CA magazine

WEBINAR SERIES

Implementing IFRS 13 *Fair Value Measurement*

CA Chartered Accountants of Canada

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AGENDA

- Overview
- Application
- Next steps
- Resources

OVERVIEW

REASONS FOR ISSUING IFRS 13

- Requirements for measuring and disclosing information about fair value were dispersed and did not always articulate a clear objective

- Some IFRSs that referred to fair value contained limited guidance on the topic; others contained extensive guidance

- Guidance not always consistent, contributing to diversity in practice

SCOPE AND OBJECTIVE

- IFRS 13 applies to IFRSs that require or permit fair value measurements or disclosures about fair value measurements, except in specified circumstances
- Not *when* to measure fair value but *how* to determine fair value
- Single framework for measuring fair value, answers:
    1. What is fair value?
    2. How should an entity measure fair value?
    3. What should be disclosed about fair value measurements?
- Applies to both initial and subsequent measurement

CONSIDER OTHER STANDARDS

- IFRS 3, Business combinations
- IFRS 5, Non-current assets held for sale & discontinued…
- IAS 16, Property, plant and equipment
- IAS 18, Revenue
- IAS 32, Financial instruments: presentation
- IAS 36, Impairment of assets
- IAS 39, Financial instruments: recognition and measurement
- IAS 40, Investment property
- IAS 41, Agriculture

UNDERLYING CONCEPTS

- 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"*
- IFRS 13 concepts emphasize:
  - "exit price"
  - transaction in principal or else most advantageous market
  - perspective of market participants; not entity specific
  - highest and best use (for non-financial assets)
  - independent, knowledgeable, able and willing
  - not a forced transaction or distress sale

UNDERLYING CONCEPTS – cont'd

- Places process of measuring fair value in context of real world
  - what would market participants actually pay or demand?
  - what price would market participants place on risks?
- Does not require identifying specific market participants or being able to sell/transfer item valued at measurement date
- Entity's own intentions not relevant (where they differ from the assumptions of market)

HOW TO DETERMINE FAIR VALUE?

Step 1: Identify item being measured

What is being measured? What is the unit of account?

Step 2: Determine market

What is the principal or most advantageous market (i.e., market in which an orderly transaction would take place for asset or liability)?

Step 3: Identify assumptions

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

Step 4: Select valuation techniques

What are the appropriate valuation technique(s)?

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IDENTIFY ITEM BEING MEASURED

- Stand-alone asset or liability or a group of assets and/or liabilities (e.g., cash-generating unit)
  - depends on “unit of account” under IFRS
  - determined in accordance with the standard that requires or permits the fair value measurement, with certain exceptions
- Characteristics market participants would take into account
  - asset’s condition and location
  - restrictions on an asset’s sale or use

DETERMINE MARKET

Step 1: Identify markets to which the entity has access

Step 2: Among those markets, determine principal or most advantageous market

- Principal market (i.e., greatest volume/level of activity)
- Most advantageous market (i.e., market that maximizes the amount that would be received to sell the asset or minimizes the amount that would be paid to transfer the liability, after taking into account transaction costs and transport costs)

The market in which the entity would normally enter into a transaction to sell the asset or to transfer the liability is presumed to be the principal market or the most advantageous market, unless evidence to contrary

SELECT VALUATION TECHNIQUES

- For some assets and liabilities, observable market transactions/information may be available
  - a quoted price in an active market provides the most reliable evidence of fair value and is used without adjustment where available, with certain exceptions
  - where a particular item measured at fair value has both a bid price and an ask price, use the "price within the bid-ask spread that is most representative of fair value in the circumstances"
- For assets and liabilities where observable market transactions are not available, measure fair value using other valuation technique(s)

SELECT VALUATION TECHNIQUES – cont'd

- Valuation techniques must maximize use of relevant observable inputs and minimize use of unobservable inputs
  - Market approach
    - uses prices and other relevant information generated by market transactions involving identical or comparable items
  - Cost approach
    - reflects the amount that would be required currently to replace an asset's service capacity
  - Income approach
    - converts future amounts to a discounted current amount
- Consider multiple valuation techniques and most representative point within the range

