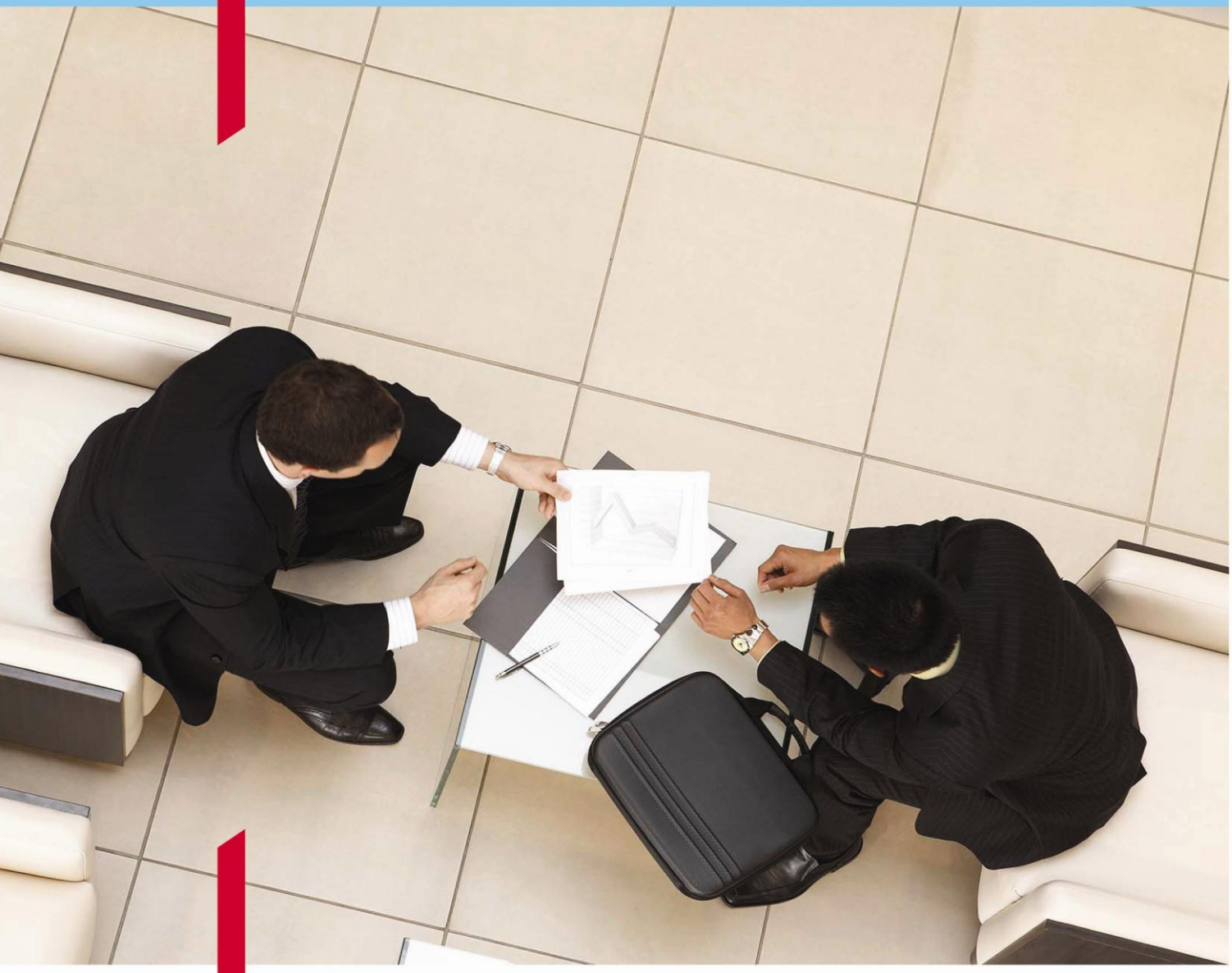
IFRS AT A GLANCE

IFRS 13 *Fair Value Measurement*



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IFRS 13 *Fair Value Measurement*

Effective Date
Periods beginning on or after 1 January 2013

SCOPE

IFRS 13 applies when another IFRS requires or permits fair value measurements (both initial and subsequent) or disclosures about fair value measurements, except as detailed below:

Exemption from both measurement and disclosure requirements:
- Share-based payment transactions within the scope of IFRS 2 *Share-based Payment*
- Leasing transactions within the scope of IAS 17 *Leases*
- Measurements that have some similarities to fair value, but are not fair value, such as:
  - Net realisable value in IAS 2 *Inventories*
  - Value-in-use in IAS 36 *Impairment of Assets*.

