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U.S. GAAP AND IFRS

Fair Value Measurement

Questions and Answers

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Contents

Substantial Convergence

This edition of *Questions and Answers* provides questions and answers on fair value measurement under both U.S. GAAP and IFRS.

FASB ASC Topic 820, *Fair Value Measurement*, was originally issued in September 2006 as FASB Statement No. 157, *Fair Value Measurement*. The IFRS equivalent, IFRS 13, *Fair Value Measurement*, was issued in May 2011. At the same time, the FASB issued ASU 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. The ASU amended U.S. GAAP to achieve the Boards' objectives of a converged definition of fair value and substantially converged measurement and disclosure guidance.

ASC Topic 820 and IFRS 13 define fair value, establish a framework for measuring fair value and a fair value hierarchy based on the source of the inputs used to estimate fair value, and require disclosures about fair value measurements. The standards do not establish new requirements for *when* fair value is required or permitted, but provide a single source of guidance on *how* fair value is measured. In general, this guidance is applied when fair value is required or permitted by other applicable GAAP.

While ASC Topic 820 and IFRS 13 are substantially converged, thus minimizing the differences between U.S. GAAP and IFRS, some differences arise due to the interaction of this guidance with other standards (e.g., in determining the unit of account or on the initial recognition of financial instruments). The differences that we regard as significant are highlighted in this publication.

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About this Publication

The purpose of this publication is to assist you in understanding the requirements of, and the differences between, FASB ASC Topic 820, *Fair Value Measurement*, and IFRS 13, *Fair Value Measurement*.

Organization of the Text

Each section of this publication includes a short overview, followed by questions and answers. Our commentary is referenced to the FASB ASC (or Codification) and to current IFRS literature, where applicable.

- With respect to U.S. GAAP, references in the text to the Codification Topic mean ASC Topic 820. In other cases, the name of the Codification Topic or Subtopic is specified (e.g., the Derivatives and Hedging Codification Topic).
- With respect to IFRS, references in the text to the Standard mean IFRS 13. In other cases, the standards are identified (e.g., the financial instruments standards).
- References to the relevant literature are included in the left-hand margin, with the IFRS references in square brackets below the U.S. GAAP references. For example, *820-10-35-9* is paragraph 35-9 of ASC Subtopic 820-10; and *IFRS 13.22* is paragraph 22 of IFRS 13.

The main text is written in the context of U.S. GAAP. To the extent that the requirements of IFRS are the same, the references in the left-hand margin include both U.S. GAAP and IFRS. However, if the requirements of IFRS are different from U.S. GAAP, or a different wording might result in different interpretations in practice, a box at the end of that question and answer discusses the requirements of IFRS and how they differ from U.S. GAAP.

The questions and answers are numbered in steps of ten so that future questions and answers can be added without breaking the flow of the commentary on fair value measurement. Also, much of the content of this publication has been derived from Issues In-Depth, No. 12-2, *Questions and Interpretive Responses for Fair Value Measurement*, published by KPMG LLP in March 2012. A table of concordance is included in Appendix II.

Effective Dates and Transition

ASC Topic 820, and the related amendment ASU 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*, do not include new requirements for companies (public or nonpublic) in the 2013 reporting season.

However, IFRS 13 is a new standard, effective for annual reporting periods beginning on or after January 1, 2013. This means that companies with a calendar year-end will be applying the Standard for the first time in 2013. The Standard is applied prospectively as at the beginning of the annual period in which it is initially applied (i.e., comparatives are not re-presented and new comparative disclosures are not required). Any changes from adjusting valuation techniques at the date of adoption are recognized in the period of adoption, either in profit or loss or in other comprehensive income, depending on the requirements of the underlying standard.

Summary of Differences Between U.S. GAAP and IFRS

Throughout this publication, we highlight what we regard as significant differences between U.S. GAAP and IFRS on the topic of fair value measurement. However, many of these differences do not relate to the fair value measurement standards themselves. Instead, they arise because of the interaction of those standards with other requirements under U.S. GAAP and/or IFRS. For example, Question C90 discusses a key difference in respect of the unit of account; and Question I20 discusses day one gains or losses on the initial recognition of financial instruments, another key difference.

The following summarizes what we regard as the few significant differences between U.S. GAAP and IFRS that derive from the fair value measurement standards themselves.

U.S. GAAP	IFRS
Disclosures (Section N)	
• Nonpublic entities are exempt from some disclosure requirements. In addition, certain qualifying nonpublic entities have additional disclosure exemptions about financial instruments.	• Unlike U.S. GAAP, there are no disclosure exemptions for nonpublic entities.
• There is no requirement to disclose quantitative sensitivity information about Level 3 recurring measurements of financial instruments.	• Unlike U.S. GAAP, quantitative sensitivity information about Level 3 recurring measurements of financial instruments is required.
Practical Expedient for Investments in Investment Companies (Section Q)	
• There is a practical expedient to measure the fair value of investments in investment companies at net asset value if certain criteria are met.	• Unlike U.S. GAAP, there is no practical expedient for investments in investment companies.

A. An Introduction to Fair Value Measurement

This section provides a brief introduction to some of the key terms used in fair value measurement, as well as a diagram that shows the flow of the publication in relation to the process of measuring fair value and determining the appropriate disclosures.

The key term that drives this process is *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. Fair value is an *exit price* (e.g. the price to sell an asset rather than the price to buy that asset). An exit price embodies expectations about the future cash inflows and cash outflows associated with an asset or liability from the perspective of a *market participant* (i.e. based on buyers and sellers who have certain characteristics, such as being independent and knowledgable about the asset or liability).

Fair value is a market-based measurement, rather than an entity-specific measurement, and is measured using assumptions that market participants would use in pricing the asset or liability, including assumptions about risk. As a result, an entity's intention to hold an asset or to settle or otherwise fulfil a liability is not relevant in measuring fair value.

Fair value is measured assuming a transaction in the *principal market* for the asset or liability (i.e. the market with the highest volume and level of activity). In the absence of a principal market, it is assumed that the transaction would occur in the *most advantageous market*. This is the market that would maximize the amount that would be received to sell an asset or minimize the amount that would be paid to transfer a liability, taking into account transaction and transportation costs. In either case, the entity needs to have access to that market, although it does not necessarily have to be able to transact in that market on the measurement date.

A fair value measurement is made up of one or more *inputs*, which are the assumptions that market participants would make in valuing the asset or liability. The most reliable evidence of fair value is a quoted price in an active market. When this is not available, entities use a valuation technique to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.

These inputs also form the basis of the *fair value hierarchy*, which is used to categorize a fair value measurement (in its entirety) into one of three levels. This categorization is relevant for disclosure purposes. The disclosures about fair value measurements are extensive, with more disclosures being required for measurements in the lowest category (Level 3) in the hierarchy.

		Section
	Determine whether the item is in scope	B
Establish parameters:	Identify the item being measured	C
	Identify the unit of account and the unit of valuation	C
	Identify market participants, and identify the market	D, E
Select appropriate valuation approach(es) and technique(s):	Approach: market Example technique: quoted prices in an active market	F
	Approach: income Example technique: discounted cash flows	F
	Approach: cost Example technique: depreciated replacement cost	F
Determine inputs to measure fair value:	Level 1 Example: quoted price for an identical asset in an active market	G, H
	Level 2 Example: quoted price for a similar asset in an active market	G, H
	Level 3 Example: discounted cash flows	G, H
Measure fair value:	Fair value at initial recognition	I
	Highest and best use	J
	Liabilities and own equity instruments	K
	Portfolio measurement exception	L
	Inactive markets	M
	Disclose information about fair value measurements	N
	Application issues	O, P, Q

B. Scope

Overview

- The Fair Value Measurement Codification Topic provides guidance on how to measure fair value when such measurement is required by other Codification Topics/Subtopics, and specifies the related disclosures to be made in the financial statements. The Codification Topic does not mandate when a fair value measurement is required.
- The Codification Topic applies to the following, subject to certain exceptions:
  - Fair value measurements (both initial and subsequent) that are required or permitted by other Codification Topics/Subtopics;
  - Fair value measurements that are required or permitted to be disclosed by other Codification Topics/Subtopics, but which are not included in the balance sheet; and
  - Measurements that are based on fair value, or disclosures of such measurements.
- The exceptions from the scope of the Codification Topic include equity-based payments to nonemployees, most share-based payment transactions, and leasing transactions.

B10. What are some examples of assets and liabilities that are measured at fair value based on the Codification Topic?

The following are some examples of assets and liabilities that fall within the scope of the Codification Topic for the purpose of measurement and/or disclosure. The scope of the disclosure requirements, including the distinction between recurring and nonrecurring fair value measurements, is discussed in more detail in Section N.

	Topic	Measurement	Disclosure
Topic 320, Topic 825	Financial instruments available-for-sale or held for trading (recurring fair value measurements)	✓	✓
Topic 320	Financial instruments held-to-maturity[1]	✗	✓
Topic 946	Investments of investment companies	✓	✓
Topic 805	Nonfinancial assets and nonfinancial liabilities initially measured at fair value in a business combination or other new basis event, but not measured at fair value in subsequent periods	✓	✗

1 Measurement on initial recognition is based on the Codification Topic/Standard.

	Topic	Measurement	Disclosure
Topic 350	Indefinite-lived intangible assets measured at fair value based on an impairment assessment, but not necessarily recognized or disclosed in the financial statements at fair value on a recurring basis	✓	✓
Topic 350	Reporting units measured at fair value in the first step of a goodwill impairment test	✓	✗
Topic 350	Nonfinancial assets and nonfinancial liabilities measured at fair value in the second step of a goodwill impairment test when an impairment is recorded (i.e., measured at fair value on a nonrecurring basis to determine the amount of goodwill impairment, but not necessarily recognized or disclosed in the financial statements at fair value)	✓	✓
Topic 360	Nonfinancial long-lived assets (asset groups) measured at fair value for an impairment assessment (i.e., nonrecurring fair value measurements)	✓	✓
Topic 410	AROs initially measured at fair value (i.e., nonrecurring fair value measurements)[2]	✓	✓
Topic 420	Nonfinancial liabilities for exit or disposal activities initially measured at fair value (i.e., nonrecurring fair value measurements)	✓	✓

IFRS different from U.S. GAAP

Like U.S. GAAP, some fair value measurements may be within the scope of the Standard only for measurement or disclosure purposes, and others may be within the scope of the Standard for both measurement and disclosure purposes. However, the examples of such items differ in some respects from U.S. GAAP because of differences in the underlying literature. The following are examples relevant to IFRS.

	Topic	Measurement	Disclosure
[IAS 39]	Financial instruments available-for-sale or held for trading (recurring fair value measurements)	✓	✓
[IAS 39]	Financial instruments held-to-maturity	✗[1]	✓

2 Asset retirement obligations, which are also referred to as decommissioning provisions under IFRS.

	Topic	Measurement	Disclosure
[IFRS 1]	Fair value used as deemed cost by a first-time adopter of IFRS (e.g., for property, plant and equipment)	✓	✓
[IFRS 3]	Fair value used to initially measure nonfinancial assets and nonfinancial liabilities in a business combination	✓	✗
[IFRS 13.7(c)]	Measurements of the fair value less costs of disposal of cash-generating units for impairment testing	✓	✗
[IAS 16]	Property, plant and equipment measured using the revaluation model	✓	✓
[IAS 40]	Investment properties measured using the fair value model	✓	✓
[IAS 41]	Biological assets measured at fair value	✓	✓
[IFRS 5]	Assets held for disposal, measured at fair value less costs to sell	✓	✓

B20. Does the Codification Topic apply to measurements that are similar to but not the same as fair value?

820-10-15-262

No. The Codification Topic does not apply to measurements that have similarities to fair value, but which are not fair value or are not based on fair value. These other terms have meanings different from fair value.

330-10-20

For example, the Codification Topic does not apply to market value used when measuring inventories at the lower of cost or market. The term *market* means current replacement cost (by purchase or by reproduction) except that: (a) market shall not exceed the net realizable value (i.e., estimated selling price in the ordinary course of business less reasonably predictable costs of completion and disposal); and (b) market shall not be less than net realizable value reduced by an allowance for an approximately normal profit margin. Because this definition is not consistent with the exit price notion when measuring fair value, it is specifically excluded from the scope of the Codification Topic.

948-310-35-1

In contrast, the measurement of fair value in determining the lower of cost or market of mortgage loans held for sale is within the scope of the Codification Topic.

IFRS different from U.S. GAAP

[IFRS 13.6(c), IAS 2.9]

Like U.S. GAAP, the Standard does not apply to measurements that are similar to but not the same as fair value, and therefore inventories are excluded from the scope of the Standard. However, unlike U.S. GAAP, inventories are measured at the lower of cost or net realizable value under IFRS.

[IAS 39.46]

In addition, unlike U.S. GAAP, there is no separate designation for mortgage loans held for sale. Such financial assets would usually be measured at amortized cost. In that case, the Standard does not apply to the measurement of such loans.

B30. Are cash equivalents that meet the definition of a security within the scope of the Codification Topic?

ASC Master Glossary

Yes. Many short-term investments that have been appropriately classified as cash equivalents, including money market funds, meet the definition of a security. These types of investments are subject to the accounting and disclosure requirements for debt securities.

320-10-45-12

If the securities are categorized as trading securities, they fall within the scope of the Codification Topic (for both measurement and disclosure purposes).

IFRS different from U.S. GAAP

[IAS 7.6, 39.9]

Unlike U.S. GAAP, although certain short-term investments may meet the criteria to be classified as cash equivalents, their measurement basis may be different from U.S. GAAP.

[IAS 39.9]

The measurement of the investments after initial recognition would be in the scope of the Standard only if they are measured at fair value subsequent to their initial recognition.

B40. Does the Codification Topic apply to loans measured for impairment testing using the practical expedient in the applicable Subtopic?

Yes. The measurement and disclosure requirements of the Codification Topic are applicable when a loan's impairment is measured using the practical expedient under the applicable Subtopic (i.e., based on the loan's observable market price, or the fair value of the collateral). The Codification Topic applies even if the underlying collateral is nonfinancial.

310-10-35-32

When a loan is impaired, a creditor measures impairment based on the present value of the expected future cash flows discounted at the loan's effective interest rate. However, as a practical expedient, a creditor may measure impairment based on a loan's observable market price, or the fair value of the collateral if the loan is collateral dependent (i.e., a loan for which the repayment is expected to be provided solely by the underlying collateral).

310-10-35-23

If the fair value is used to measure impairment for a collateral-dependent impaired loan for which repayment is dependent on the sale of the collateral, the fair value should be adjusted for the estimated costs to sell. In addition, regardless of the measurement method used, a creditor measures impairment based on the fair value of the collateral when the creditor determines that foreclosure is probable.

IFRS different from U.S. GAAP

[IAS 39.AG84, IG.E.4.8]

Unlike U.S. GAAP, IFRS does not specify whether measurements of impairment of financial assets carried at amortized cost that are based on the instrument's fair value using an observable market price are within the scope of the disclosure requirements of the Standard.

[IAS 39.AG84]

Unlike U.S. GAAP, IFRS does not state that an entity may, as a practical expedient, measure the impairment of a collateral-dependent loan based on the fair value of the collateral. IFRS requires the calculation of the present value of the estimated future cash flows of a collateralized financial asset to reflect the cash flows that may result from foreclosure less costs to obtain and sell the collateral, whether or not foreclosure is probable. The related implementation guidance states that the measurement of an impaired financial asset secured by collateral reflects the fair value of the collateral.

In our view, in calculating the impairment loss for these assets, an entity could choose either of the following approaches:

- Approach 1: Use the fair value of the collateral at the end of the reporting period less costs to obtain and sell the collateral.
- Approach 2: Use the cash flows that may result from foreclosure less the costs to obtain and sell the collateral.

Under both approaches, the amounts are discounted from the expected date of realization to the reporting date using the financial asset's original effective interest rate.

B50. In a plan sponsor's financial statements, does the Codification Topic apply to pension plan assets measured at fair value?

715-60-35-107, 960-325-35-2
[IFRS 13.5]

Yes. Plan assets measured at fair value in accordance with other applicable Codification Topics/Subtopics are in the scope of the Codification Topic for measurement purposes. Those measurements are not scoped out of the measurement requirements of the Codification Topic.

715-60-35-107, 960-325-35-2

The applicable plan sponsor guidance on the measurement of plan assets requires the fair value of an investment to be reduced by brokerage commissions and other costs normally incurred in a sale if those costs are significant (similar to fair value less cost to sell). Therefore, the Codification Topic applies only to the fair value component of the measurement basis.

820-10-50-10
[IFRS 13.7(a)]

However, plan sponsors are not required to provide the disclosures of the Codification Topic for plan assets. Instead, plan sponsors' financial statements continue to follow the applicable benefit plan disclosure requirements.

Topic 715, 820-10-15-1
[IFRS 13.5]

In addition, the measurement and disclosure requirements of the Codification Topic do not apply to a defined benefit obligation, because the obligation is not measured at fair value.

IFRS different from U.S. GAAP

[IAS 19.113]

Unlike U.S. GAAP, the employee benefits standard requires plan assets to be measured at fair value without a reduction for costs to sell.

[IAS 19.115, 119]

Although the measurement of the fair value of plan assets is in the scope of the Standard, as an exception from the fair value measurement basis, and unlike U.S. GAAP, if the payments under a qualifying insurance policy or a reimbursement right exactly match the amount and timing of some or all of the benefits payable under a defined benefit plan, the present value of the related obligation is deemed to be the fair value of the insurance policy or reimbursement right (subject to recoverability).

B60. Does the Codification Topic apply to the financial statements of an employee benefit plan?

960-325-50-1

Yes. The measurement and disclosure requirements of the Codification Topic generally apply to the financial statements of an employee benefit plan, and in particular to its investments that are measured at fair value. Employee benefit plans encompass defined benefit plans, defined contribution plans, employee stock ownership plans, and health and welfare plans.

960-325-35-2

The Codification Subtopics applicable to benefit plans on the subsequent measurement of other investments require fair value to be reduced by brokerage commissions and other costs normally incurred in a sale if those costs are significant (similar to fair value less cost to sell). Therefore, the Codification Topic applies only to the fair value component of the measurement basis.

