; look to relevant IFRS

The transaction

Principal market	The market with the greatest volume and level of 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. ONLY used in the absence of a principal market

- Entity must have access to the principal (or most advantageous) market
  - Determined from the entity's perspective, based on ability to access
- Absent evidence to the contrary, the market in which the entity would normally sell the asset or transfer the liability is assumed to be the principal (or most advantageous) market

Highest and best use

Is the possible use of a *non-financial asset*?

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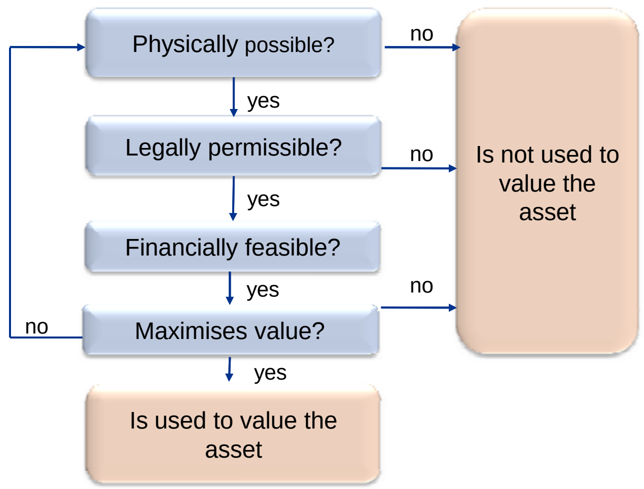

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Example – highest and best use

- An entity acquires in a business combination land that is currently used as a site for a factory
- Recent zoning changes permit residential use of land and some adjacent sites have been developed for residential use
- The highest and best use of the land is determined by comparing
  - value based on current use
    - As an industrial property (current use), the values of the land and factory are 300,000 and 140,000 respectively
  - value as a vacant site ready for residential development, considering the costs to demolish the factory and prepare the land as vacant site
    - As a site for residential property development, fair value of vacant site, after considering costs for demolishing the factory and other conversion costs, is 550,000
- Conclusion: The land is valued at 550,000 and the buildings at 0

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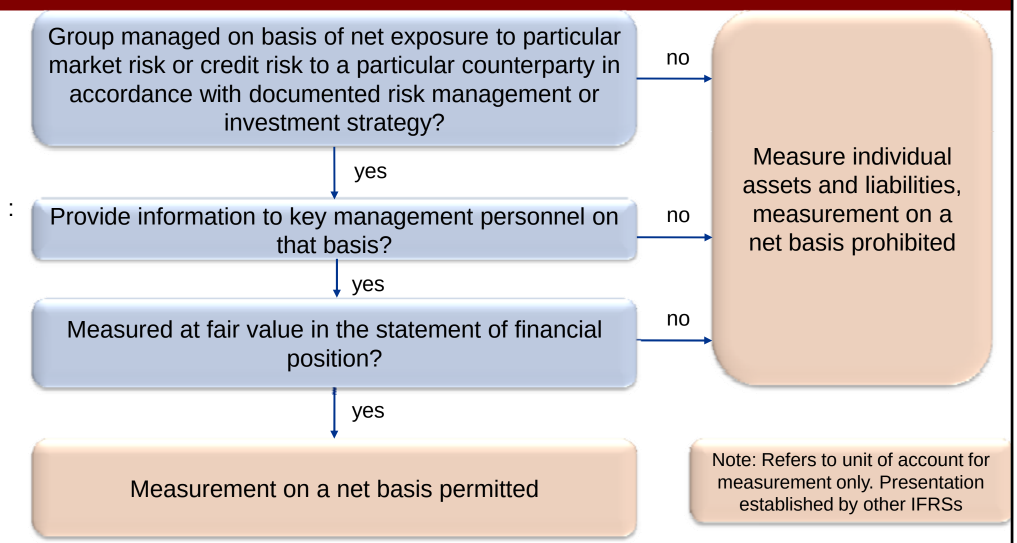
Groups of financial instruments – Net Exposures