Exemption from disclosures requirements only:
- Plan assets measured at fair value in accordance with IAS 19 *Employee Benefits*
- Retirement benefit plan investments measured at fair value in accordance with IAS 26 *Accounting and Reporting by Retirement Benefit Plans*
- Assets for which recoverable amount is fair value less costs of disposal in accordance with IAS 36.

DEFINITION OF FAIR VALUE

The measurement date price that would be received / paid to sell an asset/transfer a liability in an orderly transaction between market participants.

Asset or liability
Fair value measurement considers the specific characteristics of the particular asset or liability:
- The condition and location of the asset
- Any restrictions on the sale or use of the aset.

Transaction
Fair value measurement assumes that the transaction takes place:
- In the principal market for the asset or liability
- Or in the absence of a principal market, in the most advantageous market for the asset or liability.

Market participants
An entity measures the fair value of an asset or a liability using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest. Market participants do not need to be identified.

Price
Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal, or most advantageous, market at the measurement date under current market conditions (i.e. an exit price) regardless of whether that price is directly observable or estimated using another valuation technique.

APPLICATION TO NON-FINANCIAL ASSETS

HIGHEST AND BEST USE (HBU)

Fair value measurement of a non-financial asset takes into account a market participant's (not the entity's) ability to generate economic benefits by using the asset in its HBU or by selling it to another market participant that would use the asset in its HBU.

Factors to consider in determining HBU:
- Physically possible
- Legally permitted
- Financially viable.

VALUATION PREMISE - STAND ALONE

If the highest and best use is on a stand-alone basis, fair value is the price that would be received in a current sale to a market participant that would use the asset on a standalone basis.

VALUATION PREMISE - COMBINATION

If the HBU is in combination with other assets, fair value is the price that would be received in a current sale to market participants assuming the asset will be used in combination with those assets (which are also assumed to be available to the market participants).

APPLICATION TO LIABILITIES AND AN ENTITY'S OWN EQUITY INSTRUMENTS

GENERAL PRINCIPLES

Assume that the **liability** would remain outstanding and the market participant transferee would be required to fulfil the obligation. The liability would not be settled with the counterparty or otherwise extinguished on the measurement date.

Assume that entity's own **equity** instrument would remain outstanding and the market participant transferee would take on the rights and responsibilities associated with the instrument. The instrument would not be cancelled or otherwise extinguished on the measurement date.

HELD BY OTHER PARTIES AS ASSETS

When a quoted price for the transfer of an identical or a similar liability or entity's own equity instrument is not available and the identical item is held by another party as an asset, measure the fair value of the liability or equity instrument from the perspective of a market participant that holds the identical item as an asset at the measurement date, by:
- Using the quoted price in an active market for the identical item
- If that price is not available, using other observable inputs
- If the observable prices above are not available, using another valuation technique (income approach, or market approach).

NOT HELD BY OTHER PARTIES AS ASSETS

When a quoted price for the transfer of an identical or a similar liability or entity's own equity instrument is not available and the identical item is not held by another party as an asset, an entity is required to measure the fair value of the liability or equity instrument using a valuation technique from the perspective of a market participant that owes the liability or has issued the claim on equity.

NON PERFORMANCE RISK

- The fair value of a liability reflects the effect of non-performance risk (NPR)
- NPR includes (but is not limited to) an entity's own credit risk (as defined in IFRS 7 *Financial Instruments: Disclosures*)
- NPR is assumed to be the same before and after the transfer of the liability
- Consideration to the effect of its credit risk and any other factors that might influence the likelihood that the obligation will or will not be fulfilled. That effect may differ depending on the liability, for example:
  - Whether the liability is an obligation to deliver cash (a financial liability) or an obligation to deliver goods or services (a non-financial liability)
  - The terms of credit enhancements related to the liability, if any.