820-10-50-2

Because a plan's investments are required to be measured at fair value at each reporting date, the recurring disclosure requirements of the Codification Topic are required to be included in the benefit plan's financial statements (see Section N).

IFRS different from U.S. GAAP

[IFRS 13.7(b), IAS 26.8, 32]

Unlike U.S. GAAP, investments held by retirement benefit plans and measured at fair value in accordance with IAS 26 *Accounting and Reporting by Retirement Benefit Plans* are within the scope of the Standard for measurement purposes, but not for disclosure purposes.

B70. Do the fair value concepts apply when measuring the change in the carrying amount of the hedged item in a fair value hedge?

Yes, in our view the concepts of fair value measurement in the Codification Topic apply to measuring the change in the carrying amount of the hedged item in a fair value hedge.

815-25-35-1
[IFRS 13.5]

The hedged item in a fair value hedge is remeasured to fair value in respect of the risk being hedged. Therefore, although the hedged item in a fair value hedge might not be required to be carried at fair value, the measurement of changes in the fair value of the hedged item attributable to the hedged risk(s) should be performed in accordance with the principles of the Codification Topic.

820-10-50-2
[IFRS 13.5, 93]

Although the determination of the change in fair value of the hedged item should be measured in accordance with the principles of the Codification Topic, the disclosure requirements of the Codification Topic do not apply to the hedged item unless the measurement basis in the balance sheet is, or is based on, fair value, independent of hedge accounting (e.g., available-for-sale securities). When the hedged item has a hybrid carrying amount whose measurement is based on a measurement basis that is not fair value, the requirements of the Codification Topic would not apply.

Hedging is the subject of Section O.

Example B70: Applying the Fair Value Concepts in a Fair Value Hedge

Company B has a fixed interest liability denominated in U.S. dollars and measured at amortized cost. Company B enters into a pay-LIBOR receive-fixed interest rate swap to hedge 50% of the liability in respect of its benchmark interest exposure. The swap qualifies for hedge accounting. The proportion of the liability that is hedged (50%) will be remeasured with respect to changes in fair value due to changes in the designated benchmark interest rate from the beginning of the hedge relationship. The liability will not be remeasured for any changes in its fair value due to changes in credit spread, liquidity spread, or other factors.

The fair value related to changes in benchmark interest rates is measured following the guidance in the Codification Topic. However, the related disclosures do not apply because the hedged item, the liability, is measured on a hybrid basis (adjusted amortized cost) that is not fair value or based on fair value.

C. The Item Being Measured and the Unit of Account

Overview

- An entity takes into account characteristics of the asset or liability that market participants would take into account in a transaction for the asset or liability at the measurement date. In the case of an asset, these characteristics may include, for example:
  - The condition and location of the asset; and
  - Restrictions, if any, on the sale or use of the asset.
- The *unit of account* is the level at which an asset or a liability is aggregated or disaggregated for recognition purposes. It is also the level at which an asset or a liability generally is aggregated or disaggregated for the purpose of measuring fair value. When these two units differ, the term *unit of valuation* is used to describe the unit used for measurement.
- For a discussion of how the unit of account interacts with the portfolio measurement exception, see Section L.

C10. How should an entity determine the appropriate unit of account (unit of valuation) when measuring fair value?

820-10-35-11A
[IFRS 13.14]

Generally, the unit being measured is determined based on the unit of account account in accordance with the Codification Topics/Subtopics specific to the asset or liability. The unit of account for fair value measurement and the unit of account for recognition generally are the same. For convenience, when the unit of account for fair value measurement and the unit of account for recognition are different, we refer to the level at which an asset or liability is aggregated or disaggregated to measure fair value as the unit of valuation.

820-10-35-10E, 35-18E
[IFRS 13.27, 32, 48, BC47]

There are two exceptions included in the Codification Topic itself:

- The unit of account (unit of valuation) for financial instruments generally is the individual financial instrument (e.g., a share). However, an entity is permitted to measure the fair value of a group of financial assets and financial liabilities on the basis of the net risk position, if certain conditions are met (see Section L).
- In certain circumstances, an entity is required to measure nonfinancial assets in combination with other assets or with other assets and liabilities (see Section J).

350-20-35-1, 948-310-35-3

The following are examples:

- For goodwill impairment testing, the unit of account (unit of valuation) is the reporting unit in Step 1 of the test.

- For loans (e.g., mortgage loans) held-for-sale, the unit of account and therefore the unit of valuation is an accounting policy election determined based on the entity's policy of measuring the loans on an aggregate or individual loan basis.

[IFRS 13.14, BC47]

IFRS different from U.S. GAAP

Although the Standard has the same requirements as the Codification Topic in determining the unit of account, the underlying examples may differ from U.S. GAAP because of differences in the underlying literature. The following are examples relevant to IFRS.

- For goodwill impairment testing, the unit of account (unit of valuation) is the (group of) cash-generating unit(s).
- For financial instruments, the unit of account (unit of valuation) generally is the individual instrument unless the portfolio measurement exception applies (see Section L).

C20. If an asset requires installation in a particular location before it can be utilized, should the measurement of fair value of the installed asset consider these costs?

820-10-55-36
[IFRS 13.B3, IE11–IE12]

Generally, yes. Installation costs generally are considered an attribute of the asset when measuring fair value if the asset would provide maximum value to the market participant through its use in its current location in combination with other assets or with other assets and liabilities (see Section J).

820-10-55-3, 55-37
[IFRS 13.B3, IE12]

Therefore, all costs (excluding transaction costs) that are necessary to transport and install an asset for future use should be included in the measurement of fair value. Examples include delivery and other costs necessary to install an asset for its intended use. Installation costs are added to the estimated uninstalled value indication (e.g., replacement cost) for the asset, which results in measurement of fair value on an installed basis.

820-10-35-37A
[IFRS 13.73, 81, 86]

Many assets that require installation generally will require a fair value measurement based on Level 3 inputs. However, for some common machinery that is traded in industrial markets, Level 2 inputs may be available. In this situation, the inclusion of installation costs in the measurement of fair value may result in a Level 3 categorization of the measurement if the installation costs are significant (see Section H).

C30. Do restrictions on the sale or transfer of a security affect its fair value?

820-10-35-2B
[IFRS 13.11]

It depends. When measuring the fair value of a security with a restriction on its sale or transfer, judgment is required to determine whether and in what amount an adjustment is required to the price of a similar unrestricted security to reflect the restriction.

820-10-35-2B
[IFRS 13.11, IE28]

To make that determination, the entity should first analyze whether the restriction is security-specific or entity-specific (i.e., whether the restriction is an attribute of the instrument or an attribute of the holder).

- For security-specific restrictions, the price used in the fair value measurement should reflect the effect of the restriction if this would be considered by a market participant in pricing the security; this may require an adjustment to the quoted price of otherwise similar but unrestricted securities.
- For entity-specific restrictions, the price used in the fair value measurement should not be adjusted to reflect the restriction because it would not be considered by a market participant in pricing the security.

Factors used to evaluate whether a restriction is security-specific or entity-specific may include whether the restriction is:

- Transferred to a (potential) buyer;
- Imposed on a holder by regulations;
- Part of the contractual terms of the asset; or
- Attached to the asset through a purchase contract or another commitment.

820-10-30-3A(d), 35-40
[IFRS 13.19–20, 76]

For restrictions determined to be entity-specific, fair value measurements for the security do not reflect the effect of such restrictions. As a result, securities that are subject to an entity-specific restriction are considered identical to those that are not subject to entity-specific restrictions. Consequently, a quoted price in an active market is a Level 1 input for the security that is subject to an entity-specific restriction. This is the case even though the entity is not able to sell the particular security on the measurement date due to an entity-specific restriction; an entity needs to be able to access the market but it does not need to be able to transact in the market at the measurement date to be able to measure the fair value on the basis of the price in that market (see Section E).

For a discussion of security-specific restrictions when the fair value of a liability or own equity instrument is measured with reference to the identical instrument held as an asset by a market participant, see Section K.

C40. What are some common restrictions on the sale or transfer of a security?

The following are some common restrictions on the sale or transfer of a security:

Restrictions on Securities Offered in a Private Offering under Rule 144A and Section 4(2) Transactions (Private Placements) of the SEC

Restrictions on the transfer of securities obtained in a Rule 144A offering attach to the security itself as a result of the securities laws applicable to these offerings.[3] For these types of offerings, the securities can only be sold (both initially and subsequently) to qualified institutional buyers (or accredited investors in the case of Section 4(2) transactions).

3 Securities and Exchange Act Rule 144A, Persons Deemed Not to Be Engaged in a Distribution and Therefore Not Underwriters.

The restriction on sale is specific to the security and also lasts for the life of the security, barring subsequent registration of the security or *seasoning* of the securities through sales outside of the U.S. or under Rule 144; for further discussion, see Question C50. Therefore, these restrictions should be considered when measuring the fair value of the security.

For securities initially obtained through a Rule 144A offering or a Section 4(2) transaction that subsequently have become registered or seasoned and are therefore tradable without restriction, an adjustment related to the restriction is no longer applicable to the fair value measurement because the restriction has been removed.

Securities Subject to a Lock-Up Provision Resulting from an Underwriter's Agreement for the Offering of Securities in a Public Offering

In many public offerings of securities, the underwriting agreement between the underwriter and the issuing entity contains a lock-up provision that prohibits the issuing entity and its founders, directors, and executive officers from selling their securities for a specified period of time; the lock-up period is usually 180 days for initial offerings and shorter for secondary offerings. These provisions give the underwriters a certain amount of control over after-market trading for the lock-up period.

Based on our understanding of common lock-up agreements, these provisions may be based on a contract separate from the security (i.e., resulting from the underwriting agreement) and apply only to those parties that signed the contract (e.g., the issuing entity) and their affiliates. Therefore, these restrictions represent entity-specific restrictions that should not be considered in the fair value measurement of the securities.

However, there may be situations in which a lock-up provision is determined to be security-specific based on the specific terms and nature of the restriction. In that case, the restriction should be considered when measuring the fair value of the securities.

Securities Owned by an Entity where the Sale is Affected by Blackout Periods

An investment in the securities of another entity will sometimes result in the investor being subject to blackout restrictions imposed by regulations on the investee (e.g., when the investor has a board seat on the investee's board of directors). When the blackout period of the investee coincides with the investor's periodic financial reporting dates, the investor is, in effect, restricted from selling its securities at its own financial reporting date. These restrictions represent entity-specific restrictions that should not be considered when measuring the fair value of the securities.

Securities Pledged as Collateral

In some borrowing arrangements, securities held by an investor are pledged as collateral supporting debt, or other commitments, of the investor. In these situations, the investor is restricted from selling the securities pledged during the period that the debt or other commitment is outstanding. Restrictions on securities resulting from the securities being pledged as collateral represent entity-specific restrictions that should not be considered when measuring the fair value of the securities.

C50. SEC Rule 144 allows the public resale of certain restricted or control securities if certain conditions are met. During the period before the restrictions lapse, should the fair value measurement reflect such restrictions?

Yes. However, the restrictions reflected in the fair value measurement should be limited to those that are security-specific.

Restricted securities are securities acquired in unregistered or private sales from the issuer or from an affiliate of the issuer. Control securities are restricted securities held by affiliates of the issuer. An affiliate is a person, such as a director or large shareholder, in a relationship of control. However, securities acquired by an affiliate in the public market are not subject to the requirements of Rule 144 (i.e., not restricted).

Generally, restricted securities acquired directly or indirectly from an issuer or its affiliate can be publicly sold under Rule 144 if the following conditions are met:

(1) There is adequate current information about the issuer before the sale can be made. Generally this means that the issuer has complied with the periodic reporting requirements of the Securities Exchange Act of 1934 (1934 Act).[4]

(2) If the issuer is subject to the reporting requirements of the 1934 Act, the securities must be held at least six months. If the issuer is not subject to the requirements of the 1934 Act, the securities must be held for more than one year.

If the securities are control securities not obtained in a public market held by affiliates, the following conditions, in addition to the conditions listed above, must be met:

(3) Sales — Sales must be handled in all respects as routine trading transactions, and brokers may not receive more than a normal commission. Neither the seller nor the broker can solicit orders to buy the securities.

(4) Volume limitations — The number of securities sold by an affiliate during any three-month period cannot exceed the greater of one percent of the outstanding shares of the same class or, if the class is listed on a stock exchange or quoted on NASDAQ, the greater of one percent or the average weekly trading volume during the four weeks preceding the filing of a notice for sale on Form 144.

(5) Filing requirements — An affiliate must file a notice with the SEC on Form 144 if the sale involves more than 5,000 shares or the aggregate dollar amount is greater than $50,000 in any three-month period. The sale must take place within three months of filing Form 144.

Conditions (1) and (2) generally are met only after a prescribed period of time has elapsed (and the issuing entity has made information publicly available). Therefore, during the period before conditions (1) and (2) are met, the securities have security-specific restrictions that may need to be reflected in the measurement of fair value

4 Securities Exchange Act of 1934, available at www.sec.gov.

for those securities; this is because these restrictions are characteristics of the security and would be transferred to market participants. Conditions (3), (4), and (5) only apply to affiliates, and therefore these conditions are entity-specific and should not be reflected in the measurement of the fair value.

C60. How should executory contracts be considered when measuring the fair value of an asset that is the subject of an executory contract?

It depends. Some assets recorded in an entity's financial statements are the subject of executory contracts that directly affect the use of, and cash flows from, those assets. For example, a company might acquire a leasing company that has several airplanes recorded as fixed assets that are leased to third parties under operating leases.

820-10-35-2E, 35-10E
[IFRS 13.14, 31]

If the unit of account is the asset on a stand-alone basis, the effects of executory contracts, including any contractual cash flows, should not be included in measuring the fair value of the underlying asset. In these cases, the fair value of the asset should be measured using the price that would be received from a market participant to sell the asset at the measurement date.

820-10-35-2E, 35-10E
[IFRS 13.14, 31]

Alternatively, if the unit of account is determined to be an aggregation of the contract with the underlying asset, the effects of the executory contract would be considered.

820-10-35-10E
[IFRS 13.31]

If the unit of valuation is determined to be on a stand-alone basis but the entity has evidence that suggests that a market participant would sell both the executory contract and the underlying asset as a group, it may be appropriate to measure fair value for the entire group. Once measured, the group fair value would be allocated to the individual components required by other applicable accounting literature (e.g., in the same way that an impairment loss is allocated to fixed assets).

C70. In measuring the fair value of a financial instrument, how should an entity consider the existence of an arrangement that mitigates credit-risk exposure in the event of default?

820-10-35-16D, 35-18A
[IFRS 13.14, 69]

If the unit of account is the individual financial instrument, then a separate arrangement that mitigates credit-risk exposure in the event of default is not reflected in the fair value of the individual financial instrument; instead, the arrangement is measured as a separate financial instrument. Examples of such arrangements include a master netting agreement or a credit support agreement that requires the exchange of collateral on the basis of each party's net exposure to the credit risk of a group of financial instruments.

In our experience, for individual instruments that are actively traded on an exchange, the actual counterparty to the trade transaction is, in many instances, the exchange entity (e.g., the clearing house for the exchange). For these exchange transactions, we understand that even when there is no master netting agreement between the exchange and the entity, credit risk is usually deemed to be minimal because the operating procedures of the exchanges require the daily posting of collateral, which is, in effect, an arrangement that mitigates credit-risk exposure in the event of default.

For a discussion of fair value measurement under the portfolio measurement exception, see Question L70.

C80. Does a requirement to post collateral affect the fair value measurement of the underlying instrument?

820-10-35-2B, 35-18, 55-11
[IFRS 13.11, 69, B19]

Yes. Because the asset or liability requires that collateral be posted, that feature is instrument-specific and should be included in the fair value measurement of the asset or liability. Therefore, the asset or liability is supported by posted collateral and the discount rate reflects these conditions. Any nonperformance risk adjustment related to credit risk used in measuring the fair value of the asset or liability may be different from the adjustment if the collateral was not present (i.e., a lower discount rate assigned to the counterparty risk or lower loss severity when counterparty default is assumed to occur).

Example C80: Collateralized Derivative Instrument

Company C holds a collateralized derivative instrument where the parties to the derivative contract post collateral on a daily basis, and the maximum exposure to the asset holder is the one-day change in the asset's fair value. The collateralization is required as a result of the terms of the instrument and not as a result of separate arrangements that mitigate credit-risk exposures in the event of default.

In this case, market participants apply an appropriate rate reflecting the reduced credit risk (e.g., an overnight index swap rate) as the discount rate used in the valuation of the asset or liability. On the other hand, if the derivative instrument was not collateralized, the parties' credit risk would be included in the fair value measurement of the instrument. For further discussion on measuring the fair value of liabilities, see Section K.

If the derivative would have had a separate arrangement that mitigates credit-risk exposure in the event of default (i.e., not within the requirements of the derivative contract), that agreement would not be included in the fair value measurement of the derivative if the unit of valuation is the individual derivative. However, if an entity applies the portfolio measurement exception to a group of financial assets and financial liabilities entered into with a particular counterparty, then the effect of such an agreement would be included in measuring the fair value of the group of financial assets and financial liabilities if market participants would do so.

Derivative instruments are the subject of Section O.

C90. What is the unit of account for investments in subsidiaries, equity-method investees and joint ventures?

820-10-35-2E

It depends. The unit of account is prescribed by the applicable Codification Topic/Subtopic that requires or permits the fair value measurement. The measurement of investments in subsidiaries, equity-method investees, and joint ventures at fair value may be required in a number of circumstances such as business combinations, impairment assessments, and the measurement of retained investments upon a loss of control, among others.

IFRS different from U.S. GAAP

IFRS 13.14

Unlike U.S. GAAP, there is uncertainty under IFRS about the unit of account for investments in subsidiaries, associates, and joint ventures. The unit of account for such investments is not clear because the investment held by the entity comprises a number of individual shares.

The following are examples of situations in which the unit of account (and therefore the unit of valuation) for such an investment needs to be determined to measure fair value.

