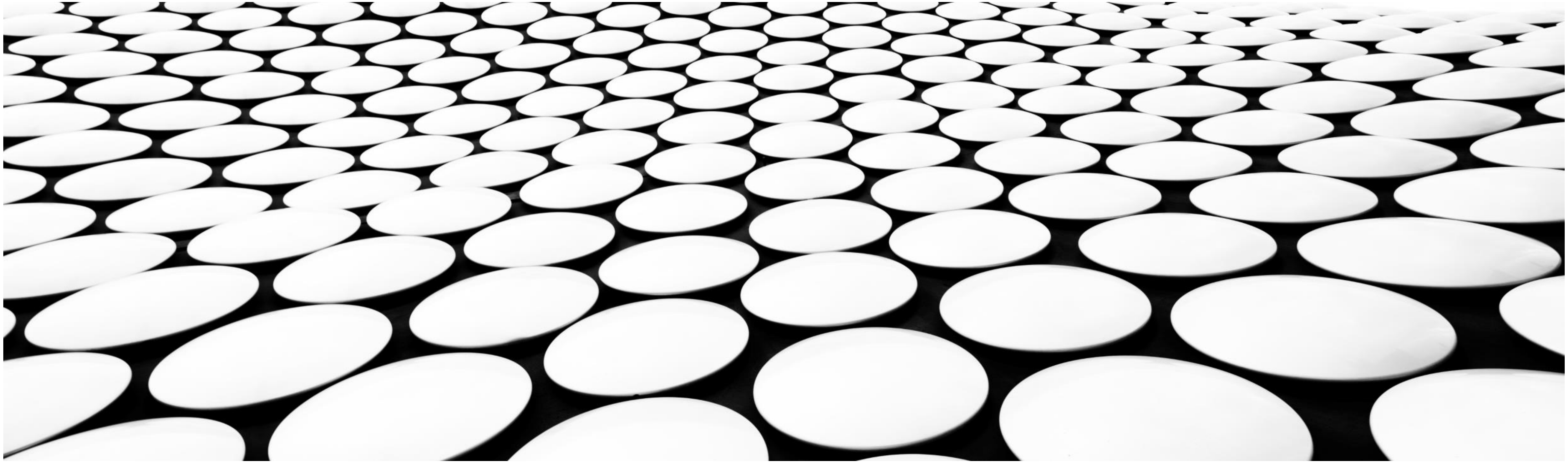
INTERNATIONAL FINANCIAL REPORTING STANDARDS FAIR VALUE MEASUREMENT – IFRS 13

B D CHATTERJEE FCA, ACMA, ACS, DIP IFR (ACCA) – UNITED KINGDOM



FAIR VALUE MEASUREMENT
INTERNATIONAL FINANCIAL REPORTING STANDARDS
IFRS 13

FAIR VALUE MEASUREMENT – IFRS 13

What is Fair Value?

Fair value is 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.

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What is meant by orderly transaction ?

A transaction that

- assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities;

- it is not a forced transaction (e.g. a forced liquidation or distress sale).

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What is entry price and exit price?

ENTRY PRICE	EXIT PRICE
• Entry price is the price *paid to acquire* an asset or *received to assume a liability* in an exchange transaction.	• Exit price is the price that would be *received to sell* an asset or *paid to transfer* a liability.

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Who are Market Participants ?

Market participants are buyers and sellers in the principal (or most advantageous) market for the asset or liability that have all of the following characteristics:

(a) They are independent of each other, i.e. they are not related parties as defined in IAS 24, although the price in a related party transaction may be used as an input to a fair value measurement if the entity has evidence that the transaction was entered into at market terms.

(b) They are knowledgeable, having 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.

(c) They are able to enter into a transaction for the asset or liability.

(d) They are willing to enter into a transaction for the asset or liability, i.e. they are motivated but not forced or otherwise compelled to do so.

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What is meant by Principal Market ?

- Principal market is the market with
  - the *greatest volume* and
  - *level of activity*
- for the asset or liability.