SELECT VALUATION TECHNIQUES – cont'd

- Adjusted net asset approach represents a combination of valuation techniques
  - might be appropriate where entity value derived mainly from holding assets
  - might also be appropriate for early stage development entity
- Fair value of a business derived by reference to the fair value of its assets and liabilities
  - need to ensure all assets and liabilities are included (e.g., including intangible assets or unrecognized contingencies)
  - consider need to apply a minority interest discount
  - adjust for lack of liquidity, time elapsed since the information's reporting date, and other facts/circumstances

SELECT VALUATION TECHNIQUES – cont'd

- Valuation techniques applied consistently between periods
  - appropriate to change valuation technique or how it's applied if the change results in a measurement equally or more representative of fair value in the circumstances,
    - new markets develop or new information available
    - valuation techniques improve
    - information previously used is no longer available
  - revisions resulting from changes in the valuation technique are treated as changes in accounting estimates (but usual IAS 8 disclosures not required)

CONSIDER DISCLOSURES

- Detailed disclosure requirements
- Recurring vs. non-recurring fair value measurements
- Items to note:
  - IFRS 13 retains the 1/2/3 fair value measurement hierarchy, but does not restrict it to financial instruments (e.g., non-financial assets in business combinations)
  - fair value hierarchy also applies to fair value measurements provided in the notes, not just those recognized in the statement
  - extensive disclosure for Level 3 items (e.g., reconciliation, valuation techniques, gains & losses, sensitivity analysis)

CONSIDER DISCLOSURES – cont'd

Disclosure	Recurring			Non-Recurring			Fair Value Disclosed		
	1	2	3	1	2	3	1	2	3
Fair value at end of reporting period	x	x	x	x	x	x			
Reasons for measurement				x	x	x			
Level within the fair value hierarchy	x	x	x	x	x	x	x	x	x
Transfer within the fair value hierarchy	x	x							
Description of valuation technique(s)		x	x		x	x		x	x
Changes to valuation techniques(s) & reasons		x	x		x	x		x	x
Quantification of unobservable inputs			x			x			
Reconciliation of opening & closing balance			x						
Unrealized remeasurement gains/losses			x						
Description of valuation processes/policies			x			x			
Narrative sensitivity to changes in unobservable inputs			x						
Quantitative sensitivity to changes in unobservable inputs (financial items)			x						
If highest and best use differs from actual, reasons why	x	x	x	x	x	x	x	x	x

APPLICATION

APPLICATION - NON-FINANCIAL ASSETS

- IFRS 13 applies to non-financial assets measured at fair value (e.g., business combination)
- Non-financial assets are measured on the basis that would maximize their use – the “highest and best use” – even if intended or actual use is different
  - premise that holder’s intentions not necessarily relevant
  - consider intangible asset being held defensively
- Does not change the requirements for “net realizable value” or other concepts that are not strictly fair value measurements

APPLICATION - LIABILITIES & OWN EQUITY

- Issued liability or equity instrument (e.g., issued as consideration in a business combination)
- Instrument transferred at measurement date
- Assumes the transferee would fulfill the liability, or take on the rights and responsibilities attaching to the equity instrument (not that the transferee would settle/cancel/extinguish)
  - amount may differ from face value due to changes in market rates, credit risk or other factors
- “Highest and best use” concept not applicable
- Relative internal efficiency of an entity settling the liability using own internal resources not reflected in liability fair value

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APPLICATION - PREMIUMS OR DISCOUNTS

- Premiums or discounts reflecting “size as a characteristic of the entity’s holding” are not permitted
  - if a level 1 price exists for an item falling under IAS 39, use that price “even if a market’s normal daily trading volume is not sufficient to absorb the quantity held and placing orders to sell the position in a single transaction might affect the quoted price”
    - e.g., for an “available for sale” holding of 100,000 shares with a quoted price per share of $8, fair value is $800,000
  - however, may adjust fair value for matters such as a control premium or non-controlling interest discount for an item falling under IFRS 10, where the unit of account is not necessarily an individual share

