IFRS 13
Fair Value Measurement

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Agenda

- Objectives for issuing IFRS 13
- Scope
- Fair value measurement approach
- Fair value hierarchy
- Disclosures
- Transition from current IFRS
- Business impact

Objectives for issuing IFRS 13

- Clarifies definition of “fair value”
- Single framework for how to measure fair value
  - Previously, requirements were dispersed throughout IFRS and were not consistent
  - Does not change when fair value is used
- Enhanced fair value disclosures
- Increased convergence with US GAAP

Scope

- Applies when another IFRS requires or permits:
  - Fair value measurement (asset or liability, both financial and non-financial) or disclosures about fair value measurements
- IFRS 13 scope excludes:
  - IFRS 2, *Share-based Payment*
  - IAS 17, *Leases*
  - Similar terms (such as ‘net realizable value’ in IAS 2, *Inventories*, or ‘value in use’ in IAS 36, *Impairment of Assets*)
- IFRS 13 disclosures exclude:
  - Employee benefit plans under IAS 19, *Employee Benefits*, and IAS 26, *Retirement Benefit Plans*
  - Recoverable amount (based on fair value less costs of disposal) under IAS 36, *Impairment of Assets*

Fair value measurement approach
Definition and overview

***Fair value*: 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 (an exit price)**

- Determine:
  - Particular asset or liability that is being measured
  - For a non-financial asset, the valuation premise
  - Principal (or most advantageous) market
  - Appropriate valuation technique(s)
  - Inputs to valuation technique(s) based on market participant assumptions

Fair value measurement approach
What changed and who are affected?

What changed?
- Clearly an exit price
- Use principal market
- Highest and best use for non-financial assets
- Fair value of liabilities and equity instruments considered from perspective of market participants who hold as assets
- No blockage discounts
- More disclosures for non-financial assets

Who are affected?
- Entities that use fair value model for investment property
- Entities that revalue plant, property and equipment (PPE) or intangible assets
- Entities with biological assets or agricultural produce
- Entities with financial instruments

Fair value measurement approach
Asset or liability being measured

- Characteristics of asset or liability are considered if market participants would consider those characteristics when pricing the asset or liability at the measurement date
- Asset or liability measured at fair value might be:
  - A *stand-alone* asset or liability
  - A *group* of assets, a group of liabilities or a group of assets and liabilities
- Examples:
  - Condition and location of the asset
  - Restrictions on the sale or use of the asset
- Unit of account is determined in accordance with the IFRS that requires or permits fair value measurement

Fair value measurement approach
Principal market and most advantageous market

- A fair value measurement assumes that the transaction to sell the asset or transfer liability either:
  - Takes place in the principal market, for the item being measured
    - Principal market is the market with the greatest volume and level of activity for the asset or liability
    - Entity must have access to the principal market at the measurement date
    - Rebuttable presumption that the principal market is the market in which the entity normally transacts
  - Absent a principal market, the most advantageous market is
    - The market that maximizes amount that would be received to sell the asset or minimizes the amount that would be paid to transfer the liability, after considering transaction costs and transport costs

Fair value measurement approach
Transaction costs and transport costs

- Transaction costs are:
  - <u>Not</u> included in a fair value measurement
  - <u>Not</u> a characteristic of an asset or a liability
  - Specific to a transaction and differ depending on how an entity enters into a transaction for the asset or liability
  - Accounted for in accordance with other IFRS
- Transport costs are not transaction costs
  - If location is a characteristic of the asset, the price in the principal (or most advantageous) market is adjusted for the costs incurred to transport the asset from its current location to that market.
  - Relevant for commodities, agricultural produce, biological assets

Fair value measurement approach
Market participants

- A fair value measurement uses assumptions that market participants would use
  - Assumes that market participants act in their own economic best interest
- Market participants are buyers and sellers in principal (or most advantageous) market that are:
  - Independent of each other (not related parties)
  - Knowledgeable, assumed to have a reasonable understanding about the asset or liability based on all available information
  - Able to enter into a transaction for the asset or liability
  - Willing to enter into a transaction for the asset or liability

Fair value measurement approach
Highest and best use for non-financial assets

- Fair value considers a market participant's ability to generate economic benefits by using the asset in its highest and best use
- Its highest and best use considers a use that is:
  - Physically possible
  - Legally permissible
  - Financially feasible
- Current use is presumed to be highest and best use, unless factors suggest that a different use would maximize the value of the asset
- Highest and best use is always considered when measuring fair value, even if entity intends a different use
  - Disclose the reason(s) that the asset is being used in a manner that differs from its highest and best use