[IAS 28.18]

- Investments in associates and joint ventures that are accounted for in accordance with the financial instruments standards by a venture capital or similar organization.

[IFRIC 17.11, 13]

- Shares in a subsidiary, associate, or joint venture distributed to owners.

[IFRS 3.32(a)(iii), 42]

- A previously held equity interest in an acquiree in accounting for a business combination achieved in stages.

[IFRS 10.25(b), IAS 28.22]

- A retained interest following a loss of control, joint control, or significant influence.

In our view, an entity may choose an accounting policy, to be applied consistently, to identify the unit of account of an investment in a subsidiary, associate or joint venture as:

- The investment as a whole; or
- The individual share making up the investment.

In applying a consistent accounting policy, an entity should choose the same policy for similar items. The choice of accounting policy is important, because the value of an aggregate holding may be different from the sum of the values of the components measured on an individual basis.

This issue in currently part of an IASB project, *Fair Value Measurement: Unit of Account*. An exposure draft is expected in Q1 2014.

D. Market Participants

Overview

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:

- They are independent of each other;
- They are knowledgable, 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;
- They are able to enter into a transaction for the asset or liability; and
- 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).

D10. Does an entity need to specifically identify market participants?

820-10-35-9
[IFRS 13.22–23]

No. An entity need not identify specific market participants even though the fair value of the asset or liability is based on the assumptions that market participants would use in pricing the asset or liability when acting in their economic best interest. Instead, the entity identifies characteristics that distinguish market participants generally, considering factors specific to:

- The asset or liability;
- The principal (or most advantageous) market for the asset or liability; and
- Market participants with whom the entity would transact in that market.

D20. Can a market participant be a related party?

820-10-20
[IFRS 13.A, BC57]

No. By definition, market participants are independent of each other and therefore cannot be related parties. However, 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.

D30. How should an entity determine what assumptions a market participant would make in measuring fair value?

820-10-35-2B, 35-36B
[IFRS 13.11]

An entity selects inputs that are consistent with the characteristics of the asset or liability that market participants would take into account in a transaction for the asset or liability. These characteristics include:

- The condition and location of the asset; and
- Restrictions, if any, on the sale or use of the asset.

820-10-20
[IFRS 13.BC58–BC59]

Market participants are assumed to be knowledgable about the asset or liability, using all available information, including information that would be expected to become available in customary and usual due diligence. To the extent that additional uncertainty exists, it is factored into the fair value measurement.

820-10-35-36B
[IFRS 13.69]

In some cases, those characteristics result in the application of an adjustment, such as a premium or discount (e.g., a control premium or a noncontrolling interest discount – see Section G). However, a fair value measurement generally does not incorporate a premium or discount:

- That is inconsistent with the item's unit of account under the Codification Topic/ Subtopic that requires or permits the fair value measurement (see Section C);
- That reflects size as a characteristic of the entity's holding, such as a blockage factor (see Questions G30 and G40); or
- If there is a quoted price in an active market for an identical asset or liability unless one of the exceptions allowing adjustments to Level 1 inputs applies (see Questions G70 and H30).

820-10-35-37
[IFRS 13.72, 87]

As discussed in Section H, the fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date (Level 1 inputs) and the lowest priority to unobservable inputs (Level 3 inputs). Unobservable inputs also reflect the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk.

D40. If the entity is unwilling to transact at a price provided by an external source, can that price be disregarded?

820-10-35-3, 35-6B, 35-54H
[IFRS 13.3, 15, 20, 22]

No. Fair value measurements are market-based measurements, not entity-specific measurements. The fair value of an asset or a liability is measured using assumptions that market participants would use in pricing the asset or liability, assuming that market participants act in their economic best interest. As a result, an entity's intention to hold an asset or to settle a liability is not relevant in measuring fair value. Therefore, an entity cannot disregard a price reflecting current market conditions simply because the entity is not a willing seller at that price.

D50. How should an entity adjust the fair value measurement for risk inherent in the asset or liability?

820-10-55-6-9
[IFRS 13.88]

An entity assumes that market participants have a reasonable understanding of the rights and obligations inherent in the asset or liability being measured that is based on information that would be available to them after customary due diligence (see Question D30). Therefore, it is assumed that the market participant would apply any and all necessary risk adjustments to the price to compensate itself for market, nonperformance (including credit), liquidity, and volatility risks.

820-10-55-11
[IFRS 13.11, B14(a)–(b)]

As a result, an entity applies a liquidity discount in measuring the fair value of a particular asset or liability if market participants would apply this factor based on the inherent characteristics of the asset or liability and the unit of valuation.[5] Similarly, an entity uses a risk-adjusted discount rate that market participants would use

5 A liquidity discount or adjustment is an adjustment to reflect the marketability of an asset or liability (see Question G40).

even when the entity has a different view of the inherent risk of the asset or liability because the entity has specific expertise that leads it to conclude that risk is lower than other market participants.

820-10-35-54A
[IFRS 13.89]

In measuring fair value, an entity uses the best information available in the circumstances, which might include its own data. In developing unobservable inputs, an entity may begin with its own data, but adjusts it if reasonably available information indicates that market participants would use different data or there is something particular to the entity that is not available to market participants (e.g., entity-specific synergies, expertise, or organizational differences that would not be available to other market participants).

E. Principal and Most Advantageous Markets

Overview

- The principal market is the market with the greatest volume and level of activity for the asset or liability.
- The most advantageous market is the 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 transportation costs.
- A fair value measurement assumes that the transaction takes place in the principal market for the asset or liability. Only in the absence of a principal market does the entity assume that the transaction takes place in the most advantageous market.

E10. If an entity identifies a principal market for the asset or liability, can it disregard the price in that market and instead use the price from the most advantageous market?

820-10-35-6
[IFRS 13.18–19]

In general, no. If an entity identifies a principal market, it cannot consider prices from other, more advantageous markets. Only if the entity does not have access to the principal market does it measure fair value assuming a transaction in the most advantageous market.

820-10-35-6B
[IFRS 13.19–20, BC48]

In many cases, the principal market and the most advantageous market are the same. In either case, to use pricing from a market, the entity needs to be able to access the market in which the transaction is assumed to occur. However, the identification of a principal market is not limited to those markets in which the entity would actually sell the asset or transfer the liability. Furthermore, although the entity has to be able to access the market, it does not need to be able to buy or sell the particular asset (or transfer the particular liability) on the measurement date in that market.

820-10-35-5
[IFRS 13.19, BC53]

The determination of the principal market and the most advantageous market is an independent analysis performed by each entity, allowing for differences between entities with different activities and between different businesses within an entity. For example, when a swap transaction takes place between an investment bank and a commercial entity, the former may have access to wholesale and retail markets while the latter may only have access to retail markets.

Example E10: Principal versus Most Advantageous Market

Company E holds an asset that is traded in three different markets but it usually buys and sells in Market C. Information about all three markets follows.

	Market A	Market B	Market C
Volume (annual)	30,000	12,000	6,000
Trades per month	30	12	10
Price	50	48	53
Transportation costs	(3)	(3)	(4)
Possible fair value	47	45	49
Transaction costs	(1)	(2)	(2)
Net proceeds	46	43	47

Company E identifies the principal market for the asset as Market A because it has the highest volume and level of activity. It identifies the most advantageous market as Market C because it has the highest net proceeds.

Company E bases its measurement of fair value on prices in Market A. Pricing is taken from this market even though Company E does not normally transact in that market and it is not the most advantageous market. Therefore, fair value is 47, considering transportation costs but not transaction costs (see Question E40), even though P normally transacts in Market C and could maximize its net proceeds in that market.

If Company E is unable to access Markets A and B, then it would use Market C as the most advantageous market. In that case, fair value would be 49.

The example highlights the presumption that the principal market is the market in which the entity usually transacts may be overcome. The fact that Company E has information about Market A that it cannot ignore results in Market A being the principal market, and not Market C.

E20. How should an entity determine the principal market, and how frequently should it re-evaluate its determination?

There is no explicit guidance on how an entity should identify the principal market, over what period it should analyze transactions for that asset or liability, or how often it should update its analysis.

820-10-35-54A
[IFRS 13.17]

An entity is not required to undertake an exhaustive search of all possible markets to identify the principal market or, in the absence of a principal market, the most advantageous market. However, it should take into account all information that is reasonably available. For example, if reliable information about volumes transacted is publicly available (e.g., in trade magazines or on the internet), it may be appropriate to consider this information to determine the principal market.

820-10-35-5A
[IFRS 13.17, BC53]

Absent evidence to the contrary, the principal (or most advantageous) market is presumed to be the market in which the entity normally enters into transactions to sell the asset or transfer the liability.

In our view, an entity should update its analysis to the extent that events have occurred or activities have changed in a manner that could change the entity's determination of the principal (or most advantageous) market for the asset or liability.

E30. Can an entity have multiple principal or most advantageous markets for identical assets and liabilities within its consolidated operations?

820-10-35-6A
[IFRS 13.19]

Yes. An entity has to have access to the principal (or most advantageous) market in order to use a price from that market. Therefore, the identification of the relevant market is considered from the perspective of the specific entity. In some cases, different entities within a consolidated group (and businesses within those entities) may have different principal or most advantageous markets for the same asset or liability.

For example, a parent company trades a particular asset in its principal market for that asset. Due to regulatory restrictions, its overseas subsidiary is prohibited from transacting in that market. As a result, the overseas subsidiary has a different principal market for the same asset.

E40. How are transaction costs and transportation costs treated in identifying the principal or most advantageous market and in measuring fair value?

820-10-20
[IFRS 13.A, 26]

Transaction costs are directly attributable costs that an entity would incur in selling an asset or transferring a liability. *Transportation costs* are not included in transaction costs. They are the costs that would be incurred to transport an asset from its current location to the principal (or most advantageous) market. Examples of transportation costs include trucking, shipping, rail, pipeline, cartage, and other costs directly incurred in the bundling and physical movement of the asset.

820-10-35-9B – 35-9C
[IFRS 13.A, 25–26]

Whether transaction and transportation costs are taken into account in identifying the principal and most advantageous markets, and in measuring fair value, is summarized in the following table.

	Transaction costs	Transportation costs
Identifying the principal market	✗	✗
Identifying the most advantageous market	✓	✓
Measuring fair value	✗	✓

820-10-35-98 – 35-9C
[IFRS 13.25–26]

Transaction and transportation costs are not considered in identifying the principal market, because such a market is identified based only on the volume and level of activity. However, such costs are considered in identifying the most advantageous market, because it is identified based on the net proceeds from the assumed transaction.

820-10-35-9B – 35-9C
[IFRS 13.25–26]

Once the market for the transaction has been identified, the measurement of fair value is an independent, different calculation.

- Fair value is not adjusted for transaction costs; instead, they are accounted for in accordance with other applicable Codification Topics/Subtopics. This is because transaction costs are a characteristic of the transaction, and not a characteristic of the asset or liability.
- Fair value is adjusted for transportation costs, if location is a characteristic of the asset (see Section C). For example, the fair value of crude oil held in the Arctic Circle would be adjusted for the cost of transporting the oil from the Arctic Circle to the appropriate market.

E50. Can transportation costs be included in the entity's measurement of fair value using an identified basis differential?

815-10-55-81 – 55-83
[IFRS 13.A, 26]

No. An identified basis differential generally cannot be used as a proxy for transportation costs.

This is because an identified basis differential between the price at the location of the asset and at the principal (or most advantageous) market generally also includes other factors besides location. Basis differentials reflect multiple factors, such as timing, quality, and location and can be volatile because they capture the passage of time (a financing element), changes in the relative value of different qualities or grades of commodities, and changes in the attractiveness of locations from the central pricing hub relative to each other factor. Supply and demand is a critical factor in influencing the changes in basis due to quality and location. Basis differentials are therefore not a simple fixed transportation charge, but rather a complex and volatile variable in and of itself.

E60. How should future transaction costs be treated when the fair value is measured using discounted cash flows?

820-10-35-9B
[IFRS 13.25]

As Question E40 discussed, an investor does not subtract transaction costs that it would incur to sell an investment at the measurement date because these transaction costs are not a characteristic of the asset. This is the case regardless of the valuation technique used.

However, it might be appropriate for future transaction costs (i.e., in subsequent sales transactions) to be deducted in a discounted cash flow (DCF) analysis. For example, for entities that use a DCF analysis to determine the fair value of real estate, and the DCF analysis includes an assumption that a market participant would sell the property in the future, there is a practice to subtract transaction costs (e.g., selling costs) expected to be incurred at the time of that future disposition.

In contrast, when valuing a business enterprise in a DCF analysis, future transaction costs (e.g., selling costs) are generally not included because it is assumed that a market participant would maximize economic benefit by continuing to operate the business indefinitely into the future. In our experience, market participants entering into a transaction for a business would generally not consider transaction costs associated with a sale in the future. A terminal value within a DCF analysis generally reflects the value of future cash flows at the end of a discrete cash flow period but does not imply that a market participant would sell the business at that point in time.

Example E60: Role of Transaction Costs in Measuring the Fair Value of Certain Real Estate

Company E measures the fair value of its investment real estate. A DCF analysis resulting in an estimated value of $100 million for the investment real estate asset at the measurement date includes a cash inflow (discounted) of $80 million for future sale proceeds and a cash outflow (discounted) of $5 million for selling costs associated with the future sale at the end of an assumed five-year holding period. The remaining cash flows (discounted) of $25 million in the $100 million value are from net operating cash flows during the five-year holding period. If the real estate was sold at the measurement date, selling costs of $4 million would be incurred by the existing investor.

Company E measures the fair value at $100 million (i.e., including the assumed cash outflow for transaction costs at the end of the five-year holding period) on the basis that the DCF analysis is prepared from the perspective of a market participant buyer who would consider future transaction costs in determining the price that it would be willing to pay for the asset.

However, it would not be appropriate for Company E to measure the asset at a value of $96 million (i.e., estimated value of $100 million less transaction costs of $4 million that would be incurred if the asset were sold at the measurement date) because market participants would transact at $100 million on the measurement date.

E70. If an entity sells its loans to market participants that securitize them, can the market for securities issued by these market participants (securitization market) be the principal market?

820-10-35-2B
[IFRS 13.11]

No. A fair value measurement is for particular assets or liabilities, which, in this case, are the loans.

820-10-35-2B
[IFRS 13.11]

The securities issued by the market participant that securitizes the loans are significantly different from the loans and have different characteristics. The process of securitizing and issuing interests in a securitization vehicle fundamentally changes the investors' interest in the underlying loans. The price received for the sale of the interests in a securitization vehicle includes earnings associated with the securitization process. It would be inappropriate to reflect the earnings related to the securitization process in the fair value measurement of loans.

820-10-35-5
[IFRS 13.16]

Also, a fair value measurement assumes that the transaction to sell the asset takes place in the principal market for that asset. The securitization market cannot be the principal market for the loans because what is being sold or transferred in the securitization market are the securities issued by the vehicle that securitized the loans. However, as discussed in Question G90, it may be appropriate to consider securitization prices as an input into the valuation technique.

E80. How do transaction costs affect the initial measurement of a financial asset or financial liability?

820-10-35-9

For a financial asset or financial liability measured at fair value, the fair value measurement would be performed based on an exit price notion. A fair value measurement excludes transaction costs. For a financial asset or financial liability not required to be measured at fair value upon initial recognition, transaction costs would be accounted for under other applicable standards, including the Codification Topics relating to investments in debt and equity securities and the Codification Topic for investment companies.

946-10-16-2, 40-1

Portfolio securities are reported at fair value by entities within the scope of the Investment Companies Codification Topic. These fair value measurements should be performed using the guidance in the Fair Value Measurement Codification Topic. However, the Codification Topic relating to investment companies requires investments in debt and equity securities to be recorded initially at their transaction price, including commissions and other charges. Accordingly, entities within the scope of the Investment Companies Codification Topic should record the transaction costs in the cost basis of investment securities, which will then affect the realized and unrealized gain or loss calculations.

ASC Master Glossary

The Codification Topic relating to investments in debt and equity securities by noninvestment companies does not provide specific guidance on accounting for transaction costs; however, it refers to "holding gains or losses." The ASC Master Glossary defines holding gains or losses as "The net change in fair value of a security exclusive of dividend or interest income recognized but not yet received and exclusive of any write-downs for other than temporary impairment." Therefore, transaction costs generally are not included as part of the cost basis of securities and are expensed as incurred by noninvestment companies.

However, since the Codification Topic relating to investments in debt and equity securities does not provide specific guidance on initial recognition for investments within its scope, some companies other than investment companies also have had a policy of including transaction costs as part of the cost of purchased securities under the view that the Fair Value Measurement Codification Topic specifically addresses fair value measurements without impacting their previous accounting policy elections for transaction costs associated with purchased securities.

IFRS different from U.S. GAAP

[IFRS 13.25, 9.5.1.1, IAS 39.43]

Unlike U.S. GAAP, on initial recognition an entity measures a financial asset or financial liability at its fair value, plus or minus, in the case of a financial asset or financial liability not classified as fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.

[IFRS 13.25, 9.5.1.1, IAS 39.43]

Therefore, an initial measurement of a financial asset or financial liability classified as fair value through profit or loss excludes transaction costs that are directly attributable to the entry transaction, while the initial measurement of all other financial assets and financial liabilities includes transaction costs that are directly attributable to the entry transaction.

F. Valuation Approaches and Techniques

Overview

- In measuring the fair value of an asset or a liability, an entity selects those valuation approaches and techniques that are appropriate and for which sufficient data is available to measure fair value.
- The technique chosen should maximize the use of relevant observable inputs and minimize the use of unobservable inputs (see Section G).
- A *valuation approach* is a broad category of techniques, while a *valuation technique* refers to a specific technique such as a particular option pricing model.
- Valuation techniques used to measure fair value fall under three approaches:
  - Market approach—Valuation techniques that fall under the market approach often derive market multiples from a set of comparable assets.
  - Income approach—Valuation techniques that fall under the income approach convert future amounts such as cash flows or income streams to a current amount on the measurement date.
  - Cost approach—Valuation techniques under the cost approach reflect the amount that would be required to replace the service capacity of an asset. The concept behind the cost approach is that an investor will pay no more for an asset than the cost to buy or construct a substitute asset of comparable utility.