APPLICATION - VALUATION TECHNIQUES

- IFRS 13 does not preclude the use of quoted prices provided by third parties, such as brokers or pricing services, provided quoted prices determined in accordance with IFRS 13
- Just because *some* form of market price is available, does not mean it complies with IFRS 13 – for instance there may have been a decrease in the volume of activity, so that the most recent prices may not reflect current risks
- Consider whether the inputs used for valuation techniques are consistent and comparable to the item being valued
  - e.g., might need to adjust for different liquidity or tax environments

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APPLICATION - UNQUOTED SECURITIES

- IAS 39 requires measuring these investments at fair value (unless range of reasonable fair value estimates is significant and probabilities of the various estimates cannot be assessed) and provides guidance on inputs to valuation techniques
- Revisit fair value measurements to ensure they reflect IFRS 13 - not assume fair value not changed materially since the date the instruments were purchased - e.g., need to consider risk premium that would currently be demanded by market
- Black-Scholes valuation model does not in itself ensure appropriate measurement – consider whether the value accurately reflects amount market participants would pay

APPLICATION - ASSETS SUBJECT TO RESTRICTIONS

- Assets might be subject to restrictions because of escrow arrangements, contractual provisions or other matters
- May affect price market participants would pay for asset, compared to the same unrestricted asset
  - Consider if restriction lowers fair value
- Minimal specific guidance in IFRS 13, but need to consider
  - the restriction's nature and duration
  - the extent to which buyers are limited by it
  - other qualitative/quantitative factors specific to both the instrument and the issuer

APPLICATION - FAIR VALUE DISCLOSURES

- Carefully consider disclosures stating fair value not materially different from their carrying value (e.g., debt at amortized cost)
  - May be valid, assuming, for example, no changes in market interest rates or relative credit quality
  - need to return to core concepts of how market participants would look at the instrument and price they would demand to transfer the liability

TRANSITION TO IFRS 13

- IFRS 13 is applicable to annual reporting periods beginning on or after 1 January 2013
- Apply prospectively as of the beginning of the annual period in which initially applied
  - i.e., would apply to March 31, 2013 interim periods, but does not require revisiting measurements already made for the March 31, 2012 comparative period
- Disclosure requirements do not apply to comparative information

NEXT STEPS

- Carefully consider every item in statement of financial position
  - is it measured at fair value?
  - if so, how does the current measurement valuation methodology compare to the concepts in IFRS 13?
  - is it necessary to implement a new valuation technique?
  - do values flowing from existing valuation techniques need to be adjusted (e.g., to reflect a risk premium that would be charged by market participants)?