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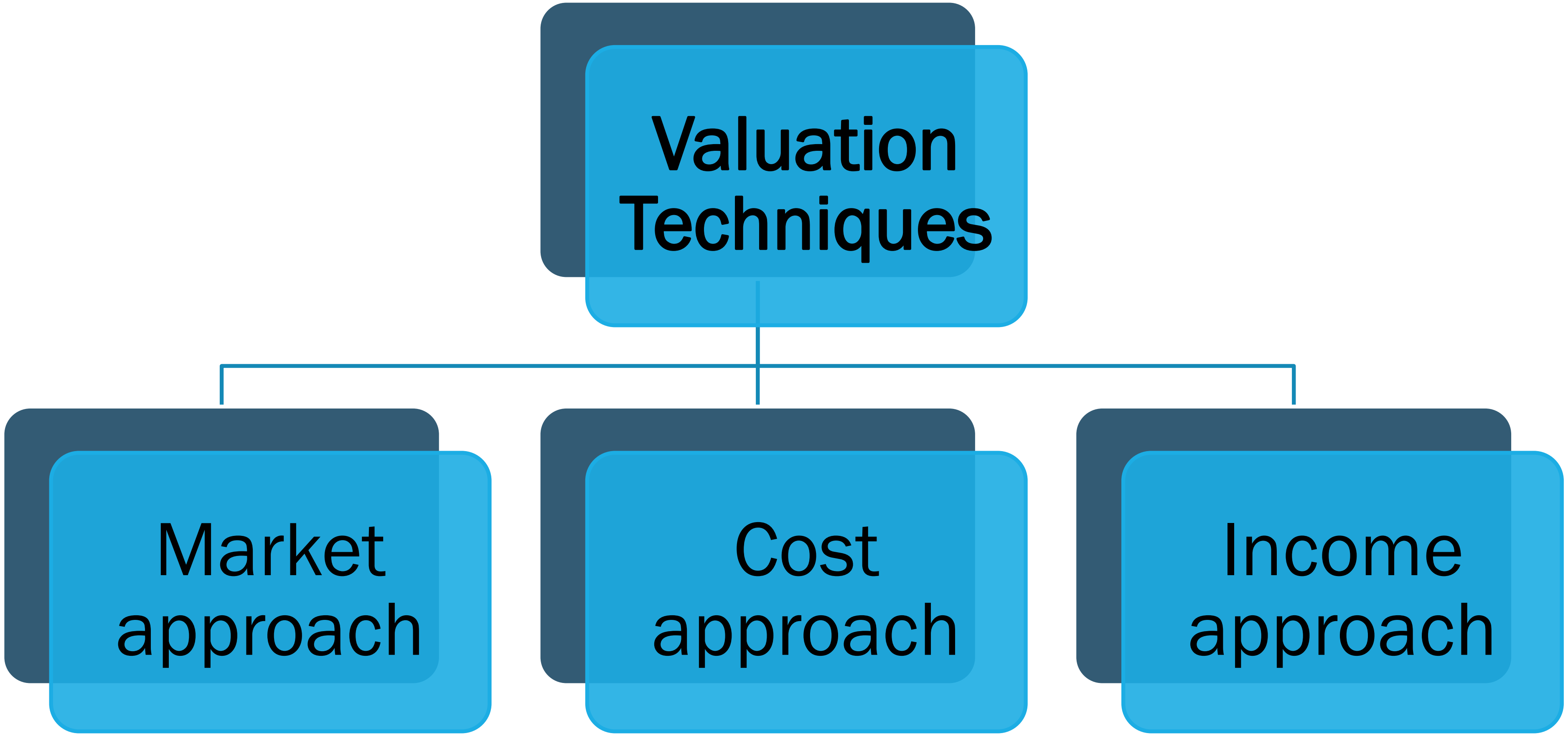
What are valuation techniques ?



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What is Market Approach?

Valuation techniques	Description
Market approach	a) The market approach uses prices and other relevant information generated by market transactions involving identical or comparable (i.e. similar) assets, liabilities or a group of assets and liabilities, such as a business. b) Valuation techniques consistent with the market approach often use market multiples derived from a set of comparables. c) Multiples might be in ranges with a different multiple for each comparable. The selection of the appropriate multiple within the range requires judgment, considering qualitative and quantitative factors specific to the measurement. c) Valuation techniques consistent with the market approach include matrix pricing. Matrix pricing is a mathematical technique used principally to value some types of financial instruments, such as debt securities, without relying exclusively on quoted prices for the specific securities, but rather relying on the securities' relationship to other benchmark quoted securities.

