Fair value measurement

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 IND AS
- Additional disclosures required about fair value measurements, including for nonfinancial assets and liabilities
- The standard provides guidance on ‘how’ to measure fair value rather then ‘when’ to measure fair value; does not require additional fair value measurements

Scope

- IND AS 113 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 105
  - Investment property/intangibles/PP&E held at fair value
  - Biological assets

Out of scope – measurement & disclosures

- IND AS 102
- IND AS 17

Out of scope – disclosures

- IND AS 19
- IND AS 26
- IND AS 36

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, IND AS 113 does not prescribe the unit of account for fair value measurement; look to relevant standards

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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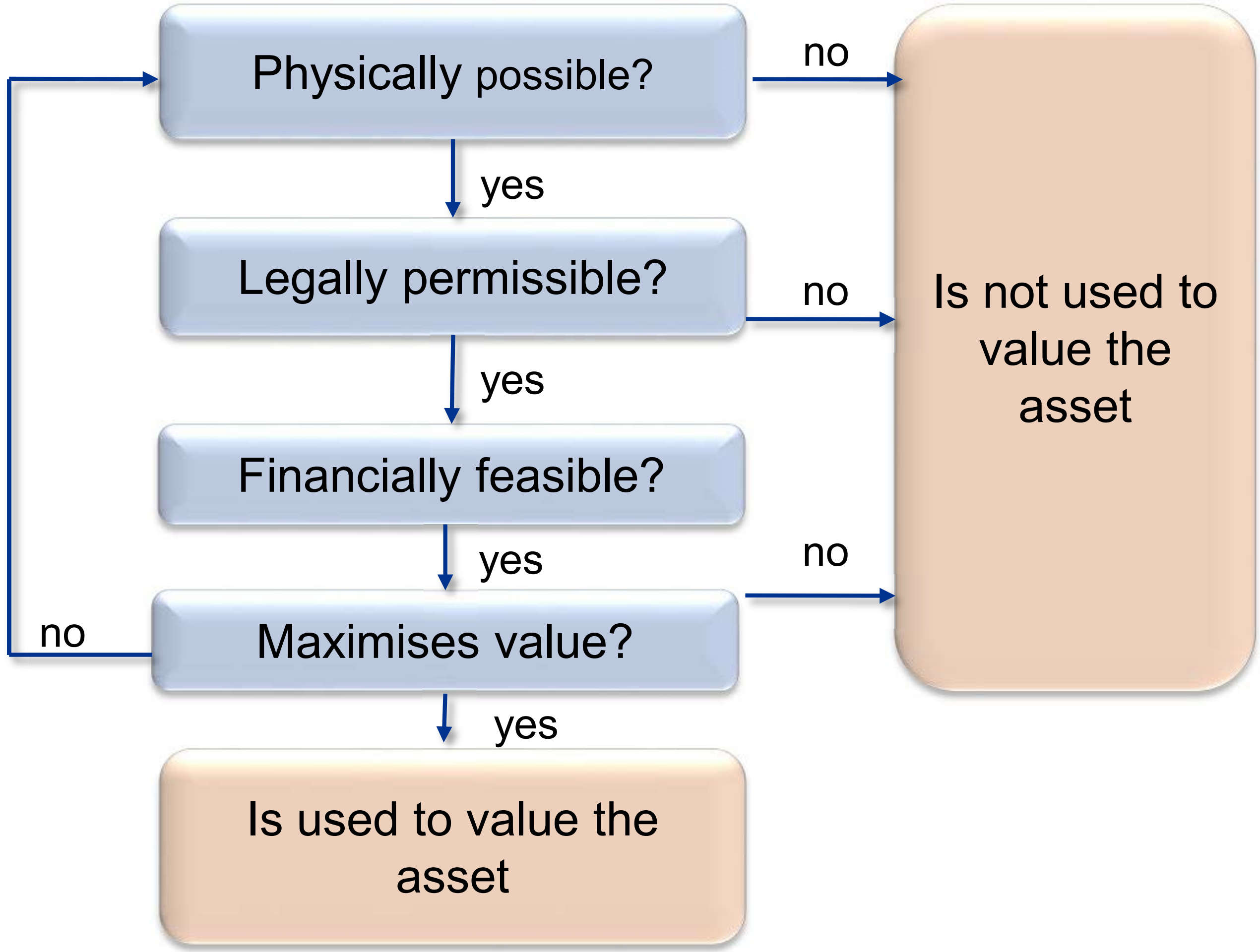