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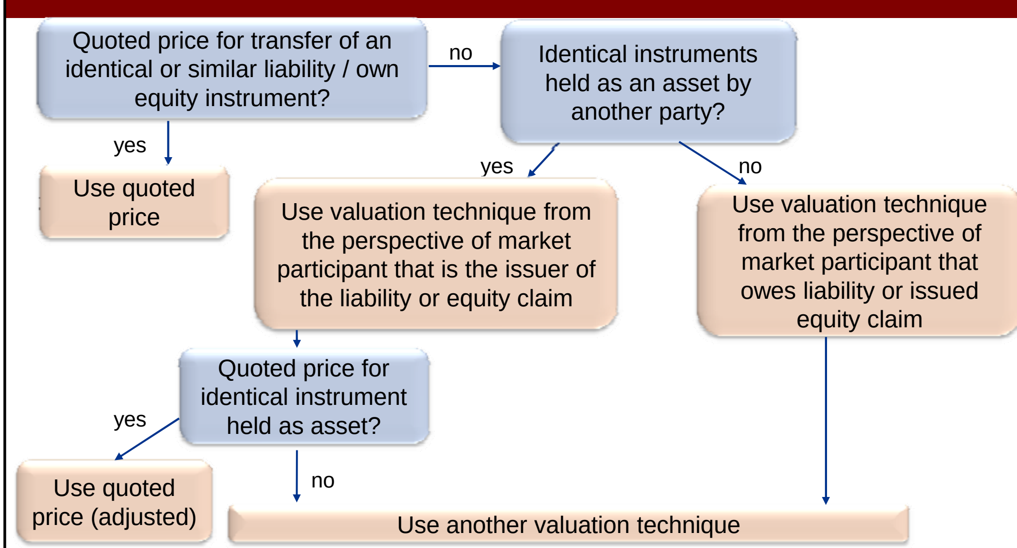
Application to liabilities and an entity's own equity instruments



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Application to liabilities and own equity instruments

Non-performance risk of a liability

- Fair value of a liability reflects non-performance risk, i.e. the risk that an entity will not fulfil the obligation
- Non-performance risk includes, but is not limited to, credit risk and is assumed to be the same before and after the transfer
- Inseparable third-party credit enhancements may need to be excluded

Restrictions on transfer

- Separate input or adjustment to other input not made for a restriction on an entity's ability to transfer a liability or own equity instrument
- Restriction assumed to be reflected in other inputs

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Fair value at initial recognition

- Transaction is between related parties
- Transaction is forced
- Unit of account represented by the transaction is different from unit of account used for measuring fair value
- The market in which transaction takes place is different from the market in which the entity would sell the asset or transfer the liability

May indicate that transaction price and fair value may differ

IFRS 13 does not prescribe rules for recognition of gains or losses at initial recognition – look to IFRS that permits/requires the fair value measurement

Assumed position is to take to profit or loss unless other IFRS says otherwise

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Valuation techniques

Market approach	Uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities
Income approach	Converts future amounts (e.g. cash flows or income and expenses) to a single present (discounted) amount
Cost approach	Reflects the amount that would currently be required to replace the service capacity of an asset (current replacement cost)

Inputs to valuation techniques

Inputs refer broadly to assumptions that market participants would use when pricing the asset or liability, including assumptions about risk

Observable - inputs that are developed based on observable market data and reflect market participants' assumptions	Unobservable - inputs for which market data are not available and which are developed based on the best available information about market participant assumptions

- **Valuation technique should maximise use of relevant observable inputs and minimise use of unobservable inputs**

Premiums and discounts

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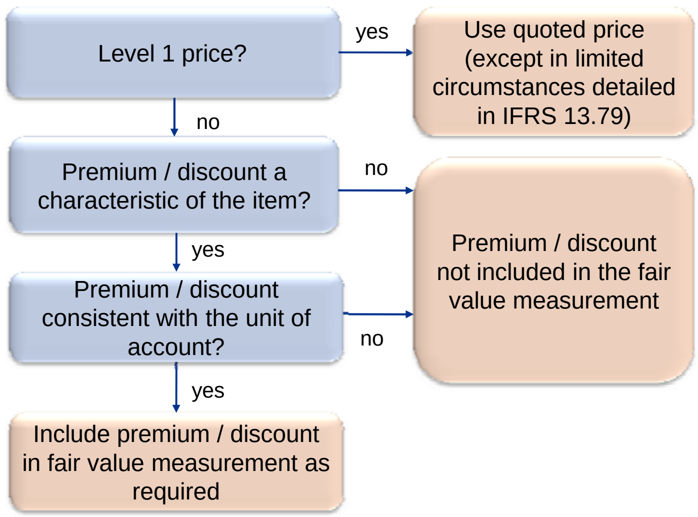