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What is Cost Approach?

Valuation techniques	Description
Cost approach	The cost approach reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost).

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What is Income Approach?

Valuation techniques	Description
Income approach	The income approach converts future amounts (e.g. cash flows or income and expenses) to a single current (i.e. discounted) amount. When the income approach is used, the fair value measurement reflects current market expectations about those future amounts. Valuation techniques include, for example, the following: (a) present value techniques; (b) option pricing models, such as the Black-Scholes-Merton formula or a binomial model (i.e. a lattice model), that incorporate present value techniques and reflect both the time value and the intrinsic value of an option; and (c) the multi-period excess earnings method, which is used to measure the fair value of some intangible assets.

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What is Present Value Technique?

Valuation techniques	Description
Present Value Technique	Present value (i.e. an application of the income approach) is a tool used to link future amounts (e.g. cash flows or values) to a present amount using a discount rate. A fair value measurement of an asset or a liability using a present value technique captures all the following elements from the perspective of market participants at the measurement date: (a) an estimate of future cash flows for the asset or liability being measured. (b) expectations about possible variations in the amount and timing of the cash flows representing the uncertainty inherent in the cash flows. (c) the time value of money, represented by the rate on risk-free monetary assets that have maturity dates or durations that coincide with the period covered by the cash flows and pose neither uncertainty in timing nor risk of default to the holder (i.e. a risk-free interest rate). (d) the price for bearing the uncertainty inherent in the cash flows (i.e. a *risk premium*). (e) other factors that market participants would take into account in the circumstances. (f) for a liability, the non-performance risk relating to that liability, including the entity's (i.e. the obligor's) own credit risk.

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What is Present Value Technique?

Valuation techniques	General Principles
Present Value Technique	(a) Cash flows and discount rates should reflect assumptions that market participants would use when pricing the asset or liability. (b) Cash flows and discount rates should take into account only the factors attributable to the asset or liability being measured. (c) To avoid double-counting or omitting the effects of risk factors, discount rates should reflect assumptions that are consistent with those inherent in the cash flows. (d) Assumptions about cash flows and discount rates should be internally consistent. For example, nominal cash flows, which include the effect of inflation, should be discounted at a rate that includes the effect of inflation. The nominal risk-free interest rate includes the effect of inflation. Real cash flows, which exclude the effect of inflation, should be discounted at a rate that excludes the effect of inflation. Similarly, after-tax cash flows should be discounted using an after-tax discount rate. Pre-tax cash flows should be discounted at a rate consistent with those cash flows. (e) Discount rates should be consistent with the underlying economic factors of the currency in which the cash flows are denominated.

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What are the inputs to Valuation techniques ?

IFRS - 13 establishes a Fair Value hierarchy that categorizes valuation related inputs into three levels, namely:

- ❑ **Level 1 input** - These inputs are quoted prices (unadjusted) in active markets for identical assets/liabilities that the entity can access at the measurement date.

- ❑ **Level 2 inputs** - These inputs are other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

- ❑ **Level 3 inputs** - These inputs are unobservable inputs for assets/liabilities. Unobservable inputs are used to measure Fair Value to the extent that relevant observable inputs are not available.

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What are observable and unobservable inputs ?

Observable inputs	Unobservable inputs
Observable inputs are those inputs that are developed using market data, such as publicly available information about actual events or transactions, and that reflect the assumptions that market participants would use when pricing the asset or liability.	Unobservable inputs are those Inputs for which market data are not available and that are developed using the best information available about the assumptions that market participants would use when pricing the asset or liability.

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What is meant by Participants Specific Value ?

Participant specific value is the estimated value of an asset or liability considering specific advantages or disadvantages of either of the owner or identified acquirer or identified participants.

Participant specific value may be measured for an existing owner or for an identified acquirer or for a transaction between two identified parties and consider factors which are specific to such party(ies) and which may not be applicable to market participants in general.

For example, a participant specific value for a potential acquirer in connection with acquisition of a manufacturing facility will consider aspects which have location and business specific advantages or synergies which may not be available to market participants in general.

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What are Transaction costs ?

The costs to sell an asset or transfer a liability in the principal (or most advantageous) market for the asset or liability that are directly attributable to the disposal of the asset or the transfer of the liability and meet both of the following criteria:

(a) They result directly from and are essential to that transaction.