F10. What are some examples of the different valuation techniques used?

The following are examples of different valuation techniques used under the three valuation approaches, and examples of common usage of those techniques.

MARKET APPROACH	
Technique	**Examples of Common Usage**
Quoted price in an exchange market (see Section G)	Equity securities, futures
Quoted prices in dealer markets	• On-the-run Treasury notes • To-be-announced (TBA) mortgage-backed-securities.

MARKET APPROACH	
Technique	**Examples of Common Usage**
Market multiples derived from a set of comparable assets (e.g., a price to earnings ratio expresses an entity's per-share value in terms of its earnings per share)	Unlisted equity interests
Matrix pricing	Debt securities similar to benchmark quoted securities
INCOME APPROACH	
Technique	**Examples of Common Usage**
Present value techniques	• Debt securities with little, if any, trading activity • Unlisted equity instruments
Black-Scholes-Merton model or lattice model	Over-the-counter European call option or American call option
Multi-period excess earnings method: based on a discounted cash flow analysis that measures the fair value of an asset by taking into account not only operating costs but also charges for contributory assets; this isolates the value related to the asset to be measured and excludes any value related to contributory assets	Intangible assets, such as customer relationships and technology assets, acquired in a business combination
Relief-from-royalty method	Intangible assets expected to be used actively
COST APPROACH	
Technique	**Examples of Common Usage**
Depreciated replacement cost (DRC) method: considers how much it would cost to replace an asset of equivalent utility taking into account physical, functional and economic obsolescence; it estimates the replacement cost of the required capacity rather than the actual asset	Factory plant and equipment

F20. When more than one valuation technique is used, what factors should an entity consider in weighting the indications of fair value produced by the different techniques?

820-10-35-16AA
[IFRS 13.61, BC142]

An entity should consider, among other things, the reliability of the valuation techniques and the inputs that are used in the techniques. If a particular market-based approach relies on higher-level inputs (e.g., observable market prices) compared to a particular income-based approach that relies heavily on projections of income, the entity will often apply greater weight to the measurement of fair value generated by the market-based approach because it relies on higher-level inputs.

820-10-05-1C
[IFRS 13.61]

An entity should maximize the use of relevant observable inputs and minimize the use of unobservable inputs. Therefore, higher-level inputs that are available and relevant should not be ignored (see Section G).

820-10-35-24B
[IFRS 13.63]

Any, or a combination of, the techniques discussed in the Codification Topic can be used to measure fair value if the techniques are appropriate in the circumstances. However, when multiple valuation techniques are used to measure fair value (e.g., when valuing a reporting unit for impairment testing purposes), the Codification Topic does not prescribe a mathematical weighting scheme; rather it requires judgment.

In our experience, in many cases valuation professionals produce an evaluated price that uses a market approach based on observable transactions of identical or comparable assets or liabilities and an income approach that is calibrated to market data.

820-10-35-24B
[IFRS 13.63]

When multiple valuation techniques are used to measure fair value, the techniques should be evaluated for reasonableness and reliability, and how they should be weighted. The respective indications of value should be evaluated considering the reasonableness of the range of values indicated by those results. The objective is to find the point within the range that is most representative of fair value in the circumstances. In some cases, a secondary method is used only to corroborate the reasonableness of the most appropriate valuation technique.

F30. In using the income approach to measure the fair value of a nonfinancial asset or nonfinancial liability, what are some of the key components that will have the most significant effect on the overall fair value measurement?

Measuring the fair value of a nonfinancial asset or nonfinancial liability using an income approach (e.g., a discounted cash flow method) requires consideration of the following.

The Type of Valuation Model Employed

The type of valuation model employed is important because the model impacts the nature of the projected financial information. There are three primary types of discounted cash flow valuation methods:

820-10-55-10
[IFRS 13.B18]

- The *discount rate adjustment technique* uses one set of forecasted cash flows and includes a premium in the discount rate for all possible risks, including risks in the timing of the cash flows, liquidity risks, credit risks, market risks, etc.

820-10-55-15
[IFRS 13.B25]

- The *expected present value technique method 1 (EPV Method 1)* uses expected cash flows (which represent a probability-weighted average of all possible cash flow scenarios) and adjusts those expected cash flows by subtracting a cash-risk premium. Because the adjusted cash flows represent certainty-equivalent cash flows, the discount rate used is a risk-free interest rate.

820-10-55-16
[IFRS 13.B26]

- The *expected present value technique method 2 (EPV Method 2)* also uses expected cash flows but does not adjust those expected cash flows by subtracting a cash-risk premium. EPV Method 2 adjusts for risk by adding a risk premium to the risk-free interest rate for discounting purposes. The expected cash flows are discounted at a rate that corresponds to an expected rate of return associated with the probability-weighted cash flows (expected rate of return).

The Discount Rate

820-10-55-16
[IFRS 13.B24–B26]

The discount rate for the *discount rate adjustment technique* and the *EPV Method 2* should consider all of the risks associated with the cash flows being discounted to the extent that these risks have not been considered in the cash flows. For the EPV Method 2, the discount rate comprises a risk-free rate and a risk premium that a market participant would require to take on the risk of investing in the asset given the alternative investment opportunities. To determine this discount rate, an entity may employ a model used for pricing risky assets, such as the capital asset pricing model.

F40. How should the fair value of an intangible asset acquired in a business combination be measured if the acquirer plans to discontinue its active use?

820-10-35-10E
[IFRS 13.27, 30]

The method used to measure the fair value of an intangible asset to be retired or whose active use will be discontinued is no different from any other nonfinancial asset, and should be based on its highest and best use by market participants (see Section J). One common methodology is the with-versus-without method. This method is useful for intangible assets that market participants would be expected to use defensively. It measures the incremental cash flows that would be achieved by market participants arising from their ownership of an existing intangible asset by locking up the competing acquired intangible asset. Fair value is measured as the difference between the fair value of the group of assets of the market participant:

- Assuming that the acquired intangible asset were to be actively used by others in the market; and
- Assuming that the acquired intangible asset was withdrawn from the market.

F50. Is the cumulative cost of construction an acceptable technique for measuring the fair value of real estate property?

820-10-55-3F, 55-7
[IFRS 13.B10, B15]

Generally, no. For real estate properties undergoing development, estimating fair value can prove difficult as much of the data used as inputs to a traditional valuation analysis is not available. Few, if any, sales of comparable projects during construction exist from which meaningful fair value inputs can be derived. As a result of this lack of relevant and applicable market data, some real estate investment funds may consider the total cost expended in the measurement of the fair value of a development property.

Although the cumulative cost of construction of a development property may be an appropriate input to consider in measuring the property's fair value, particularly in the very early stages of development, it would generally not be expected to equal the property's fair value. The property's fair value, in the absence of observable and comparable transactions, generally should be based on a discounted cash flow model where cash inflows and outflows are discounted at a risk-adjusted rate of return required by market participants.

In practice, as development progresses, the probability of completion increases and certain risks associated with the investment decrease, which increases the fair value of the property. Those risks include, but are not limited to, failure to secure necessary planning and other permissions on a timely basis, construction cost overruns, changes in market conditions during construction that could lead to delays in leasing/sales and/or reduced lease rates or sale prices, and higher than projected operating expenses. In addition, there is an element of developer's profit that would be expected to increase the fair value of the property.

In our view, market participant assumptions used in a discounted cash flow model would include estimates of cash outflows needed to complete the project and the developer's profit for the remaining work to be completed (unless market participants are assumed to be developers), as well as cash inflows and outflows from operating the property and ultimately selling it at some point in the future. We believe that, a market participant would also be expected to consider the likelihood of achieving those estimated cash inflows based on the risks associated with completion of development and ultimate operations of the property as described above.

If a situation arises in which it is determined that the cumulative cost of construction is a reasonable proxy for fair value (e.g., in the very early stages of development), it would not be appropriate to include third-party costs associated with the acquisition of an investment in the determination of cost. Such costs typically relate to direct incremental costs incurred for due diligence and closing the transaction and should be excluded from a fair value measurement following the general principle that the fair value of an asset or liability is not adjusted for transaction costs (see Question E40). Accordingly, regardless of industry practice, under the requirements of the Codification Topic, transaction costs should not be included in the fair value measurement.

G. Inputs to Valuation Techniques

Overview

- Inputs to valuation techniques are the assumptions that market participants would use in pricing the asset or liability.
- Inputs are categorized into three levels:
  - *Level 1 inputs*—Unadjusted quoted prices in active markets for identical assets or liabilities that the entity can access at the measurement date.
  - *Level 2 inputs*—Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices).
  - *Level 3 inputs*—Unobservable inputs for the asset or liability.
- These inputs include assumptions about risk, such as the risk inherent in a particular valuation technique used to measure fair value and the risk inherent in the inputs to the valuation technique.
- An entity selects the valuation techniques:
  - That are appropriate in the circumstances;
  - For which sufficient data is available; and
  - That maximize the use of relevant observable inputs and minimize the use of unobservable inputs.

G10. If quoted prices in an active market are available and readily accessible, is it permissible for an entity to use a lower level input as a starting point for measuring fair value?

820-10-35-41C, 35-40
[IFRS 13.76, 79–80]

Generally, no. An entity does not make an adjustment to a Level 1 input except under specific circumstances. If an identical instrument is actively traded, a price is available and the entity can access that price at the measurement date, the fair value measurement should equal the product of the quoted market price (unadjusted) times the quantity of instruments held by the entity at the reporting date (i.e., PxQ) (see Question C90).

G20. If Level 1 inputs are not available, does that change the objective of the fair value measurement?

820-10-35-37
[IFRS 13.72, 87]

No. The fair value measurement objective remains the same regardless of the level of the inputs to the fair value measurement. Unobservable inputs also reflect the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk.

G30. Can a blockage factor be considered in measuring fair value?

820-10-35-36B
[IFRS 13.69, 80]

No. A blockage factor is a discount that reflects the number of instruments (i.e., Q) as a characteristic of the entity's holding relative to daily trading rather than a characteristic of the asset or liability. An entity is prohibited from applying a blockage factor for a fair value measurement for all three levels of the fair value hierarchy. This is the case even in respect of positions that comprise a large number of identical assets and liabilities, such as financial instruments.

820-10-35-44
[IFRS 13.69, 80]

An entity selects inputs that are consistent with the characteristics of the unit of valuation for the asset or liability that market participants would take into account. An entity should not select inputs that reflect size as a characteristic of the entity's holding even if the market's daily trading volume is not sufficient to absorb the entire quantity held by the entity without changing the market price.

820-10-35-54H
[IFRS 13.BC156–157]

If an entity decides to enter into a transaction to sell a block of identical assets or liabilities (e.g., financial instruments), the consequences of that decision should not be recognized before the transaction occurs regardless of the level of the hierarchy in which the fair value measurement is categorized. Selling a block as opposed to selling the underlying assets or liabilities individually or in multiple, smaller pieces is an entity-specific decision. These differences are not relevant in a fair value measurement, and therefore they should not be reflected in the fair value of an asset or a liability.

G40. When a Level 1 input is not available for a single asset or liability, should certain premiums or discounts (other than blockage factors) be considered in measuring fair value?

820-10-35-36B, 35-44
[IFRS 13.69, 80]

Yes, in certain circumstances. While a blockage factor reflects the marketability based on the size of a total position that is an aggregate of multiple units of account, a liquidity adjustment reflects the marketability based on the unit of valuation. Therefore, the unit of valuation is critical to determining whether a discount's nature is that of a blockage factor or a liquidity adjustment.

820-10-35-36B, 35-44
[IFRS 13.69, 80]

When no Level 1 input is available, a premium or discount should be applied in a fair value measurement if:

- Market participants would include the premium or discount when pricing the asset or liability given its unit of valuation, which is specified in other guidance; and
- A premium or discount reflects the perspective of market participants that act in their economic best interest.

The application of a control premium would be appropriate in the absence of a Level 1 input for the individual items if:

- The unit of valuation is a controlling interest;
- The price to which a control premium is applied reflects the price of an interest without control; and
- A market participant would pay a premium above that price to obtain control.

820-10-35-36B
[IFRS 13.69, BC47(b)]

However, control premiums are not applied in measuring the fair value of financial instruments if the unit of valuation is the individual instrument and the individual instrument does not convey control; this is regardless of the level in the fair value hierarchy.

820-10-35-50, 35-51
[IFRS 13.69]

When a security is not traded in an active market and its fair value is based on a model-based valuation (thereby causing the measurement to be categorized in Level 2 or Level 3), the inclusion of a liquidity adjustment (see Question G50) may be appropriate.

IFRS different from U.S. GAAP

Unlike U.S. GAAP, there is uncertainty about the unit of account (unit of valuation) in some cases, in particular for investments in subsidiaries, associates, and joint ventures. This difference, which is discussed in Question C90, affects whether a premium or discount (other than a blockage factor) is considered in measuring fair value.

G50. How is a liquidity adjustment determined?

As discussed in Question G40, a liquidity adjustment is an adjustment to reflect the marketability of an asset or liability based on its unit of account.

820-10-35-36B, 35-44
[IFRS 13.69]

The amount of a liquidity adjustment should be determined based on the liquidity of the specific asset's or liability's unit of valuation in the entity's principal (or most advantageous) market and not on the size of the entity's holding relative to the market's daily trading volume.

G60. When an investment company holds a controlling interest in an entity, should it include a control premium in its measurement of fair value?

820-10-35-41C, 35-44

It depends. If the instruments being valued are actively traded (i.e., for instruments for which there are Level 1 inputs for the noncontrolling equity instruments), fair value is measured as the product of the quoted price and the quantity held by the entity (i.e., PxQ). In this situation, an adjustment for a control premium would not be appropriate for Level 1 inputs.

This conclusion for instruments categorized as Level 1 in the fair value hierarchy does not apply to equity instruments held by an investment company that are categorized as Level 2 and Level 3. Specifically, for investment companies within the scope of the Investment Companies Codification Topic, there are situations in which a control premium may be appropriate if an entity holds a controlling interest. The Investment Companies Codification Topic does not clearly establish a unit of account for investment companies and does not prohibit the use of either the individual security or the grouping of one issuer's equity securities together as the unit of account. Practice has evolved so that investment companies use a single unit of account in these situations if market participants would take those characteristics (including a control premium) into account.

This interpretation is based on conversations with the FASB staff. The conclusion referenced above requiring a PxQ measurement for Level 1 instruments and the preclusion of blockage factors for all levels would appear to not allow recognition of a control premium unless the unit of account was the controlling interest (grouping the individual instruments) versus the individual instruments. However, this interpretation is consistent with investment company practice prior to the adoption of the Codification Topic. We understand that the FASB was aware of this historical practice and explicitly decided not to make a consequential amendment to the Investment Companies Codification Topic that would prohibit it.

IFRS different from U.S. GAAP

Unlike U.S. GAAP, in our view there is an accounting policy choice for the unit of account for investments in subsidiaries, which is explained in Question C90.

G70. What criteria must be met to qualify for the practical expedient not to use Level 1 inputs?

820-10-35-41C(a)
[IFRS 13.79(a)]

As a practical expedient, an entity may measure the fair value of certain assets and liabilities using an alternative method that does not rely exclusively on quoted prices. This practical expedient is appropriate only when the following criteria are met:

- The entity holds a large number of similar (but not identical) assets or liabilities; and
- Quoted prices from an active market, while available, are not readily accessible for these assets or liabilities individually (i.e., given the large number of similar assets or liabilities held by the entity, it would be difficult to obtain pricing information for each individual asset or liability at the measurement date).

In our view, the use of such an alternative method as a practical expedient also is subject to the condition that it results in a price that is representative of fair value. We believe that the application of a practical expedient is not appropriate if it would lead to a measurement that is not representative of an exit price at the measurement date.

For a discussion of the categorization of the resulting fair value measurement in the hierarchy, see Questions H30 and H90.

G80. How is the fair value measurement of an asset or liability affected by the transaction price for similar or identical assets or liabilities?

820-10-35-54J
[IFRS 13.B44]

An entity considers all of the following in measuring fair value or estimating market risk premiums:

- If the evidence indicates that a transaction is not orderly, the entity places little, if any, weight (compared with other indications of fair value) on that transaction price (see Section M).

- If the evidence indicates that a transaction is orderly, the entity takes into account that transaction price. The amount of weight placed on that transaction price when compared with other indications of fair value will depend on facts and circumstances, such as the volume of the transaction, the comparability of the transaction to the asset or liability being measured, and the proximity of the transaction to the measurement date.
- If the entity does not have sufficient information to conclude whether a transaction is orderly, it takes into account the transaction price. However, that transaction price may not represent fair value; that is, the transaction price is not necessarily the sole or primary basis for measuring fair value or estimating market risk premiums. If the entity does not have sufficient information to conclude whether particular transactions are orderly, it places less weight on those transactions when compared with other transactions that are known to be orderly.

820-10-35-54G
[IFRS 13.B43(c)]

A fair value measurement is not intended to reflect a forced transaction or a distressed sale price. Nevertheless, the presence of distressed sellers in a particular market may influence the price that could be obtained by a non-distressed seller in an orderly transaction.

820-10-35-50
[IFRS 13.83(c)]

Although significant adjustments to a Level 2 input may be necessary as a result of a significant decrease in the volume or level of activity for the asset or liability in relation to normal market activity, Level 2 inputs related to transactions that are either orderly or where there is insufficient information to conclude whether a transaction was orderly are considered to be relevant and therefore should be considered in the valuation technique.

G90. In measuring the fair value of loans, can an entity consider the current transaction price for the securities that would be issued by a market participant that securitizes the loans?

820-10-35-36
[IFRS 13.67, 72]

It depends. A valuation technique should maximize observable inputs and minimize unobservable inputs. In addition, the fair value hierarchy gives priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1 inputs) and the lowest priority to unobservable inputs (Level 3 inputs).