Fair value hierarchy

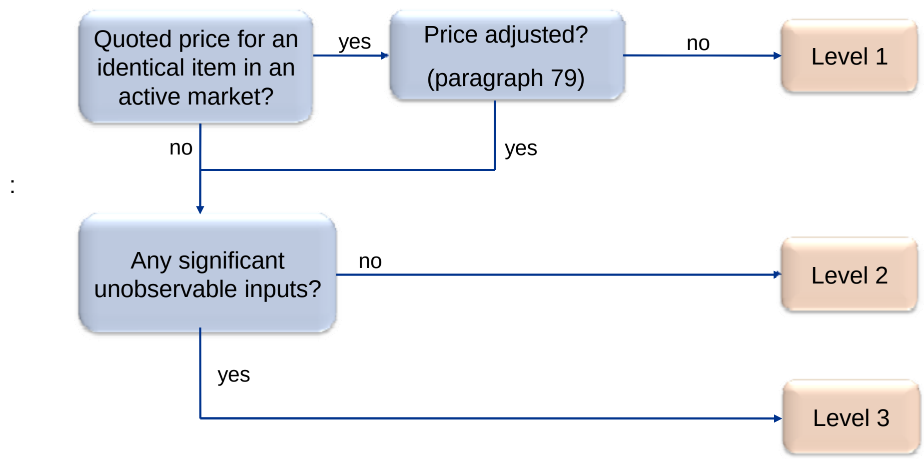
- IFRS 13 contains a hierarchy of fair value inputs
- Hierarchy the same as introduced by IFRS 7
- The fair value hierarchy prioritises the inputs to valuation techniques used to measure fair value into three levels, considering the relative subjectivity of inputs

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

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

Level 3 – unobservable inputs

Fair value hierarchy (cont'd)



Fair value hierarchy (cont'd)

Level 1 Inputs

- Quoted prices in an active market for identical assets or liabilities provide the best evidence of fair value
- A market is active if transactions take place with sufficient frequency and volume to provide pricing information on an ongoing basis
- If there is a Level 1 price, an entity must use that price for the fair value measurement. Exceptions include:
  - entity can use, in certain cases as a practical expedient, an alternative pricing methodology that does not rely exclusively on available quoted prices (e.g. matrix pricing)
  - in some circumstances, quoted price in an active market may not represent fair value at the measurement date (e.g. when significant events take place after the close of the market but before the measurement date)
- The use of alternative pricing will result in a lower level fair value measurement

Fair value hierarchy (cont'd)

Level 2 Inputs

- Include
  - 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 (e.g. interest rates and yield curves, volatilities, prepayment speeds, loss severities, credit risks and default rates)
  - inputs derived principally from or corroborated by observable market data by correlation or other means
- An adjustment to a Level 2 input that is not based on observable data and is significant to the entire measurement would result in a Level 3 measurement

Fair value hierarchy (cont'd)

Level 3 Inputs

- The objective of fair value measurement does not change when fair value is measured using unobservable inputs
- Unobservable inputs should reflect assumptions that market participants would use when pricing the asset or liability, including assumptions about risk
- An entity should develop the unobservable inputs using the best information available, which may include an entity's own data

Inputs based on bid and ask prices

- When inputs are determined based on bid and ask prices (e.g. in a dealer market), fair value measurement should, irrespective of the level in the hierarchy, use the price in the bid-ask spread that is most representative of fair value
- Use of bid prices for long positions (assets) and ask prices for short positions (liabilities) is permitted but not required
- IFRS 13 does not preclude use of mid-market pricing or other pricing conventions used by market participants as a practical expedient for fair value measurements within a bid-ask spread
- IAS 39 stated that bid-ask spread includes only transaction costs – IFRS 13 does not make such statement only noting that it does not include adjustments for counterparty credit risk

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Fair value in markets that are no longer active

- IFRS 13 includes guidance broadly consistent with guidance in the IASB's Expert Advisory Panel Report (October 2008) for when markets are no longer active
- The objective of a fair value measurement does not change when a market for an asset or liability is not active. However it is taken into account that:
  - measuring fair value in a market that is not active depends on the facts and circumstances and requires significant judgement
  - in an inactive market, transactions or prices quoted may not be determinative of fair value (e.g. there may be transactions that are not orderly)
  - further analysis of transactions or quoted prices is needed, and a significant adjustment to transactions or quoted prices may be necessary to measure fair value
  - An entity's intention to hold an asset is not relevant

Fair value in markets that are no longer active (continued)