Fair value measurement approach
Valuation premise for non-financial assets

- Highest and best use might be either:
  - In combination with other assets and/or liabilities
    - Assumed that the complementary assets and liabilities would be available to market participants
    - Complementary liabilities include liabilities that fund working capital, but do not include liabilities to fund assets other than those within the group
    - Assumptions for highest and best use must be consistent for all assets and/or liabilities of the group
  - On a stand-alone basis
- A fair value measurement assumes asset is sold based on applicable unit of account

Example: Highest and best use

Land acquired in a business combination is currently developed for industrial use as a site for a manufacturing facility. Nearby sites were recently developed for residential high-rise condominiums. It was determined that the land could be used to develop residential high-rise condominiums.

How is highest and best used determined?

- In this case, the highest and best use is determined from the higher of:
  - The value of the land used in the manufacturing operation
  - The value of the land as a vacant site for residential use
- Note that transformation costs (e.g., costs to demolish the manufacturing facility) would be considered in the value of land as a vacant site

Fair value measurement approach
Liabilities and an entity’s own equity instruments

- A fair value measurement assumes:
  - A liability would remain outstanding and market participant would be required to fulfill the obligation
  - An equity instrument would remain outstanding and market participant would take on associated rights and responsibilities
  - Liabilities and equity instruments would <u>not</u> be cancelled or extinguished on measurement date
- When using a valuation technique, consider:
  - Price that would be used if that liability or equity instrument was held by another party as an asset
  - Compensation a market participant would demand for taking on obligation (if no corresponding asset exists)

Fair value measurement approach
Adjustments to assets when measuring liabilities

- Quoted price of a liability or an entity's own equity instrument held by another party as an asset are <u>only</u> adjusted if factors specific to asset are <u>not</u> applicable to liability or equity instrument:
  - Quoted price for asset relates to a similar (but not identical) liability or equity instrument held by another party as an asset
    - Example: credit quality of issuer differs from that reflected in the fair value of similar liability or equity instrument held as an asset
  - Unit of account for asset differs from liability or equity instrument:
    - Example: price for an asset reflects a combined price for a package comprising both (1) amounts due from the issuer and (2) a third-party credit enhancement; if unit of account for the liability is <u>not</u> the combined package, the entity would adjust the observed price for the asset to exclude the effect of the third-party credit enhancement

Fair value measurement approach

Non-performance risk when measuring liabilities

- Non-performance risk:
  - Reflected in fair value of a liability
  - Includes an entity's own credit risk
  - Is assumed to be the same before and after transfer of liability
- Fair value measurements consider effect of credit risk and any other factors that might influence the likelihood that the obligation will or will not be fulfilled. Examples:
  - Whether the liability is an obligation to deliver cash or an obligation to deliver goods or services
  - Terms of credit enhancements
- Unit of account considerations:
  - If inseparable third-party credit enhancement is accounted for separately from the liability, then the effect of the credit enhancement is not included in the fair value measurement

Fair value measurement approach
Financial instruments - Measurement exception

- Permitted to measure fair value of a group of financial assets and liabilities based on price that would be received to sell a net long position or to transfer a net short position for a particular risk exposure, only if entity meets all of the following:
  - Manages financial instruments on basis of net exposure to a particular market risk or to a credit risk of a particular counterparty in accordance with documented strategy
  - Provides information on that basis about the group of financial assets and financial liabilities to key management personnel
  - Is required to or has elected to measure the financial assets and financial liabilities at fair value at each reporting date
- Does not change presentation requirements
- Cannot be used for a portfolio that consists of only financial assets

Fair value measurement approach
Financial instruments - Bid-ask spread

- Price within bid-ask spread most representative of fair value is used to measure fair value

- Mid-market pricing or other pricing conventions are not precluded as a practical expedient for fair value measurements within a bid-ask spread

Fair value measurement approach
Premiums and discounts

- Blockage factors prohibited
  - **Blockage factor** – an adjustment to a quoted price for reduction that would occur if a market participant were to sell a large holding of assets or liabilities in one or a few transactions
- Other premiums and discounts may be included if consistent with all of the following:
  - Unit of account (in the IFRS that requires/permits fair value)
  - Market participants' economic best interest
  - Characteristics of the asset or liability being measured
- Examples of other premiums and discounts that might be appropriate:
  - Control premiums
  - Lack of marketability discounts