820-10-35-53
[IFRS 13.67, 72, 87]

As a result, it may be appropriate to include securitization prices as an input into the valuation technique if market participants would consider this pricing. This would be the case particularly if a reliable observable price for the loans is not available, even if the securitization market may not be considered the principal market (discussed in Question E70). If the valuation technique uses these inputs then the fair value of the loans generally would be obtained by adjusting the securitization prices (including the value of retained interests) for the costs that would be incurred and the estimated profit margin that would be required by a market participant to securitize the loans.

G100. How should the fair value of a reporting unit that is a subsidiary be measured if the entity owns a 60% controlling interest and the remaining noncontrolling interest shares are publicly traded?

350-20-35-22 – 35-24
[IFRS 13.69, BC47]

In measuring the fair value of a reporting unit for goodwill impairment testing purposes, the unit of account is the collection of assets and liabilities forming the controlled entity. Acquisitions of public companies frequently involve payment of a premium to the pre-announcement share price, primarily because of synergies and other benefits that flow from control over another entity. In these circumstances, the quoted market price of an individual equity security may not be representative of the fair value of the reporting unit as a whole. Therefore, a control premium adjustment may be appropriate.

Future developments under IFRS

Under IFRS, the issue described in Question G100 is currently part of an IASB project, *Fair Value Measurement: Unit of Account*. During its March 2013 meeting, the IASB tentatively decided that the fair value measurement of a cash-generating unit that is a subsidiary whose shares are publicly traded should be the product of its quoted price (P) multiplied by the quantity (Q) of instruments held (i.e., excluding a control premium). An exposure draft is expected in Q1 2014.

G110. If an entity has adopted a convention for prices subject to a bid-ask spread but evidence exists that the price under the convention is not representative of fair value, should the entity adjust its valuation?

820-10-35-36C
[IFRS 13.70]

Yes. An entity should not ignore available evidence that its pricing convention (e.g., mid-market pricing) is producing an amount that is not representative of fair value. The price within the bid-ask spread that is representative of fair value in the circumstances should be used to measure fair value.

820-10-35-36C – 35-36D
[IFRS 13.70–71]

The Codification Topic does not preclude an entity from establishing policies to use mid-market pricing or other pricing conventions that are used by market participants as a practical expedient for fair value measurements within a bid-ask spread. However, in our view, the use of mid-market pricing or other pricing conventions is subject to the condition that it results in a price that is representative of fair value. Therefore, an entity cannot ignore available evidence that its pricing convention does not result in an amount that is representative of fair value. When using a pricing convention, an entity should ensure that the assumptions used each reporting period reflect current market conditions.

Example G110: Mid-Market Pricing

Company G invests in a financial asset that has bid and ask prices with a very wide bid-ask spread. Company G's approach is to use the mid-market pricing convention for measuring fair value.

If Company G's approach is to use mid-market pricing for assets and liabilities measured at fair value that have bid and ask prices, and the bid-ask spread is particularly wide or the applicable bid-ask spread has widened significantly for a specific asset or liability, a mid-market price may not be representative of fair value in those circumstances. In that case, Company G would evaluate whether the mid-market price continues to be representative of a fair value measurement as used by market participants for that specific asset or liability.

G120. Is it appropriate for an entity that historically measured the fair value of individual positions using a mid-market pricing convention to use a different point within the bid-ask spread to achieve a desired reporting outcome?

No. In our view, it is not appropriate for an entity to change its valuation technique or policies to achieve a desired financial reporting outcome. However, a change in valuation technique or policy that results in a more representative measure of the fair value in the current circumstances would be appropriate.

G130. In measuring the fair value of exchange-traded securities, at what time of the day should the security be priced?

820-10-35-41C
[IFRS 13.B34]

In practice, an entity generally uses the closing price from the principal (or most advantageous) market on the last day of its reporting period. Some entities use prices that reflect after-hours trading, which in practice is most common for instruments that trade in foreign markets that close before similar markets in other time zones. Consideration should be given to the circumstances in which adjustments to Level 1 prices may be appropriate.

820-10-35-36C
[IFRS 13.B34]

In an exchange market, closing prices are both readily available and generally representative of fair value. However, the definition of a closing price may represent different things on different exchanges for different types of financial instruments. For example, a closing price may range from the last transaction price for the day to a price derived from a complicated calculation or process. If an asset or liability is subject to a bid-ask spread, an entity needs to assess the nature of the closing price.

946-320-S99

For mutual funds and other similarly regulated entities, the measurement date may be determined either by reference to other applicable Codification subtopics or industry-specific regulations.

IFRS different from U.S. GAAP

There are no industry specific requirements under IFRS. Instead, the general principles of the Standard apply.

G140. When might a quoted price in an active market not be representative of fair value at the measurement date?

820-10-35-41C(b)
[IFRS 13.79(b)]

In some cases, a quoted price in an active market might not represent fair value at the measurement date, which might occur if a significant event takes place after the close of a market but before the measurement date (e.g., the announcement of a business combination or trading activity in similar markets). In that case, an entity chooses an accounting policy, to be applied consistently, for identifying those events that might affect fair value measurements.

820-10-35-41C(b)
[IFRS 13.79(b)]

However, if the quoted price is adjusted for new information, the adjustment results in a fair value measurement categorized within a lower level of the fair value hierarchy (see Section H).

Example G140: Adjustment to Inputs

Company G holds shares of Company T that are listed on the London Stock Exchange (LSE). On the reporting date, Company G obtains the closing price of the shares from the LSE. Subsequent to the LSE's closing time, but still on the reporting date, Company T makes a public announcement that affects the fair value of its shares as evidenced by prices for a small number of aftermarket transactions in depository receipts on the shares of Company T that are traded on the New York Stock Exchange.

Company G would use the aftermarket prices to make appropriate adjustments to the closing price from the LSE to determine the fair value of the shares at the measurement date. Because the adjustment is derived from observed market prices, the resulting fair value measurement would be a Level 2 measurement in the fair value hierarchy.

G150. How might an entity determine the necessary adjustment when the quoted price is not representative of fair value at the measurement date?

820-10-35-41C(b)
[IFRS 13.79(b)]

An entity should choose an accounting policy, to be applied consistently, to identify significant events occurring after the close of the principal or most advantageous market, but before the measurement date, which may affect fair value measurements.

In our experience, pricing data from aftermarket trades or trades for identical or similar assets or liabilities in another market may be useful to determine the existence of a significant event that affects the fair value measurement of an asset or liability. Pricing data also may be used to determine the amount of the adjustment to be made to the Level 1 price sourced from the entity's principal (or most advantageous) market.

If an entity uses pricing data from aftermarket trades or trades for identical or similar assets or liabilities in another market to determine the amount of the adjustment, it should support that adjustment through analysis of how the pricing data or their underlying factors affect the fair value of the asset or liability. This analysis may be based on quantitative and qualitative factors to assess whether the pricing data is relevant to the fair value measurement of the asset or liability being measured.

For example, if an entity uses a statistical method in its analysis, to the extent that the analysis supports a correlation coefficient that is other than 1:1, that factor may need to be applied to pricing data from aftermarket trades or trades for identical or similar assets or liabilities in another market to develop the adjustment to be applied to the Level 1 price in the entity's principal (or most advantageous) market.

This analysis also may include a comparison between the pricing data from aftermarket trades or trades for identical or similar assets or liabilities in another market and the subsequent price in the entity's principal (or most advantageous) market. To the extent that a difference is found through this analysis, an adjustment to the Level 1 price from the entity's principal (or most advantageous) market may need to reflect this difference.

Example G150: Oil Futures Contracts

Company G holds oil futures contracts at the New York Mercantile Exchange (NYMEX). On the reporting date, Company G obtains the closing price of the oil futures from NYMEX. On the reporting date, but subsequent to the closing time of NYMEX, there is a public announcement that affects oil prices and related financial instruments. This is evidenced by prices of oil forward contracts transacted in the over-the-counter (OTC) market on the reporting date.

Company G needs to evaluate the futures prices with forward contracts to factor in how correlated the futures and forward markets are. If this analysis supports a correlation, and the correlation coefficient is other than 1:1, that factor may need to be applied to the aftermarket forward prices to determine the appropriate adjustments to the price quoted on NYMEX.

Because of the adjustment to the price obtained from the principal market, the resulting fair value measurement generally would be expected to be a Level 2 measurement, unless the unobservable inputs are significant, in which case a Level 3 designation would be appropriate.

G160. If an entity uses a pricing service to obtain inputs to a fair value measurement, what is management's responsibility for evaluating the appropriateness of those inputs?

AICPA's Current SEC and PCAOB developments, December 2011

The preparation of financial statements requires management to establish accounting and financial reporting processes for determining fair value measurements, including adequate internal controls. Even though third-party sources may provide information to management as sources of fair value information, management is still responsible for:

- Complying with the applicable Codification Topics, including disclosure requirements;

- Maintaining appropriate internal controls to prevent or detect material misstatements related to the fair value measurements and disclosures; and
- Assessing the effectiveness of internal control over financial reporting related to fair value measurements.

820-10-35-54K, 35-54M
[IFRS 13.B45, B47]

Management should understand how the quote or price was determined by the pricing service. It should understand what the source of the information was, the inputs and assumptions used, and whether a quote is binding or nonbinding. It also should consider whether an adjustment to the price is necessary. In addition, management is expected to establish internal controls to determine that the pricing information received from a vendor and used by management in the valuation process is relevant and reliable, including:

- Whether the prices are consistent with the fair value measurement objective (i.e., the price at which an orderly transaction would take place between market participants on the measurement date); and
- Whether there are a number of price indicators for a single instrument and the price indications are widely dispersed. If so, management should consider which prices best represent the price at which an orderly transaction would take place between market participants on the measurement date. If the differences in prices are significant, it generally is not appropriate to take the average of the quotes obtained from pricing services because an average does not necessarily represent a price at which a transaction would take place, and it is likely that one or more of the prices obtained better represents fair value than the others.

With respect to SEC registrants, the SEC staff noted that obtaining information from pricing sources may be critical to providing appropriate management's discussion and analysis (MD&A) and financial statement disclosure. Therefore, the better management understands the models, inputs, and assumptions used in developing the price provided by the vendor, the more likely that appropriate risk and uncertainty disclosures will be made.

The SEC Staff's communications have clarified management's responsibilities relating to prices obtained from third-party pricing sources that are used by management for estimating fair values for financial reporting purposes.[6]

6 For additional information, see KPMG's Defining Issues No. 11-65, SEC Staff Communicates Expectations about Management's Responsibilities for Fair Value Measurements of Investment Securities, available at www.kpmginstitutes.com/financial-reporting-network.

H. Fair Value Hierarchy

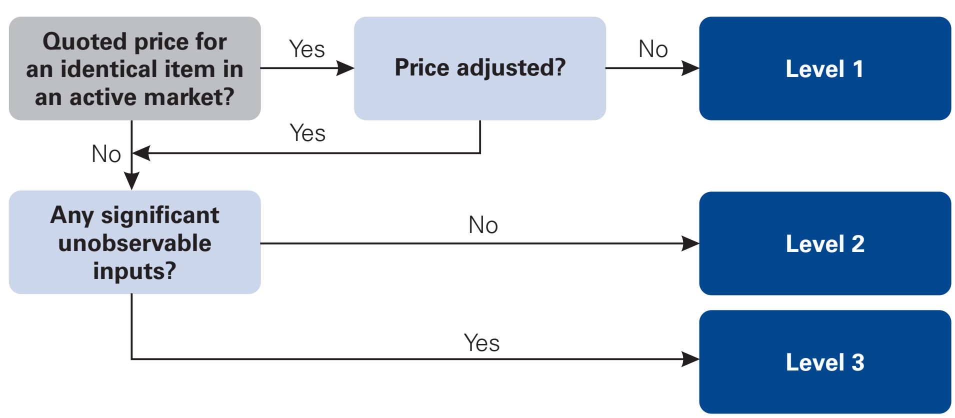
Overview

- The Codification Topic establishes a fair value hierarchy based on the inputs to valuation techniques used to measure fair value.
- The inputs are categorized into three levels – the highest priority is given to unadjusted quoted prices in active markets for identical assets or liabilities, and the lowest priority is given to unobservable inputs. For a more in-depth discussion of inputs to valuation techniques, see Section G.
- The fair value hierarchy is made up of three levels, with Level 1 being the highest level.
  - *Level 1 inputs*—Unadjusted quoted prices in active markets for identical assets or liabilities that the entity can access at the measurement date.
  - *Level 2 inputs*—Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices).
  - *Level 3 inputs*—Unobservable inputs for the asset or liability.
- Fair value measurements are categorized in their entirety based on the lowest level input that is significant to the entire measurement.
- The resulting categorization is relevant for disclosure purposes.

H10. How are fair value measurements categorized in the fair value hierarchy?

820-10-35-37 – 35-37A
[IFRS 13.73]

Fair value measurements are categorized in their entirety based on the lowest level input that is significant to the entire measurement. This is summarized in the following diagram.



820-10-35-37A – 35-38, 35-40, 35-47, 35-52
[IFRS 13.73–74, 76, 81, 86, A]

The level into which a fair value measurement is categorized in its entirety is determined with reference to the observability and significance of the inputs used in the valuation technique (see Section F). Categorization into Level 1 can only be achieved through using a quoted price in an active market for an identical asset or liability, without adjustment.

H20. If fair value is measured using inputs from multiple levels of the hierarchy, how should an entity determine the significance of an input for categorizing the fair value measurement within the hierarchy?

The Codification Topic does not provide guidance on how to determine *significance*.

820-10-35-37A
[IFRS 13.73–74]

If a fair value is measured using inputs from multiple levels of the fair value hierarchy, the inclusion of a lower level input in an entity's measurement may indicate that the input is significant. This is because the entity's decision to include the lower level input provides evidence that it considers the input to be significant to the overall measurement of fair value.

820-10-35-37A
[IFRS 13.73]

However, the final determination of whether inputs are significant is a matter of judgment that requires an entity to consider:

- Factors specific to the asset or liability; and
- The importance of the input to the overall fair value measurement, including the quantitative effect of the input on the overall fair value measurement and possible alternative assumptions for the input.

If multiple unobservable inputs are used, in our view the unobservable inputs should be considered individually and in total for the purpose of determining their significance. For example, it would not be appropriate to categorize in Level 2 a fair value measurement that has multiple Level 3 inputs that are individually significant to that measurement but whose effects happen to offset. If factors such as volatility inputs are used, an entity could apply some form of comparability methodology (e.g., a stress test of the sensitivity of the fair value estimate to an option's volatility input or a with and without comparison to assist in determining significance).

H30. When an entity uses the practical expedient in G70 to deviate from a Level 1 input, how is the resulting fair value measurement categorized in the hierarchy?

The practical expedient to deviate from a Level 1 input is discussed in Question G70.

820-10-55-3C
[IFRS 13.79(a)]

The use of an alternative pricing method results in a fair value measurement categorized within a lower level of the fair value hierarchy. An example of an alternative pricing method is matrix pricing. This pricing method involves using a selection of data points, usually quoted prices, or yield curves to calculate prices for separate financial instruments that share characteristics similar to the data points. Matrix pricing using observable market-based data points will usually result in a Level 2 categorization in the fair value hierarchy.

H40. At what level in the hierarchy should an entity categorize a fair value measurement of a publicly traded equity investment that is subject to a security-specific restriction?

820-10-35-38A
[IFRS 13.75, 79]

Generally, Level 2 or Level 3. For securities that, absent the security-specific restriction, are publicly traded in an active market (i.e., the observed price is a Level 1 input for the unrestricted security), an entity adjusts the publicly available price for the effects of the restriction to arrive at the fair value of the restricted security. Any such adjustments will cause the overall fair value measurement to be categorized as a Level 2 or Level 3 measurement.

820-10-35-38A
[IFRS 13.75, 79]

Although the overall fair value measurement will be a Level 2 or Level 3 measurement, further adjustments to the publicly traded price are generally not appropriate.

H50. At what level in the hierarchy should an entity categorize a fair value measurement of an equity investment in a privately held company?

820-10-35-37A – 35-38
[IFRS 13.73]

Generally, Level 3. The categorization of an asset or liability in the fair value hierarchy should be based on the lowest level input that significantly affects the fair value measurement in its entirety. To determine an investment's categorization in the hierarchy, an entity should consider the technique used to value the investment as well as the inputs to the measurement. Usually, there are no current observable prices for shares in private companies and accordingly the measurement of fair value is based on valuation techniques that use unobservable inputs.

820-10-35-48
[IFRS 13.B5–B6]

For example, one common technique for valuing equity securities is the market approach, which bases the measurement on multiples of income statement amounts (e.g., EBITDA, net income, revenue, etc.) for similar companies.[7] For this technique, the multiples used in the fair value measurement should, if available and applicable, be calculated based on publicly available market information for similar companies that have actively traded equity securities.

820-10-35-54A
[IFRS 13.73]

However, although market information should be used if available and relevant, the overall fair value measurement of the equity securities measured using this technique generally will be a Level 3 measurement because the other inputs into the measurement technique (e.g., entity-specific income statement amounts, comparability adjustments, etc.) are not observable.

820-10-35-54
[IFRS 13.69]

One of the other inputs that needs to be considered is a discount for the nonmarketable nature of the unquoted equity investment being measured, as compared with equity instruments of the similar companies that are publicly traded and, therefore, likely to be more liquid. An adjustment to reflect the nonmarketable nature of the investment generally will result in a fair value measurement categorized as a Level 3 measurement.

7 EBITDA means earnings before interest, taxes, depreciation, and amortization.

H60. For assets or liabilities that have maturities longer than instruments for which market pricing information is available, how should the fair value measurement be categorized?

820-10-35-40
[IFRS 13.76]

In the absence of quoted prices in active markets for identical assets or liabilities that the entity can access on the measurement date, fair value measurements should not be categorized as Level 1. To be categorized as a Level 1 measurement, the market information should be observable prices for identical instruments.

820-10-35-48
[IFRS 13.73, 75, 82]

To determine the appropriate categorization of fair value measurements of instruments that involve terms requiring both observable and unobservable inputs, an entity should consider each of the following factors.