Example – highest and best use

- 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

Key factors

Exit price

Unit of account determination

Bid and ask

Transaction cost

Transaction cost in determining most advantageous market

Block discount

Restriction should be considered

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**

Fair value hierarchy

- IND AS 113 contains a hierarchy of fair value inputs
- Hierarchy the same as introduced by IND AS 107
- 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)

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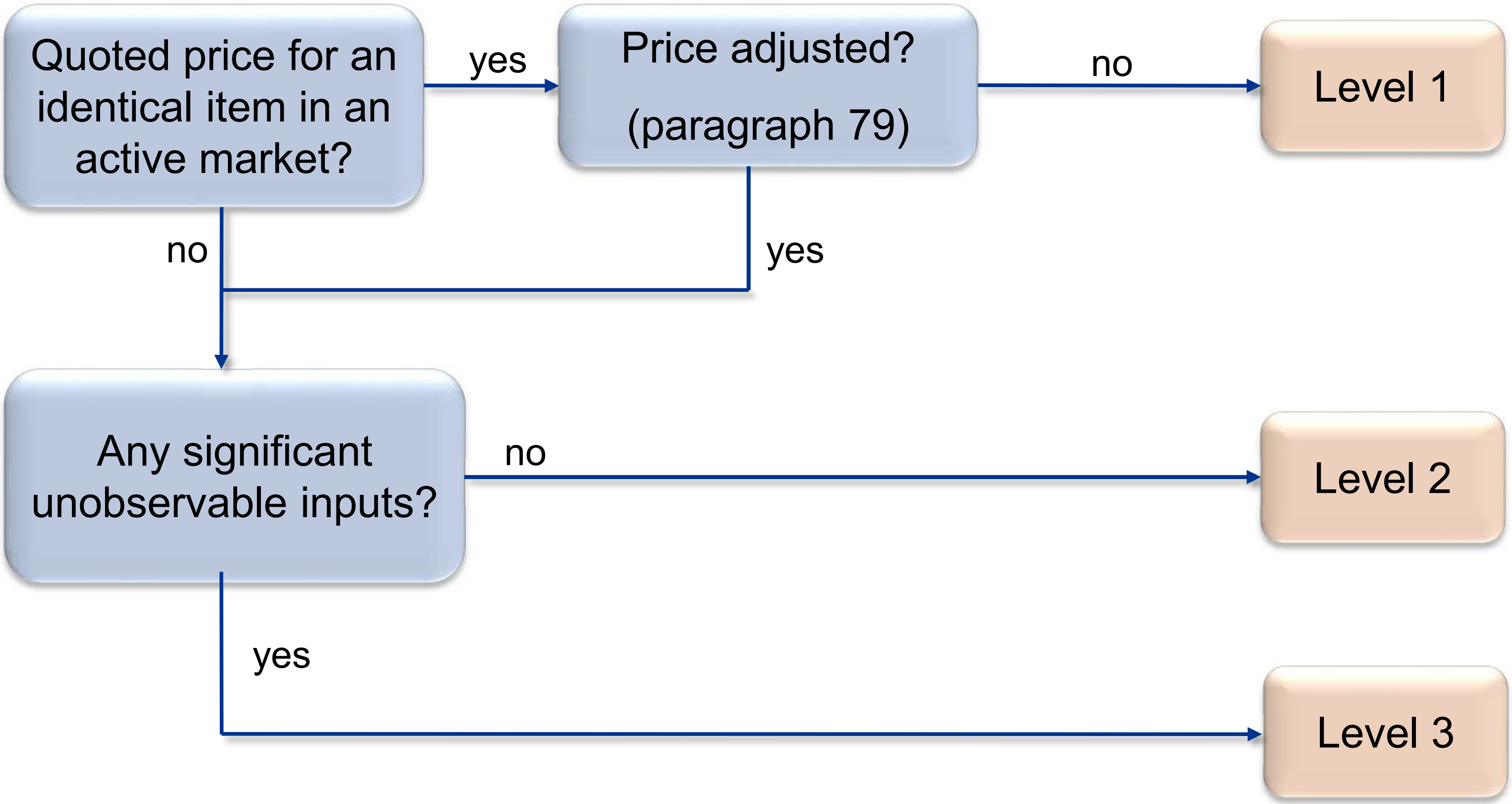

Fair value hierarchy (cont'd)

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
- 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

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
- IND AS 113 requires certain minimum disclosures by classes of assets and liabilities
- IND AS 113 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)

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 IND AS 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 IND AS 34

Thank you

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