RESTRICTION PREVENTING TRANSFER

When measuring the fair value of a liability or an entity's own equity instrument, an entity is not permitted to include a separate input or an adjustment to other inputs relating to the existence of a restriction that prevents the transfer of the item.

The effect of a restriction that prevents the transfer of a liability or an entity's own equity instrument is either implicitly or explicitly included in the other inputs to the fair value measurement.

DEMAND FEATURE

The fair value of a financial liability with a demand feature (e.g. a demand deposit) is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.

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APPLICATION TO FINANCIAL ASSETS AND FINANCIAL LIABILITIES WITH OFFSETTING POSITIONS IN MARKET RISKS OR COUNTERPARTY CREDIT RISK

An entity that holds a group of financial assets and financial liabilities is exposed to **market risks** and to the **credit risk** of each of the counterparties.

If an entity manages that group of financial assets and financial liabilities on the basis of its net exposure to either market risks or credit risk, the entity is permitted to **apply an exception** ('offsetting exemption') to IFRS 13 for measuring fair value.

That exception permits an entity to measure the fair value of a group of financial assets and financial liabilities on the basis of the price that would be received to sell a net long position (i.e. an asset) for a particular risk exposure or to transfer a net short position (i.e. a liability) for a particular risk exposure in an orderly transaction between market participants at the measurement date under current market conditions.

Accordingly, an entity is required to measure the fair value of the group of financial assets and financial liabilities consistently with how market participants would price the net risk exposure at the measurement date.

An entity is permitted to use the exception only if the entity does all the following:

- Manages the group of financial assets and financial liabilities on the basis of the entity's net exposure to a particular market risk (or risks) or to the credit risk of a particular counterparty in accordance with the entity's documented risk management or investment strategy
- Provides information on that basis about the group of financial assets and financial liabilities to the **entity's key management personnel**, as defined in IAS 24 *Related Party Disclosures*
- Is required or has elected to measure those financial assets and financial liabilities at fair value in the statement of financial position at the end of each reporting period.

The exception does not relate to presentation.

An Entity is required to make an accounting policy election in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Error* when using the exception.

EXPOSURE TO MARKET RISKS

When using the exception, the entity is required to:

- Apply the price within the bid-ask spread that is most representative of fair value in the circumstances to the entity's net exposure to those market risks
- Ensure that the market risk (or risks) to which the entity is exposed within that group of financial assets and financial liabilities is substantially the same:
  - Any basis risk resulting from the market risk parameters not being identical are required to be taken into account in the fair value measurement of the financial assets and financial liabilities within the group
  - Similarly, the duration of the entity's exposure to a particular market risk (or risks) arising from the financial assets and financial liabilities are required to be substantially the same.

EXPOSURE TO CREDIT RISK

When using the exception the entity is required to:

- Include the effect of the entity's net exposure to the credit risk of that counterparty or the counterparty's net exposure to the credit risk of the entity in the fair value measurement when market participants would take into account any existing arrangements that mitigate credit risk exposure in the event of default.

The fair value measurement is required to reflect market participants' expectations about the likelihood that such an arrangement would be legally enforceable in the event of default.

FAIR VALUE AT INITIAL RECOGNITION

When an asset is acquired or a liability is assumed in an exchange transaction, the transaction price is the price paid to acquire the asset or received to assume the liability (entry price). In contrast, the fair value of the asset or liability is the price that would be received to sell the asset or paid to transfer the liability (exit price).

In many cases the transaction price will equal the fair value – however it is necessary to take into account factors specific to the transaction and to the asset or liability.

VALUATION TECHNIQUES

Must use appropriate valuation techniques in the circumstances and for which sufficient data are available to measure fair value.

Revisions resulting from a change in the valuation technique or its application are accounted for as a change in accounting estimate in accordance with IAS 8.

INPUTS TO VALUATION TECHNIQUES

Valuation techniques used to measure fair value are required to maximise the use of relevant observable inputs and minimise the use of unobservable inputs.