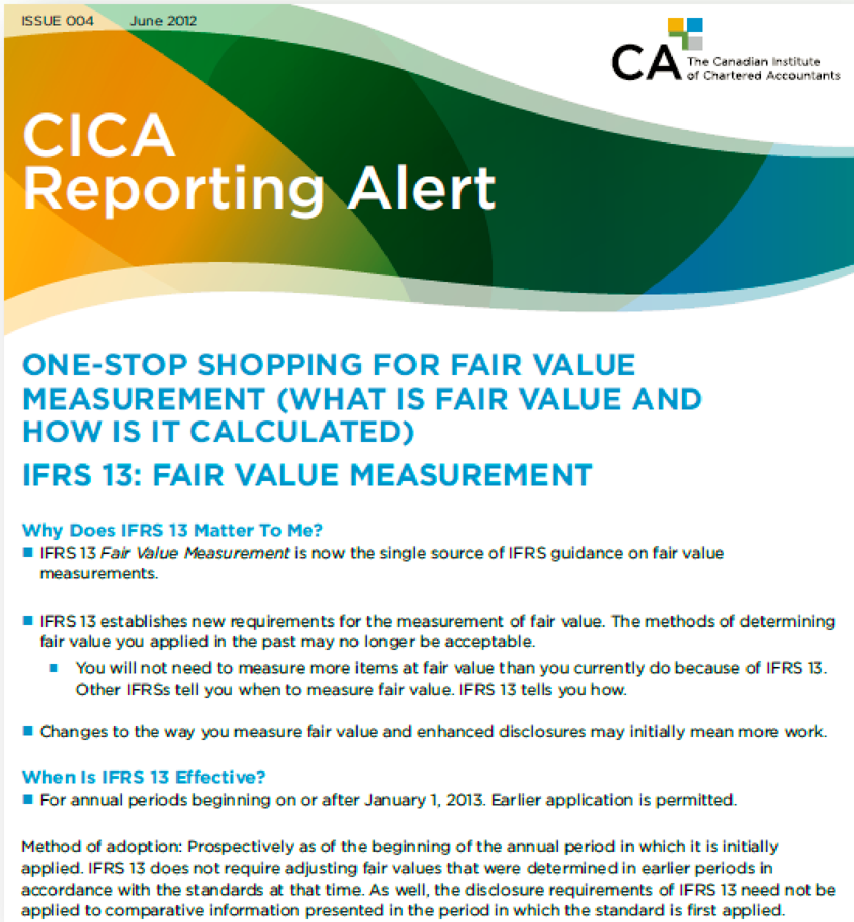
NEXT STEPS – cont'd

- Financial instruments not measured at fair value
  - what is disclosed in notes about instrument's fair value?
  - do current disclosure conform with IFRS 13?
- Are any non-financial assets measured at fair value on an ongoing basis in the financial statements?
  - May not be common for smaller entities, but need to consider the measurement techniques for investment properties, biological assets, or other items
- Is fair value used as a basis to determine recoverable amount for impairment testing?

NEXT STEPS – cont'd

- IFRS 13 should affect the planning for business combinations
  - smaller entities often consider valuation issues only after closing transaction
  - where third party valuations are used, need to ensure these reflect the principles of IFRS 13
  - keep in mind the "highest and best use" principle
  - may ultimately impact on goodwill with an ongoing impact on impairment testing

RESOURCES



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CICA Reporting Alert

ONE-STOP SHOPPING FOR FAIR VALUE MEASUREMENT (WHAT IS FAIR VALUE AND HOW IS IT CALCULATED)

IFRS 13: FAIR VALUE MEASUREMENT

Why Does IFRS 13 Matter To Me?

- IFRS 13 *Fair Value Measurement* is now the single source of IFRS guidance on fair value measurements.
- IFRS 13 establishes new requirements for the measurement of fair value. The methods of determining fair value you applied in the past may no longer be acceptable.
  - You will not need to measure more items at fair value than you currently do because of IFRS 13. Other IFRSs tell you when to measure fair value. IFRS 13 tells you how.
- Changes to the way you measure fair value and enhanced disclosures may initially mean more work.

When Is IFRS 13 Effective?

- For annual periods beginning on or after January 1, 2013. Earlier application is permitted.

Method of adoption: Prospectively as of the beginning of the annual period in which it is initially applied. IFRS 13 does not require adjusting fair values that were determined in earlier periods in accordance with the standards at that time. As well, the disclosure requirements of IFRS 13 need not be applied to comparative information presented in the period in which the standard is first applied.

The CICA Reporting Alert – IFRS 13 Fair Value Measurement is designed to assist smaller public companies determine how IFRS 13 affects their business.

The CICA Reporting Alert:

- highlights guidance
- summarizes key changes
- suggests a plan of action
- answers commonly asked questions.

Click here to access CICA Reporting Alert

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RESOURCES

<u>Facilitator led course:</u>
New IFRSs for 2013 - FOUR Standards in TWO Days - NEW for 2013!

January 17 to 18, 2013, CICA Offices, Toronto, ON

Topics include:

- IFRS 10 - Consolidated Financial Statements
- IFRS 11 - Joint Arrangements
- IFRS 12 - Disclosure of Interest in Other Entities
- IFRS 13 - Fair Value Measurement

Click here to register for course:

RESOURCES

IASB publication

Measuring the fair value of unquoted equity instruments within the scope of IFRS 9 Financial Instruments

Click here to access publication

QUESTIONS?

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