Fair value hierarchy
Valuation techniques

- Use valuation techniques that:
  - Are appropriate in circumstances
  - Have sufficient data available to measure fair value
  - Maximize use of relevant observable inputs
  - Minimize use of unobservable inputs
- Three widely used valuation techniques are:
  - Market approach
  - Income approach
  - Cost approach

Fair value hierarchy
Valuation techniques (cont'd)

- Might use one or several valuation techniques
  - If range of values are indicated, select point within that range most representative of fair value
- Change in valuation technique = change in estimate
  - BUT disclosures for change in accounting estimate are not required

Fair value hierarchy

	Level 1	Level 2	Level 3
Definition	Quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date	Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly	Unobservable inputs for the asset or liability
Example	Quoted prices for an equity security that trades on the Indonesia Stock Exchange (IDX)	Interest rates and yield curves observable at commonly quoted intervals, implied volatilities, and credit spreads	Growth rate applied to historical cash flows used to value a business or non-controlling interest in an entity that is not publicly listed

Disclosures
Principles

- Disclose information that helps users to assess:
  - For assets and liabilities that are measured at fair value on a recurring or non-recurring basis after initial recognition, valuation techniques 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 other comprehensive income for the period
- Fair value disclosures are required to be made separately for each class of assets and liabilities
- Present quantitative disclosures in a tabular format unless another format is more appropriate

Disclosures

	Measured at fair value on a recurring basis	Measured at fair value on a non-recurring basis (after initial recognition)	Not measured at fair value, but fair value is required to be disclosed
Fair value at end of reporting period	✔	✔	✔
Reasons for measurement		✔	
Level of fair value hierarchy	✔	✔	✔
Amounts of transfers between Level 1 and Level 2, reasons for transfers and policy for determining when transfers occurred	✔		
If highest and best use differs from current use, that fact, and why it is being used that way	✔	✔	✔

Disclosures

	Measured at fair value on a recurring basis	Measured at fair value on a non-recurring basis (after initial recognition)	Not measured at fair value, but fair value is required to be disclosed
For Level 2 and 3, a description of valuation technique(s) and inputs used	✔	✔	✔
For Level 2 and 3, any changes in valuation technique(s), and reasons for change	✔	✔	✔
For Level 3, quantitative information about significant unobservable inputs	✔	✔	
For Level 3, description of valuation processes	✔	✔	

Disclosures
Focus on recurring Level 3 measurements

- For recurring Level 3 fair value measurements, reconcile opening balances to closing balances, showing separately:
  - Total gains or losses for period recognized in profit or loss, and line item(s) where recognized
    - Amount of above total gain or loss attributable to unrealized gains or losses relating to assets and liabilities held at the end of the reporting period, and line item(s) where recognized
  - Total gains or losses for period recognized in other comprehensive income and line item(s) where recognized.
  - Purchases, sales, issues and settlements (each separately)
  - Amounts of any transfers into or out of Level 3 (each separately)
  - Reasons for transfers into or out of Level 3
  - Accounting policy for determining when transfers occurred

Disclosures

Focus on recurring Level 3 measurements (cont'd)

- For all recurring Level 3 fair value measurements:
  - A narrative description of sensitivity to changes in unobservable inputs, if a change in those inputs to a different amount might result in a significantly higher or lower fair value
  - If there are interrelationships between those inputs and other unobservable inputs used, describe those interrelationships and how they might magnify or mitigate effect of changes in unobservable inputs
  - At a minimum, quantitatively disclose unobservable inputs
- For financial assets and financial liabilities, disclose if changing one or more of unobservable inputs to reflect reasonably possible alternative assumptions would change fair value significantly, and effect
  - Same disclosure that was previously required in IFRS 7.27B(e)

Disclosures

- Disclose if using exception to account for financial instruments in a portfolio
- For a liability measured at fair value and issued with an inseparable third-party credit enhancement, disclose existence of credit enhancement and whether it is reflected in fair value measurement

Transition from current IFRS

- Effective 1 January 2013
- Applied prospectively as of beginning of annual period
- Early application permitted
- Disclosures are not required for comparative periods

Business impact

- Consider whether entity has appropriate expertise, processes, and systems
  - Significant increase in required disclosures for non-financial instruments that are measured at fair value (e.g., investment property measured using fair value, some biological assets)
- If IFRS 13 will change amount recognized, consider:
  - Covenant compliance
  - Remuneration plans
  - Shareholder communications
  - Analyst expectations

Thank you!

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