(b) They would not have been incurred by the entity had the decision to sell the asset or transfer the liability not been made (similar to costs to sell, as defined in IFRS 5).

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What are the steps involved in Valuation Technique?

Step I - Determine unit of Account
Step II - Evaluate valuation Premise
Step III - Assess principal Market
Step IV -Determine the most advantageous market
Step V - Determine valuation Technique: - Cost approach - Market approach - Income approach
Step VI - Determine fair value

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What are the Disclosure Requirements?

An entity shall disclose information that helps users of its financial statements assess both of the following:

(a) for assets and liabilities that are measured at fair value on a recurring or non-recurring basis in the balance sheet after initial recognition, the valuation techniques and inputs used to develop those measurements.

(b) for recurring 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.

To achieve the above an entity shall consider all the following:

(a) the level of detail necessary to satisfy the disclosure requirements,

(b) how much emphasis to place on each of the various requirements,

(c) how much aggregation or disaggregation to undertake; and

(d) whether users of financial statements need additional information to evaluate the quantitative information disclosed.

If the disclosures provided in accordance with this IFRS and other IAS/IFRSs are insufficient to meet the objectives above, an entity shall disclose additional information necessary to meet those objectives.

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What are the Disclosure Requirements?

An entity shall disclose, at a minimum, the following information for each class of assets and liabilities measured at fair value (including measurements based on fair value within the scope of this IFRS) in the Statement of Financial Position after initial recognition:

(a) for recurring and non-recurring fair value measurements, the fair value measurement at the end of the reporting period, and for non-recurring fair value measurements, the reasons for the measurement.

(b) for recurring and non-recurring fair value measurements, the level of the fair value hierarchy within which the fair value measurements are categorized in their entirety (Level 1, 2 or 3).

(c) for assets and liabilities held at the end of the reporting period that are measured at fair value on a recurring basis, 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 for determining when transfers between levels are deemed to have occurred Transfers into each level shall be disclosed and discussed separately from transfers out of each level.

(d) for recurring and non-recurring fair value measurements categorized within 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. If there has been a change in valuation technique (e.g. changing from a market approach to an income approach or the use of an additional valuation technique), the entity shall disclose that change and the reason(s) for making it.

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What are the Disclosure Requirements?

(e) for recurring fair value measurements categorized within Level 3 of the fair value hierarchy, a reconciliation from the opening balances to the closing balances, disclosing separately changes during the period attributable to the following:

(i) total gains or losses for the period recognised in profit or loss, and the line item(s) in profit or loss in which those gains or losses are recognised.

(ii) total gains or losses for the period recognised in other comprehensive income, and the line item(s) in other comprehensive income in which those gains or losses are recognised.

(iii) purchases, sales, issues and settlements (each of those types of changes disclosed separately).

(iv) the amounts of any transfers into or out of Level 3 of the fair value hierarchy, the reasons for those transfers and the entity's policy for determining when transfers between levels are deemed to have occurred. Transfers into Level 3 shall be disclosed and discussed separately from transfers out of Level 3.

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What are the Disclosure Requirements?

(f) for recurring fair value measurements categorized within Level 3 of the fair value hierarchy, the amount of the total gains or losses for the period in (e)(i) included in profit or loss that is attributable to the change in unrealised gains or losses relating to those assets and liabilities held at the end of the reporting period, and the line item(s) in profit or loss in which those unrealised gains or losses are recognised.

(g) for recurring and non-recurring fair value measurements categorized within Level 3 of the fair value hierarchy, a description of the valuation processes used by the entity (including, for example, how an entity decides its valuation policies and procedures and analyses changes in fair value measurements from period to period).

(h) for recurring fair value measurements categorized within Level 3 of the fair value hierarchy:

(i) for all such measurements, a narrative description of the sensitivity of the fair value measurement 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 measurement.

(ii) for financial assets and financial liabilities, if changing one or more of the unobservable inputs to reflect reasonably possible alternative assumptions would change fair value significantly, an entity shall state that fact and disclose the effect of those changes

(i) for recurring and non-recurring fair value measurements, if the highest and best use of a non-financial asset differs from its current use, an entity shall disclose that fact and why the non-financial asset is being used in a manner that differs from its highest and best use.

THANK YOU!