- If market prices are observable for substantially all of the term of the asset or liability, the fair value measurement may be a Level 2 measurement. If market prices are not observable for substantially all of the term of the asset or liability, this may cause the measurement to be a Level 3 measurement.
- If the effect of an unobservable input on the overall fair value measurement is significant, the fair value measurement will be a Level 3 measurement. An adjustment to a Level 2 input for the effect of the unobservable term that is significant to the entire measurement may cause it to be a Level 3 measurement if the adjustment uses unobservable inputs.

Example H60: Categorization of Derivatives when Prices are not Available

Company H has an agreement to purchase natural gas every month for the next 30 months. The agreement is accounted for as a derivative instrument and therefore is measured at fair value. Assume that natural gas futures prices are available in an active market for the next 24 months after the current reporting date. However, observable natural gas futures prices with maturities ranging from 25-30 months are not available. Therefore, for the remaining 6 months of the term, Company H uses internally developed estimates of future natural gas prices.

In our view, the fair value measurement of the natural gas contract would be categorized as a Level 3 measurement because market pricing information (Level 2 inputs) is only available for 80% of the term of the contract (24 of the 30 months), which does not represent substantially the entire term of the contract. Further, it is doubtful that the effect of the unobservable market pricing information (Level 3 inputs) on the overall fair value measurement would be insignificant. However, in the following year, if quoted natural gas prices continue to be available for the following 24 months, then the fair value measurement might be categorized as a Level 2 measurement.

H70. How should an entity determine whether entity-derived inputs are corroborated by correlation to observable market data for the purpose of determining if they are Level 2 inputs?

820-10-20
[IFRS 13.A]

Market-corroborated inputs are defined as "inputs that are derived principally from or corroborated by observable market data by correlation or other means."

Topic 815
[IFRS 13.82]

An entity may use correlation analysis to prove the relationship between inputs. Correlation is a statistical concept, indicating the strength and direction of a linear relationship between two variables. In our view, for an input to be considered a Level 2 input by using correlation, the correlation between the input and relevant observable market data should be high. In using correlation or other statistical means to support Level 2 inputs, an entity may apply similar statistical considerations to those applied in establishing that a hedging relationship is highly effective using a regression analysis.

In establishing the level in the hierarchy of an input corroborated using correlation analysis, an entity considers factors such as the R-squared confidence level of the statistical analysis and the number of data points.

H80. How does an adjustment for information occurring after the close of the market affect the categorization of the measurement in the hierarchy and an entity's ability to make other adjustments?

820-10-35-41C(b)
[IFRS 13.79(b)]

An adjustment to exchange-traded pricing for information occurring after the close of the principal (or most advantageous) market, but before the measurement date, will result in a fair value measurement that is lower than Level 1.

820-10-35-41C
[IFRS 13.79]

Although the adjusted price is no longer a Level 1 measurement, in our view, an entity is not allowed to make other adjustments to the measurement (e.g., for market or other risks), except if the criteria to make one of the other adjustments to Level 1 prices in the Codification Topic are met (see Question G70 and Sections K and L). We believe that the circumstances that allow an entity to adjust Level 1 inputs only allow for adjustments related to those circumstances.

H90. If an entity obtains prices from a third-party pricing service to use in its fair value measurement of an asset or liability, how should it categorize the resulting fair value measurement in the hierarchy?

820-10-35-54
[IFRS 13.73, B45]

The use of a pricing service for inputs in a fair value measurement does not change the analysis of the categorization of the inputs in the fair value hierarchy. Prices obtained from a pricing service are not considered observable simply because they were obtained from a third party. Instead, the resulting fair value measurement is categorized in the fair value hierarchy based on the nature (or source) of the prices provided by the pricing service. Therefore, an entity using a pricing service should obtain an understanding of the valuation methods and the source of inputs used by the pricing service to properly categorize any fair value measurements based on those inputs.[8] See also Question G160.

820-10-35-52
[IFRS 13.72, B47]

For example, if a pricing service provides quoted prices (unadjusted) from active markets for identical assets or liabilities, any resulting fair value measurement equal to those prices would be Level 1. Alternatively, if the pricing service provides prices based on models generated by the pricing service, any resulting fair value measurement would be a Level 3 measurement if the pricing inputs are not observable.

820-10-35-41C(a)
[IFRS 13.79(a)]

In some cases, pricing services may provide Level 2 inputs determined using a matrix pricing methodology, even though Level 1 inputs are available to both the entity and the pricing service. Using Level 2 inputs in these situations is not appropriate unless the entity meets the criteria in Question G70. If these criteria are not met, the entity should obtain quoted prices (Level 1 inputs) either from the pricing service or from other sources.

Example H90: Fair Value Measurement from Pricing Services

If a price is obtained from a pricing service, how should it be categorized in the fair value hierarchy in each of the following scenarios?

Scenario 1: Debt Security Traded in a Dealer Market

820-10-35-41C(a)
[IFRS 13.79(a)]

Company H holds a debt security that is traded in a dealer market in which bid-ask quoted prices are available. Assume that the market is an active market for the debt security and Company H has access to this market.

If the pricing service used the price to measure the fair value of the debt security (i.e., the identical CUSIP), the debt security would be a Level 1 measurement.[9] However, if the pricing service uses a methodology for this class of debt securities based on observable market data using matrix pricing methodology in addition to Level 1 inputs when it meets the relevant criteria (see Questions G70 and H30), the price would usually be categorized as a Level 2 measurement.

Scenario 2: Exchange-Traded Debt Security

820-10-55-84
[IFRS 13.76, 79(c)]

Company H issued an exchange-traded debt security and elected to account for the instrument under the fair value option. The pricing service uses the quoted price for the security trading as an asset in an active market as its measurement of the fair value of the debt security.

Company H evaluates whether the quoted price for the asset used by the pricing service requires adjustment for factors such as a restriction preventing the sale of that asset, which would not apply to the fair value measurement of the liability.

8 See Defining Issues No. 11-65, SEC Staff Communicates Expectations about Management's Responsibilities for Fair Value Measurements of Investment Securities, available at www.kpmginstitutes.com/financial-reporting-network, for examples of activities and controls that we have observed management teams using to satisfy their responsibilities.

9 Committee on Uniform Security Identification Procedures – the U.S. alphanumeric code that identifies a financial security.

In this case, Company H determines that no adjustments are required to the quoted price of the asset. Therefore, the debt security would be categorized as a Level 1 measurement. This is because the price used to measure the fair value of the debt security is for the identical instrument issued by Company H and traded as an asset, and no adjustments were made to the quoted price of the identical instrument.

Scenario 3: Interest Rate Swap

820-10-55-21(a)
[IFRS 13.72]

Company H is a party to an interest rate swap transaction in an OTC market. There are no quoted prices in the OTC market for interest rate swaps that are identical to Company H's swap. Company H obtains rates from a third-party pricing service to use in the measurement of the fair value of the swap. For providing the price, the pricing service uses transaction rates for similar swaps in the OTC market.

While similar swaps may have been transacted in the OTC market, these swaps have different counterparties as well as different fixed coupons and residual maturities, and therefore are not identical to Company H's interest rate swaps. The price at which Company H would be able to sell the interest rate swap would result from a negotiated transaction taking into account the credit ratings of the two parties to the swap as well as the terms of the specific swap. Because the swap is not identical to similar swaps for which there are transactions in the OTC market, the price would not be categorized as a Level 1 measurement, but as Level 2 or Level 3 depending on whether significant unobservable inputs are used to produce the price.

H100. When prices derived from consensus valuations are used for measuring fair value, where in the hierarchy does the resulting measurement fall?

It depends. A consensus valuation is a common approach (e.g., for loans and derivatives) when multiple participants in a group assembled by a pricing service submit their best estimate of price (typically a mid-market price) for the assets or liabilities that each entity holds in its trading books. The pricing service returns consensus prices to each subscriber based on the data received.

820-10-35-54M
[IFRS 13.72, B47]

When assessing consensus data, it is important to understand what the prices submitted represent. If the estimates provided to the service do not represent executable quotes or are not based on observable prices, a fair value measurement derived from the consensus price would be a Level 3 measurement. However, if the inputs to the price received from the pricing service are Level 1 or Level 2 inputs, the use of those prices generally will result in a Level 2 measurement.

820-10-50-1
[IFRS 13.B45]

As discussed in Question G160, management is required to obtain an understanding of the source of the inputs for a price received from a pricing service to properly categorize any fair value measurement based on those inputs.

I. Fair Value at Initial Recognition

Overview

- If an asset is acquired (or a liability assumed), the transaction price paid for the asset (or received to assume the liability) normally reflects an entry price. However, the Codification Topic requires fair value measurements to be based on an exit price.
- Although conceptually different, in many cases the exit and entry price are equal and therefore fair value at initial recognition generally equals the transaction price.
- However, if there is a difference, it is necessary to consider whether a day one gain or loss should be recognized.

I10. Can there be a difference between the transaction price and fair value at initial recognition?

820-10-30-3 – 30-3A
[IFRS 13.57–58]

Yes, although this is expected to occur only in limited circumstances. In many cases, the transaction price (excluding transaction costs) equals the fair value. However, there may be situations in which the transaction price might not be representative of fair value at initial recognition.

820-10-30-3A, 35-37A
[IFRS 13.48, 57–59, B4]

In determining whether fair value at initial recognition equals the transaction price, an entity considers factors specific to the transaction and to the asset or liability. The transaction price might, for example, not represent fair value at initial recognition if:

- The transaction to purchase the asset or assume the liability was entered into in a market other than the entity's principal (or most advantageous) market;
- The transaction price (i.e., entry or purchase price) is not the price within the bid-offer spread that is most representative of fair value (i.e., an exit or sale price). This may apply when an entity uses bid prices for asset positions and ask prices for liabilities;
- The transaction is between related parties;
- The transaction takes place under duress or the seller is forced to accept the price in the transaction; and/or
- The unit of account represented by the transaction price is different from the unit of account for the asset or liability measured at fair value. This might be the case in a business combination, or for a financial asset or financial liability that is purchased or assumed as part of a portfolio to which the entity applies the portfolio measurement exception (see Section L). In this case, the transaction price is based on the individual item, while the initial fair value measurement is based on the entity's net position.

820-10-30-3A
[IFRS 13.59, B4]

Before concluding that it is appropriate that the fair value at initial recognition is different from the transaction price, the entity should:

- Identify the specific attributes of the transaction that generate the difference between the transaction price and the entity's estimate of fair value; and
- Consider the guidance and examples given in the Codification Topic.

820-10-30-3, 35-37A
[IFRS 9.B5.1.2A, IAS 39.AG76]

The transaction price remains an important piece of objective evidence for determining the fair value measurement of financial instruments. Therefore, as the significance of the assumptions made by an entity increases in importance to the overall measurement of fair value, the entity should consider whether the transaction price for the instrument provides better evidence of the fair value of the instrument than its own estimate of fair value.

Example I10: Difference between Transaction Price and Fair Value at Initial Recognition

820-30-3A(d)
[IFRS 13.IE24–26]

Company R, a retail counterparty, enters into an interest rate swap in a retail market with Company D, a dealer, for no initial consideration (i.e., the transaction price is zero).

- Company D can access both the retail market (i.e., with retail counterparties) and the dealer market (i.e., with dealer counterparties).
- Company R can access only the retail market.

The dealer market is the principal market for the swap. The fair value determined by transactions in the dealer market may be different from the transaction price in the retail market.

Company D

From the perspective of Company D, the dealer market is the principal market for the swap, which is different from the market in which it initially entered into the swap transaction (the retail market). Therefore, for Company D the transaction price of zero may not necessarily represent the fair value of the swap on initial recognition.

Company R

Company R cannot access the dealer market, and the retail market is the principal market from its perspective. If it were to transfer its rights and obligations under the swap, it would do so with a dealer counterparty in that retail market. Therefore, the transaction price of zero represents the fair value of the swap to Company R on initial recognition (ignoring the potential effect of the bid-ask spread).

I20. Is an entity required to recognize a day one gain or loss if the transaction price differs from the fair value measurement at initial recognition?

820-10-30-6
[IFRS 13.60]

It depends. For assets or liabilities that are measured initially at fair value, the Codification Topic requires day one gains or losses resulting from the difference between the fair value and the transaction cost to be recognized in profit or loss, unless the relevant Codification Topic that requires or permits fair value measurement specifies otherwise.

820-10-30-6

Recognition of the difference between the transaction price and the entity's estimate of fair value is not dependent on where in the fair value hierarchy the entity's fair value measurement falls (i.e., Level 1, 2, or 3).

IFRS different from U.S. GAAP

[IFRS 9.B5.1.2A, B5.2.2A, IAS 39.AG76–76A]

For financial instruments, the relevant standards contain requirements that specify when an entity is required to recognize day one gains or losses in profit or loss. Unlike U.S. GAAP, these standards prohibit the immediate recognition of a day one gain or loss unless fair value is evidenced by a quoted price in an active market for an identical financial asset or liability, or is based on a valuation technique whose variables include only data from observable markets (the observability condition).

[IFRS 9.B5.1.2A, B5.2.2A, IAS 39.AG76–76A]

Unlike U.S. GAAP, If the entity determines that the fair value at initial recognition differs from the transaction price but it is *not* evidenced by a valuation technique that uses only data from observable markets, the carrying amount of the financial asset or liability on initial recognition is adjusted to defer the difference between the fair value measurement and the transaction price. This deferred difference is subsequently recognized as a gain or loss only to the extent that it arises from a change in a factor (including time) that market participants would take into account when pricing the asset or liability.

The table illustrates the application of the day one gain and loss guidance in IFRS on initial recognition if:

- A difference arises between the transaction price (e.g., 100) and management's alternative estimate of fair value (e.g., 99); and
- The observability condition is not met.

Application of day one gain or loss guidance if observability condition is not met	
Fair value:	Management's estimate of exit price = 99
Initial measurement, ignoring transaction costs:	Fair value (99) plus the difference between transaction price and fair value of 1 (100 - 99) = 100

I30. Can there be a day one difference for a hybrid instrument if the entity has access to a market for the components of the hybrid that would result in a more advantageous measurement of the entire hybrid instrument?[10]

820-10-35-24C
[IFRS 13.11]

It depends. An entity is required to consider the hybrid instrument acquired or obtained, including all its rights and obligations, as well as any other items that would be considered by market participants, when developing a price for the hybrid instrument in its entirety.

820-10-55-1D
[IFRS 13.11]

It may be appropriate to measure the fair value of a hybrid instrument in its entirety based on the separate fair value measurements of its individual components (i.e., the host contract and one or more embedded derivatives) if that is how market participants would price the instrument in the principal (or most advantageous) market for the hybrid instrument.

820-10-30-3A
[IFRS 13.11, 58–59]

However, if the resulting measurement at initial recognition is different from the transaction price, it may be appropriate for an entity to recognize the difference between the transaction price and the entity's measurement of fair value, only if the entity can:

- Identify the specific attributes of the transaction that generate the difference between the transaction price and the entity's estimate of fair value; and
- Reconcile those attributes with the guidance on recognizing when a day one gain or loss may be appropriate (see Questions I10 and I20).

820-10-30-6

If there is a difference between the transaction price and the fair value of the hybrid instrument at initial recognition based on the fair values of its separate components, the resulting day one gain or loss is recognized in profit or loss.

820-10-35-24C
[IFRS 13.61, 69]

For the fair value of a hybrid financial instrument in its entirety to be based on the instrument's individual component parts, without adjustment, the valuation technique used should capture all of the cash flows or other exchanges of value included in the contractual terms of the hybrid instrument together with associated risks including any interdependencies between different components.

IFRS different from U.S. GAAP

[IFRS 9.B5.1.2A, B5.2.2A, IAS 39.AG76–76A]

Unlike U.S. GAAP, if there is a difference between the transaction price and the fair value of the hybrid instrument at initial recognition, recognition of a day one gain or loss depends on the observability condition (see Question I20).

10 A hybrid instrument refers to a nonderivative instrument that consists of a nonderivative host contract and one or more embedded derivatives.

J. Highest and Best Use

Overview

- *Highest and best use* is a valuation concept that represents the use of a nonfinancial asset by market participants that would maximize the value of the asset or the group of assets and liabilities (e.g., a business) within which the asset would be used.
- A fair value measurement of a nonfinancial asset considers a market participant's ability to generate economic benefits by using the asset at its highest and best use or by selling it to another market participant who would use the asset in its highest and best use.

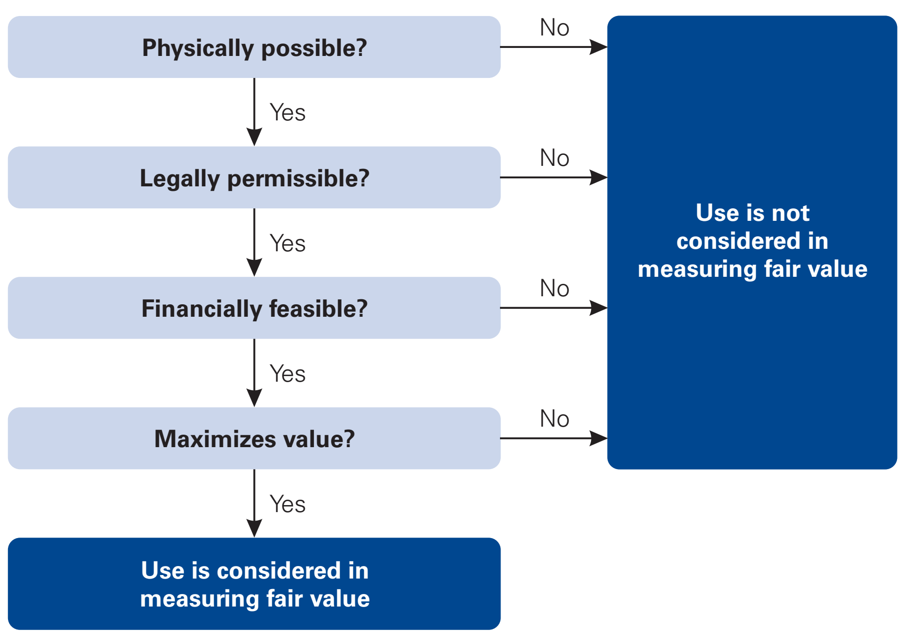
J10. Can an entity assume a change in the legal use of a nonfinancial asset when determining its highest and best use?