If an asset or a liability measured at fair value has a bid price and an ask price, the price within the bid-ask spread that is most representative of fair value in the circumstances shall be used to measure fair value regardless of where the input is categorised within the fair value hierarchy.

DISCLOSURE

Entities are required to disclose information that helps users of their financial statements assess both of the following:

- For assets and liabilities that are measured at fair value on a recurring (RFVM) or non-recurring (NRFVM) basis in the statement of financial position, the valuation techniques and inputs used to develop those measurements
- 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.

- The fair value measurement at the end of the reporting period, and for non-recurring fair value measurement the reasons for the measurement
- The level of the fair value hierarchy that the fair value measurements are categorised
- 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
- For RFVM and NRFVM categorised 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
- For Level 3 RFVM , a reconciliation from the opening balances to the closing balances, disclosing separately changes during the period attributable to the following:
  - Unrealised and realised gains and losses recognised in P&L and OCI/Purchases, sales, issues, and settlements/The amount and reason for Level 3 transfers.
- Tabular format for quantitative disclosures.

- For Level 3 RFVM and NRFVM a description of the valuation processes used by the entity
- For Level 3 RFVM, a narrative description of the sensitivity to changes in unobservable inputs – if changes would significantly impact fair value
- For Level 3 RFVM 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 is required to state that fact and disclose the effect of those changes
- For Level 3 RFVM and NRFVM, the total gains or losses in the period
- For RFVM and NRFVM, if the highest and best use of a non-financial asset differs from its current use, an entity is required to disclose that fact and why the non-financial asset is being used in a manner that differs from its highest and best use
- Determine appropriate classes of assets/liabilities based on: their nature, and fair value hierarchy
- The policy for determining when transfers between levels of the fair value hierarchy occur
- For assets/liabilities not at fair value (but the fair value is disclosed) the input fair value hierarchy.

FAIR VALUE HIERARCHY

To increase consistency and comparability in fair value measurements and related disclosures, IFRS 13 includes a fair value hierarchy that categorises into three levels the inputs to valuation techniques used to measure fair value:

- **Level 1 inputs**: Observable quoted prices, in active markets to sell
- **Level 2 inputs**: Quoted prices are not available but fair value is based on observable market data
- **Level 3 inputs**: Unobservable inputs for assets or liabilities.

TRANSITION

Refer to Appendix C of IFRS 13.

For further information about how BDO can assist you and your organisation, please get in touch with one of our key contacts listed below. Alternatively, please visit www.bdointernational.com/Services/Audit/IFRS/IFRS Country Leaders where you can find full lists of regional and country contacts.

Europe		
Alain Frydlender	France	alain.frydlender@bdo.fr
Jens Freiberg	Germany	jens.freiberg@bdo.de
Teresa Morahan	Ireland	tmorahan@bdo.ie
Ehud Greenberg	Israel	ehudg@bdo.co.il
Ruud Vergoossen	Netherlands	ruud.vergoossen@bdo.nl
Reidar Jensen	Norway	reidar.jensen@bdo.no
Denis Taradov	Russia	d.taradov@bdo.ru
René Krügel	Switzerland	rene.kruegel@bdo.ch
Pauline McGee	United Kingdom	pauline.mcgee@bdo.co.uk
Asia Pacific		
Wayne Basford	Australia	wayne.basford@bdo.com.au
Zheng Xian Hong	China	zheng.xianhong@bdo.com.cn
Fanny Hsiang	Hong Kong	fannyhsiang@bdo.com.hk
Khoon Yeow Tan	Malaysia	tanky@bdo.my
Latin America		
Marcelo Canetti	Argentina	mcanetti@bdoargentina.com
Luis Pierrend	Peru	lpierrend@bdo.com.pe
Ernesto Bartesaghi	Uruguay	ebartesaghi@bdo.com.uy
North America & Caribbean		
Armand Capisciolto	Canada	acapisciolto@bdo.ca
Wendy Hambleton	USA	whambleton@bdo.com
Middle East		
Rupert Dodds	Bahrain	rupert.dodds@bdo.bh
Antoine Gholam	Lebanon	agholam@bdo-lb.com
Sub Saharan Africa		
Nigel Griffith	South Africa	ngriffith@bdo.co.za

www.bdointernational.com