- Regardless of the valuation technique used an entity includes appropriate risk adjustments, including a risk premium reflecting the amount market participants would demand because of the risk (uncertainty) inherent in the cash flows of an asset or liability
- IFRS 13 describes factors that may indicate that there has been a significant decrease in the volume or level of activity for an asset or liability. An entity should evaluate the significance and relevance of factors to determine whether a market is not active
- If a market is not active, it is inappropriate to conclude that all transactions in that market are not orderly

Fair value in markets that are no longer active (continued)

- IFRS 13 describes certain circumstances that may indicate that a transaction is not orderly
  - an entity evaluates the circumstances to determine whether the transaction is orderly.
  - if evidence indicates that a transaction is not orderly, an entity places little, if any, weight, on that transaction price when measuring fair value
  - when an entity does not have sufficient information to conclude whether particular transactions are orderly, the entity places less weight on those transactions compared to transactions that are known to be orderly
  - an entity need not undertake exhaustive efforts to determine whether a transaction is orderly but it shall not ignore information that is reasonably available.

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Disclosures

- Objective of disclosures for assets and liabilities measured at fair value is to provide information that enables financial statements users to assess
  - methods and inputs used to develop those measurements
  - for recurring fair value measurements using significant unobservable inputs (Level 3), the effect of measurements on profit or loss or OCI
- IFRS 13 requires certain minimum disclosures by classes of assets and liabilities
- IFRS 13 requires that an entity should present quantitative disclosures in a tabular format unless another format is more appropriate

Disclosures (continued)

- Significant new disclosure requirements
  - Quantitative disclosure about unobservable inputs for Level 3
  - Description of Level 3 valuation processes, policies and procedures
  - Narrative description of sensitivity to changes in unobservable inputs for recurring Level 3 measurements, including interrelationships between inputs
  - Fair value hierarchy and valuation techniques for amounts not measured at fair value but fair value is disclosed in the financial statements
- Accounting policy choice disclosures:
  - Timing of transfers between levels of the hierarchy
  - Exemption allowing measurement of groups of financial assets and financial liabilities
- Liabilities with inseparable third-party credit enhancements

Disclosures (continued)

Ref	Requirement	Recurring			Non-recurring			FV disclosed		
		L1	L2	L3	L1	L2	L3	L1	L2	L3
93(a)	Fair value at end of reporting period	■	■	■	■	■	■			
93(a)	Reasons for the measurement				■	■	■			
93(b)	Level within hierarchy	■	■	■	■	■	■	■	■	■
93(c)	Transfers within hierarchy	■	■	■						
93(d)	Description of valuation technique and inputs		■	■		■	■		■	■
93(d)	Any changes to valuation technique and reasons		■	■		■	■		■	■
93(d)	Quantify unobservable inputs			■			■			
93(e)	Reconciliation of opening and closing balance			■						
93(f)	Unrealised gains/losses from remeasurement			■						
93(g)	Description of valuation processes and policies			■			■			
93(h)(i)	Narrative sensitivity to changes in unobservable inputs			■						
93(h)(ii)	Quantitative sensitivity to changes in unobservable inputs (for financial assets and financial liabilities only)			■						
93(i)	If highest and best use differs from actual, then reasons why	■	■	■	■	■	■	■	■	■

■ Disclosure required

Disclosures (continued)

Interim financial statements

- For financial instruments measured at fair value, the fair value disclosures required in annual financial statements also apply for interim financial reports under IAS 34
- For non-financial assets and non-financial liabilities, no additional fair value disclosure requirements are required for interim reporting beyond the existing requirements in IAS 34

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Comparison with US GAAP

- Whilst the ED contained several differences with US GAAP, the majority of these have been addressed, with the exception of the following:
  - Unit of account – may differ as unit of account is addressed in individual IFRSs and not in IFRS 13
  - Day 1 gains or losses – not addressed under IFRS 13; IAS 39 / IFRS 9 not substantially changed
  - Fair value measurements of investments in certain entities that calculate net asset value (NAV) per share
    - US GAAP provides a practical expedient that permits an entity to measure the fair value of an investment in an investment company on the basis of NAV, under certain circumstances. IFRS doesn't have equivalent provisions.
  - Quantitative sensitivity analysis for financial instruments
  - Topic 820 has different disclosures for non-public entities.

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Application date

- IFRS 13 applies for annual periods beginning on or after 1 January 2013
- Earlier application is permitted with disclosure of the fact
- IFRS 13 is applied prospectively as of the beginning of the annual period in which the final standard is initially applied
- The disclosure requirements need not be applied to comparative information provided for periods before the date of initial application

THANK YOU