820-10-35-10A
[IFRS 13.A, 27–28]

It depends. A fair value measurement of a nonfinancial asset takes into account a market participant's ability to generate economic benefits by using the asset at its highest and best use or by selling it to another market participant that would use the asset at its highest and best use.

820-10-35-10B, 35-10E
[IFRS 13.27–28, 31(a)(i), 31(b)]

In determining the highest and best use of a nonfinancial asset, the entity considers whether the use is physically possible, legally permissible, and financially feasible. The entity also considers whether maximum value would be provided to market participants by using the asset on a stand-alone basis or in combination with other assets. This is illustrated in the following diagram.



820-10-35-10C
[IFRS 13.29–30]

Highest and best use is determined from the perspective of market participants, even if the entity intends a different use. However, an entity's current use of a nonfinancial asset is presumed to be its highest and best use unless market or other factors suggest that a different use by market participants would maximize the value of the asset.

820-10-35-10B
[IFRS 13.27, 28(b), 30, BC69]

A use that is legally permissible takes into account any legal restrictions on the use of the nonfinancial asset that market participants would take into account when pricing the asset. To be considered legally permissible, the potential use of a nonfinancial asset should not be prohibited under current law in the jurisdiction.

820-10-35-10C
[IFRS 13.BC69]

When a nonfinancial asset's fair value measurement contemplates a change in its legal use (e.g., a change in zoning restrictions), the risks of changing its legal usage and the costs a market participant would incur to transform the asset should be considered.

Example J10: Land Acquired in a Business Combination

820-10-55-30 – 55-31
[IFRS 13.IE7–IE8]

Company J acquires land in a business combination. The land is currently developed for industrial use as a factory site. Although the land's current use is presumed to be its highest and best use unless market or other factors suggest a different use, Company J considers the fact that nearby sites have recently been developed for residential use as high-rise apartment buildings.

On the basis of that development and recent zoning and other changes to facilitate that development, Company J determines that the land currently used as a factory site could be developed as a residential site (e.g., for high-rise apartment buildings) and that market participants would take into account the potential to develop the site for residential use when pricing the land.

The highest and best use of the land is determined by comparing the following:

- The value of the land as currently developed for industrial use (i.e., an assumption that the land would be used in combination with other assets, such as the factory, or with other assets and liabilities); and
- The value of the land as a vacant site for residential use, taking into account the costs of demolishing the factory and other costs necessary to convert the land to a vacant site. The value under this use would take into account risks and uncertainties about whether the entity would be able to convert the asset to the alternative use (i.e., an assumption that the land would be used by market participants on a stand-alone basis).

The highest and best use of the land would be determined on the basis of the higher of these values. In situations involving real estate appraisal, the determination of highest and best use might take into account factors relating to the factory operations (e.g., the factory's operating cash flows) and its assets and liabilities (e.g., the factory's working capital).

J20. When an acquirer in a business combination plans to use an acquired intangible asset defensively, who are the market participants?

820-10-35-10D, 55-32
[IFRS 13.27, 29–30]

It depends. In evaluating the highest and best use to market participants, the possible perspectives of financial and strategic buyers may be considered to determine the asset's highest and best use. In general, the key difference between the two categories of potential market participants is that strategic buyers have existing operations and may have complementary assets with which the intangible asset may be used either actively or defensively, while financial buyers do not. There are exceptions such as when financial buyers have existing investments in a specific market with which acquired assets may be used or when financial buyers may be pursuing a roll-up strategy.

820-10-35-10D, 55-32
[IFRS 13.27, 29–30]

The highest and best use of the intangible asset to market participants may be to actively use the intangible asset with other assets, including potentially other assets already owned by market participants. This use could apply to both financial and strategic buyers. Alternatively, the highest and best use may be to use the asset defensively in a manner that results in a highest and best use of the group of complementary assets. This may be the highest and best use for strategic buyers, but would be less likely to apply to financial buyers who are more likely to use the intangible asset actively.

820-10-55-32
[IFRS 13.30]

One of the most important aspects of valuing an intangible asset that will not be used actively to generate direct cash flows, but which is expected to be used defensively to increase the value of other assets, is determining the characteristics of market participants. The entity's decision not to actively use the asset is not determinative in concluding who the appropriate market participants are or the highest and best use of the intangible asset to market participants.

J30. Can an entity use entity-specific assumptions about its future plans in measuring the fair value of an intangible asset acquired in a business combination?

820-10-35-10D
[IFRS 13.30, BC70]

No. The entity does not consider its planned future use or non-use (i.e., retired or otherwise not used) in measuring the fair value of the intangible asset. Like all nonfinancial assets, the fair value of an intangible asset is measured based on the assumptions that market participants would use in pricing the asset. Therefore, an entity considers the highest and best use by market participants in measuring the fair value to be allocated to the intangible assets in the acquisition accounting.

J40. Can an entity use differing valuation premises for nonfinancial assets within a group of assets and liabilities?

820-10-35-10E
[IFRS 13.31(a)(iii)]

No, assumptions about the highest and best use of nonfinancial assets within a group should be consistent.

Example J40: Customer Relationships

Company J acquired contractual customer relationships and technology assets as part of a business combination.

Company J notes that the relationships with customers arose in the context of the sale of products incorporating the technology. A market participant without complementary technology would likely realize lower value from the customer relationships on a stand-alone basis. However, a market participant with access to complementary technology would likely realize higher sales and profits than on a stand-alone basis and would consider this in valuing the customer relationships.

In this example, the valuation premise for each asset in the group would be in combination with the other assets and liabilities of the group.

K. Liabilities and Own Equity Instruments

Overview

- In measuring the fair value of a liability or an own equity instrument, it is assumed that the item is transferred to a market participant at the measurement date (e.g., the liability remains outstanding and the market participant transferee would be required to fulfil it).[11]
- If there is no quoted price for the transfer of an identical or a similar liability or an entity's own equity instrument, and another market participant holds the identical item as an asset, the entity measures the item's fair value from the perspective of such a market participant.
- In other cases, an entity uses a valuation technique to measure the fair value of the item from the perspective of a market participant that owes the liability or that issued the equity instrument.
- The fair value of a liability reflects the effect of nonperformance risk (i.e., the risk that an entity will not fulfil an obligation). Nonperformance risk includes, but may not be limited to, an entity's own credit risk.

K10. How does a fair value measurement based on a transfer notion differ from a valuation based on a settlement notion?

820-10-35-16
[IFRS 13.34]

A fair value measurement based on a transfer notion requires an entity to determine the price that would be paid by a market participant to another market participant to assume the obligation. Because the liability will be transferred, it is assumed that the liability remains outstanding and that the transferee will be required to fulfill the obligation; the liability is not settled with the counterparty or otherwise extinguished on the measurement date.

820-10-35-16
[IFRS 13.34, BC81]

In contrast, settlement may include different forms of extinguishment of the liability with the counterparty or any other party. The Codification Topic does not allow fair value measurements based on a settlement notion because this would incorporate an assumption of an extinguishment of the liability, which would be based on entity-specific rather than market participant assumptions. As a result, when a liability is measured at fair value, the relative efficiency of the entity in settling the liability using its own internal resources appears in earnings over the course of its settlement, not before.

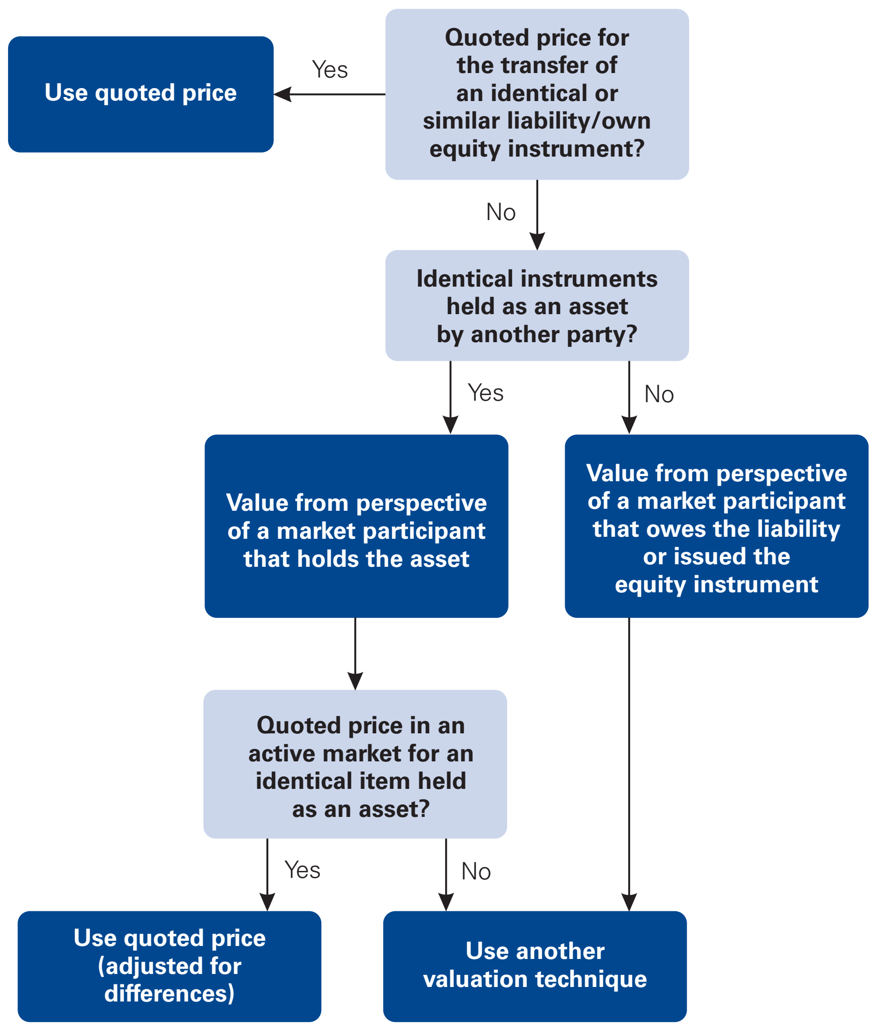
11 The Codification Topic refers to "an instrument classified in a reporting entity's shareholders' equity". For convenience, in this publication we refer to an entity's own equity instrument or own equity instrument.

K20. How should an entity measure the fair value of a liability or own equity instrument?

820-10-35-3, 35-16
[IFRS 13.34]

A fair value measurement of a liability (financial or nonfinancial) or an entity's own equity instrument assumes that the item is transferred in an orderly transaction between market participants at the measurement date. This transfer notion is conceptually consistent with the exit-price concept.

The following diagram illustrates the process that an entity uses in performing a fair value measurement of a liability or its own equity instruments:



820-10-35-16A
[IFRS 13.37]

Liabilities are rarely transferred individually because of contractual or other legal restrictions preventing their transfer (see Question K50). In addition, in many cases there is no observable market to provide pricing information about the transfer of a liability or an equity instrument. However, there might be an observable market for these items if they are held by other parties as assets (e.g., debt securities).

820-10-35-16B
[IFRS 13.37]

When there is no quoted price for the transfer of an identical or similar liability or equity instrument and another party holds the identical item as an asset, an entity measures fair value based on the perspective of a market participant that holds the identical item as an asset.

820-10-35-16D
[IFRS 13.39]

Factors that may indicate that the quoted price of the asset should be adjusted include the following considerations.

- The quoted price for the asset relates to a similar (but not identical) liability or equity instrument held by another party as an asset. For example, a liability may have a particular characteristic, such as the credit quality of the issuer, which is different from what is reflected in the fair value of a similar liability held as an asset.
- The unit of valuation for the asset is not the same as that of the liability or equity instrument. For liabilities, the price for an asset may reflect a combined price for a package comprising both the amounts due from the issuer and a third-party credit enhancement. If the unit of account for the liability is not for the combined package, the objective is to measure the fair value of the issuer's liability and not the fair value of the combined package. In these cases, the entity would adjust the observed price for the asset to exclude the effect of the third-party credit enhancement (see Question K60).

820-10-35-16BB
[IFRS 13.40–41]

When there is no quoted price for the transfer of an identical or similar liability and there is no corresponding asset, (e.g., an ARO), the entity uses a valuation technique to measure the fair value of the item from the perspective of a market participant that owes the liability. When using a present value technique, the entity might estimate the future cash outflows that market participants would expect to incur in fulfilling the obligation, including any compensation for risk and the profit margin that a market participant would require to undertake the activity.

820-10-35-16BB, 35-16I
[IFRS 13.41, B31]

An entity may estimate those future cash outflows using the following steps.

(1) Estimate the future cash flows that the entity would expect to incur in fulfilling the obligation.

(2) Exclude the cash flows that other market participants would not incur.

(3) Include the cash flows that other market participants would incur but that the entity would not incur.

(4) Estimate the compensation that a market participant would require to assume the obligation. This compensation incorporates a profit margin at a rate consistent with undertaking the activity, a risk that the actual cash outflows might differ from estimated cash outflows, an assumption of inflation, and a risk-free rate of interest.

For further discussion in the context of an ARO, see Question K80.

K30. Does an entity consider its own risk of nonperformance in measuring the fair value of its liabilities?

820-10-35-17
[IFRS 13.42]

Yes. If an entity has elected or is required to measure its liabilities at fair value, it is required to consider its own nonperformance risk, because it would be considered by market participants, in measuring fair value.

820-20
[IFRS 7.A, 13.A]

Nonperformance is the risk that an entity will not fulfill an obligation and therefore it encompasses all factors that might influence the likelihood that the obligation will not be fulfilled.

820-10-35-17
[IFRS 13.42]

In a fair value measurement, it is assumed that the nonperformance risk remains the same before and after the transfer.

K40. Other than the entity's own credit risk, what factors are considered in determining nonperformance risk?

820-10-35-17 – 35-18
[IFRS 13.43]

In considering nonperformance risk in measuring the fair value of a liability, in addition to own credit risk an entity takes into account any other factors that might influence the likelihood that the obligation will or will not be fulfilled. That effect depends on the nature of the liability, e.g., whether it is a financial liability or an obligation to deliver a good or perform a service. For example, the risk that the entity will not be able to obtain and deliver a product, such as a commodity, to its counterparty may affect the fair value measurement.

820-10-35-18 – 35-18A
[IFRS 13.43–44]

For commodity contracts, nonperformance risk may be mitigated by make-whole or other default provisions in the contract. These factors should be considered when determining any necessary adjustment for nonperformance risk (including credit risk) to the contract's (or any resulting receivable's or payable's) fair value measurement.

K50. How should a restriction on transfer be taken into account in measuring the fair value of a liability or own equity instrument?

820-10-35-18B
[IFRS 13.45]

In measuring the fair value of a liability or own equity instrument using the quoted price of the item when traded as an asset, a separate input (or adjustment to another input) to reflect a restriction that prevents the transfer of that asset is not applied.

820-10-35-18B
[IFRS 13.45–46]

The effect of a restriction that prevents the transfer of a liability or an own equity instrument is either implicitly or explicitly included in the other inputs to the fair value measurement. This is because, at the measurement date, both the creditor and the obligor are willing to accept the transaction price for the liability with full knowledge that the obligation includes a restriction that prevents its transfer.

820-10-35-18C
[IFRS 13.46]

Therefore, the restriction is already included in the transaction price and a separate input (or adjustment to another input) into the fair value measurement of the liability or own equity instrument is not required to reflect the effect of the restriction on transfer. However, an entity may adjust quoted prices for features that are present in the asset but not present in the liability, or vice versa.

K60. Should an inseparable third-party credit enhancement be included in the fair value measurement of a liability?

820-10-35-18A

Generally, no. The issuer of a liability with an inseparable third-party credit enhancement generally excludes such credit enhancement from the unit of account when measuring the fair value of the liability. However, the exclusion is not required if the enhancement is granted to the issuer of the liability, such as deposit insurance provided by a government or government agency, or provided between a parent and a subsidiary or between entities under common control.

IFRS different from U.S. GAAP

IFRS does not contain explicit guidance about the unit of account for the fair value measurement of a liability with an inseparable third-party credit enhancement; therefore, practice may differ from U.S. GAAP.

K70. What is the fair value of a liability payable on demand?

825-10-55-3

The fair value of demand deposits, savings accounts, and certain money market deposits is measured at the amount payable on demand at the measurement date. The fair value of fixed-maturity certificates of deposit is estimated using the rates currently offered for deposits of similar remaining maturities.

IFRS worded differently from U.S. GAAP

[IFRS 13.47]

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

K80. How is the fair value of an asset retirement obligation (ARO) measured?

410-20-55-13
[IFRS 13.61, B14]

Generally, using a present value technique because observable market prices for these liabilities generally would not exist. To measure the fair value of a liability for an ARO using an expected present value technique, an entity begins by estimating the expected cash flows that reflect, to the extent possible, a marketplace assessment of the cost and timing of performing the required retirement activities. Considerations in estimating those expected cash flows include developing and incorporating explicit assumptions, to the extent possible, about the following:

- The costs that a third party would incur in performing the tasks necessary to retire the asset;
- Other amounts that a third party would include in determining the price of the transfer, including inflation, overhead, equipment charges, profit margin, and advances in technology;

- The extent to which the amount or timing of a third party's costs would vary under different future scenarios and the relative probabilities of those scenarios; and
- The price that a third party would demand and could expect to receive for bearing the uncertainties and unforeseeable circumstances inherent in the obligation.

820-10-55, 35-16L
[IFRS 13.B15-B17]

A fair value measurement also includes a risk premium reflecting the amount market participants would demand because of the risk (uncertainty) in the cash flows, including consideration of the liquidity, or illiquidity, of the obligation. To determine the fair value of the ARO, this premium is included as an input into the undiscounted estimated cash flows of the obligation if a market participant would demand one. An entity can include a risk premium in the fair value measurement of the liability in one of two ways. An entity may adjust the cash flows or adjust the rate used to discount the future cash flows to their present value.

Example K80: Fair Value Measurement of an ARO

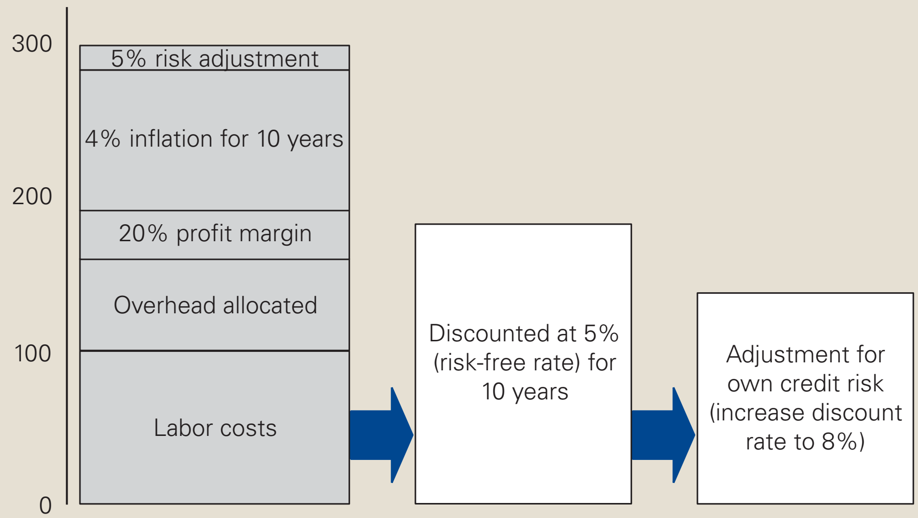
820-10-55-77 – 55-81
[IFRS 13.IE35–IE39]

Company K assumes an ARO liability in a business combination and is therefore required to measure the liability at fair value in the acquisition accounting. Company K is legally required to remediate a mine pit at the end of its useful life, which is estimated to be in 10 years. Company K uses a present value technique to measure the fair value of the ARO.

If Company K were allowed to transfer its ARO to a market participant, it would conclude that a market participant would use all of the following inputs in estimating the price.

Labor costs	100
Allocated overhead and equipment costs – 60% of labor costs	60
Third-party contractor margin of 20%, based on margins that contractors in the industry generally receive for similar activities – 160 x 20%	32
Annual inflation rate of 4%, based on market data for the applicable jurisdiction – 192 x 4% compounded for 10 years	92
5% risk adjustment that reflects the compensation that an external party would require to accept the risk that the cash flows might differ from those expected given the uncertainty in locking in today's price for a project that will not occur for 10 years – 284 x 5%	14
A risk-free rate based on 10-year government bonds in the applicable jurisdiction	5%
An adjustment to the discount rate to reflect Company K's nonperformance risk, including its credit risk	3%

The following diagram shows the composition of these costs to give a fair value of the ARO of 138: present value at 8% of 298 (100 + 60 + 32 + 92 + 14) in 10 years.



The adjustment for the time value of money is shown separately from the credit risk adjustment, to illustrate the direction of the adjustment. However, in our experience only one discount rate calculation would be undertaken.

L. Portfolio Measurement Exception

Overview

- An entity that holds a group of financial assets and financial liabilities is exposed to market risks (i.e., interest rate risk, currency risk and other price risk) and to the credit risk of each of the counterparties.
- If certain conditions are met, an entity is permitted (but not required) to measure the fair value of a group of financial assets and financial liabilities with offsetting risk positions on the basis of its net exposure.
- Under the exception, the fair value of the group is measured on the basis of the price that would be received to sell a net long position (or paid to transfer a net short position) for a particular risk exposure in an orderly transaction between market participants at the measurement date. Therefore, application of the portfolio measurement exception is considered to be consistent with the way in which market participants would price the net risk position at the measurement date.

L10. When is it appropriate for an entity to measure the fair value of a group of financial assets and financial liabilities on a net portfolio basis?

820-10-35-18E
[IFRS 13.48–49, 52]

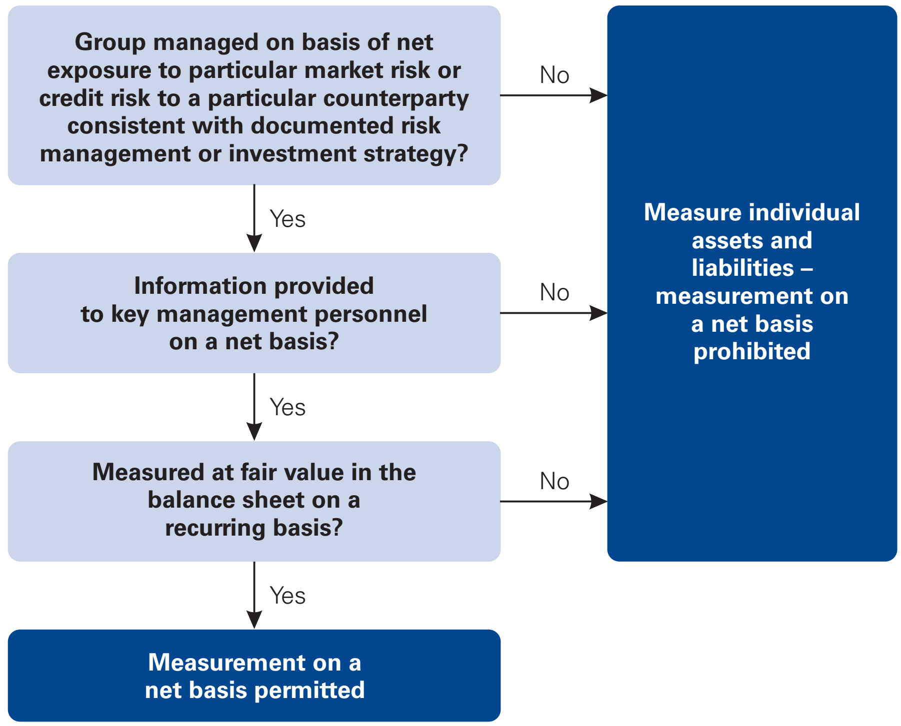
Measuring on a net-exposure basis is permitted if the conditions in the following diagram are satisfied.

820-10-35-18E
[IFRS 13.49, BC120]

An entity should assess the appropriateness of electing the portfolio measurement exception based on the nature of the portfolio being managed in the context of its risk management or investment strategy.

820-10-35-18G
[IFRS 13.51, BC121]

If the entity is permitted to use the exception, it should choose an accounting policy, to be applied consistently, for a particular portfolio. However, an entity is not required to maintain a static portfolio to use the exception.



L20. When the portfolio measurement exception is applied, how does this affect the unit of account?

820-10-35-2E, 35-18D, 35-18I, 35-18L, 35-36B
[IFRS 13.14, 48, 53, 56, 69]

In our view, application of the portfolio measurement exception changes the unit of valuation from the individual financial asset or financial liability to the net position for a particular risk exposure.

L30. When considering whether the exception applies for a group of financial assets and financial liabilities, what degree of risk offsetting is necessary?

820-10-35-18E
[IFRS 13.49(b), BC120]

There is no prescribed minimum degree of offsetting risk to qualify for the portfolio measurement exception. Assets in a portfolio do not have to be completely offset by liabilities. Evaluating the degree of offset requires judgment. In making this judgment, the entity considers whether it does in fact manage on the basis of its net (rather than gross) risk exposure and that this is consistent with its documented risk management and internal strategy and is how it provides information to key management personnel.

L40. What factors need to be considered when determining whether a particular market risk within the group of financial assets and financial liabilities could be offset when measuring fair value on a net portfolio basis?

820-10-35-18J
[IFRS 13.54–55, BC123]

In addition to the factors described in Questions L10 and L30, the Codification Topic requires that market risks being offset are substantially the same with regard to both their nature (e.g., interest rate risk, currency risk, or commodity price risk) and duration. For example, an entity could not combine the interest rate risk associated with a specific financial asset with the commodity price risk associated with a derivative liability. These risks would not qualify as being substantially the same and therefore would not qualify for the portfolio exception.

820-10-35-18J
[IFRS 13.54, BC123]

Any basis risk resulting from market risk parameters that are not identical is reflected in the fair value of the net position. For example, an entity managing its interest rate risk on a net portfolio basis may include financial instruments with different interest rate bases in one portfolio. However, any difference in the interest rate bases (e.g., LIBOR versus U.S. treasury) will be reflected in the fair value measurement.

820-10-35-18K
[IFRS 13.55, BC123]

Similarly, to the extent that there are duration differences, adjustments for duration mismatches should be reflected in the fair value of the net position for the entity's exposure to market risk. For example, if an entity has a five-year financial instrument and is managing the interest rate risk exposure for the first 12 months of the financial instrument's duration with a 12-month futures contract, the exposure to 12 months of interest rate risk may be measured on a net portfolio basis while the interest rate risk exposure from years two to five would be measured on a gross basis.

L50. Does the portfolio measurement exception also apply to financial statement presentation?

820-10-35-18F
[IFRS 13.50]

No. The net portfolio measurement exception does not relate to financial statement presentation.

820-10-35-18F
[IFRS 13.50]

Although application of the exception to financial assets and financial liabilities with offsetting positions changes the fair value measurement basis for a particular market risk(s) or counterparty risk, it does not change the requirements for presentation in the balance sheet.

820-10-35-18D, 35-18F
[IFRS 13.50]

Consequently, application of the exception may result in a measurement basis that is different from the basis of presentation of financial instruments in the balance sheet.

L60. How is a net portfolio basis adjustment resulting from the application of the exception allocated to the individual financial assets and financial liabilities that make up the portfolio?

820-10-35-18F
[IFRS 13.50]

An entity performs allocations, for presentation and disclosure purposes, on a reasonable and consistent basis using an appropriate methodology. The Codification Topic does not prescribe particular allocation methods.

820-10-35-44

The appropriate allocation method is affected by the fair value hierarchy of the financial instruments within the portfolio. We understand from conversations with the FASB staff that they believe that the fair value allocated to financial instruments within the portfolio categorized in Level 1 of the fair value hierarchy should be determined using the instrument price times the quantity (PxQ), which is consistent with the guidance in Codification Topic for Level 1 inputs (see Section G). The FASB staff indicated that the net portfolio measurement exception allows an entity to estimate the fair value of financial instruments at levels different from the unit of account prescribed by other Codification Topics, but does not provide an exception to the other conclusions and concepts of fair value measurement under the Codification Topic.

Example L60: Portfolio Exception and Allocating Fair Value

Company L holds 10,000 exchange-traded equity securities and has an off-setting position of forward contracts to sell 6,000 of the same exchange-traded equity securities. In addition, Company L concludes that the portfolio measurement exception criteria have been met and has elected to apply the portfolio measurement exception.

Company L allocates the fair value measurement adjustment that resulted from the valuation of the net portfolio position to the individual forward contracts with no adjustment being allocated to the Level 1 equity securities (i.e., equity securities are valued at PxQ). If allocating the net portfolio adjustment to the forward contracts results in an unreasonable fair value of the forward contracts, Company L should carefully re-evaluate the appropriateness of using the exception.

IFRS different from U.S. GAAP

The IASB has not addressed providing the allocation of portfolio level adjustments to instruments that would have a Level 1 measurement on a stand-alone basis. The IASB is considering the interaction of the portfolio measurement exception and the guidance on Level 1 measurements as part of its *Fair Value Measurement: Unit of Account* project. An exposure draft is expected in Q1 2014.

L70. Are net portfolio basis adjustments that have been allocated to the individual financial assets and financial liabilities in the portfolio considered when determining the categorization in the fair value hierarchy for disclosure purposes?

820-10-35-37A
[IFRS 13.73]

Yes. In categorizing fair value measurements of the individual financial assets and financial liabilities in the fair value hierarchy for disclosure purposes, net portfolio basis adjustments are considered. Each asset and liability measured at fair value is categorized within the fair value hierarchy on the basis of the lowest level input that has a significant effect on its overall fair value measurement (see Section H).

820-10-35-18D
[IFRS 13.48, 73]

The portfolio measurement exception enables an entity to measure the fair value of a group of financial assets and financial liabilities consistently with how market participants would price the net risk exposure. In our view, an allocated net portfolio basis adjustment is considered an assumption (i.e., input) that market participants would use when pricing the financial assets and financial liabilities that make up the offsetting risk position. Therefore, we believe that an allocated net portfolio basis adjustment is an input to the fair value measurement of the individual asset or liability.

820-10-35-37A
[IFRS 13.73]

An allocated net portfolio basis adjustment that is an unobservable input and that has a significant effect on the fair value measurement of an individual financial asset or financial liability would cause the entire fair value measurement to be categorized within Level 3.

Example L70: Credit-Risk Adjustment Allocation

Company L holds a group of financial assets and financial liabilities, which it manages on the basis of its net exposure to credit risk to particular counterparties and applies the net portfolio basis exception. The inputs to the net portfolio basis adjustment for a particular counterparty are unobservable, while all other inputs to the fair value measurement of the group and to the individual financial assets and financial liabilities within the group are Level 2 inputs.

Because the portfolio measurement exception does not apply to financial statement presentation, the counterparty credit-risk adjustment is allocated to the financial assets and financial liabilities within the group. The allocation of the counterparty credit-risk adjustment to the individual financial assets and financial liabilities may affect the level of the fair value measurements of those financial assets and financial liabilities within the fair value hierarchy.

If the allocated counterparty credit-risk adjustment is significant to the fair value measurement of an individual financial asset or financial liability, then that fair value measurement would be categorized within Level 3. If the credit-risk adjustment allocation is significant only to the fair value measurement of some of the individual financial instruments in the portfolio, and not to others, some would be categorized as Level 2 measurements and some as Level 3 measurements.

L80. In applying the exception, how should an entity consider the existence of an arrangement that mitigates credit-risk exposure in the event of default?

820-10-35-18D, 35-18L
[IFRS 13.14, 56, 69]

Question C70 discusses the usual position of how an entity should consider an arrangement that mitigates credit-risk exposure in the event of default. However, if an entity applies the portfolio measurement exception to a group of financial assets and financial liabilities entered into with a particular counterparty, the effect of such an agreement would be included in measuring the fair value of the group of financial assets and financial liabilities.

For individual instruments that are actively traded on an exchange, the actual counterparty to the trade transaction in many instances is the exchange entity (e.g., the clearing house for the exchange). For these exchange transactions, we understand that even when there is no master netting agreement between the exchange and the entity, credit risk is usually deemed to be minimal because the operating procedures of the exchanges require the daily posting of collateral which is, in effect, an arrangement that mitigates credit-risk exposure in the event of default.

In addition, if the exchange is not the counterparty to the trade transaction, the transaction is a principal-to-principal transaction and an arrangement that mitigates credit-risk exposure in the event of default may be considered in determining the appropriate credit adjustment for determining the fair value of the financial instrument if the entity meets the requirement to and elects to use the portfolio measurement exception.

M. Inactive Markets

Overview

- In an active market, transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.
- An orderly transaction 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.
- A fair value measurement may be affected if there has been a significant decrease in the volume or level of activity for that item compared with its normal market activity. Judgment may be required in determining whether, based on the evidence available, there has been a significant decrease.
- If an entity concludes that the volume or level of activity for an asset or liability has significantly decreased, then further analysis of the transactions or quoted prices is required. A decrease in the volume or level of activity on its own might not indicate that a transaction or a quoted price is not representative of fair value, or that a transaction in that market is not orderly.
- It is not appropriate to presume that all transactions in a market in which there has been a decrease in the volume or level of activity are not orderly.

M10. What is considered an active market?

820-10-35-54C
[IFRS 13.A, B44]

Whether transactions take place with sufficient frequency and volume to constitute an active market is a matter of judgment and depends on the facts and circumstances of the market for the asset or liability. A market with limited activity may still provide relevant pricing information when there is no contrary evidence that the pricing information is not relevant to the fair value of the asset or liability being evaluated, but may result in a lower level measurement within the fair value hierarchy (see Section H). This may be the case when the volume or level of activity for an asset or a liability has significantly decreased.

The determination of whether a market is active is not based on the size of the entity's holdings. For example, a market that trades 100,000 shares of ABC common stock per day may be considered active, even if the entity holds 20,000,000 shares of ABC stock. An active market is not necessarily limited to national exchanges like the NYSE or the LSE. Over-the-counter (OTC) markets (e.g., OTC Pink) can be and often are considered active markets.

M20. How does a decrease in volume or level of activity affect how fair value is measured?

820-10-35-16B
[IFRS 13.76–78]

It depends. If the market for identical assets or liabilities is still active and quoted prices in that market continue to be available, then the fair value of the asset or liability continues to be measured at the quoted market price on the measurement date (i.e., using a Level 1 input).

820-10-35-54C
[IFRS 13.B37]

An entity might take the following factors into consideration to determine whether there is a significant decrease in the volume or level of activity in relation to normal market activity for the asset or liability:

- There are few recent transactions.
- Price quotations are not developed using current information.
- Price quotations vary substantially either over time or among market makers (e.g., some brokered markets).
- Indices that previously were highly correlated with the fair values of the asset or liability are demonstrably uncorrelated with recent indications of fair value for that asset or liability.
- There is a significant increase in implied liquidity risk premiums, yields, or performance indicators (such as delinquency rates or loss severities) for observed transactions or quoted prices when compared with the entity's estimate of expected cash flows, taking into account all available market data about credit and other nonperformance risk for the asset or liability.
- There is a wide bid-ask spread or significant increase in the bid-ask spread.
- There is a significant decline in the activity of, or there is an absence of, a market for new issuances (i.e., a primary market) for the asset or liability or similar assets or liabilities.
- Little information is publicly available (e.g., transactions that take place in a principal-to-principal market).

820-10-35-54D
[IFRS 13.B38]

An entity should evaluate the significance and relevance of such factors to determine whether, based on the weight of the evidence, there has been a significant decrease in the volume or level of activity for the asset or liability. If an entity concludes that there has been a significant decrease in the volume or level of activity for the asset or liability relative to normal market activity, further analysis of the transactions or quoted prices is needed.

820-10-35-54E
[IFRS 13.B38]

A decrease in the volume or level of activity on its own may not indicate that a transaction price or quoted price does not represent fair value or that a transaction in that market is not orderly. However, if an entity determines that a transaction or quoted price does not represent fair value (e.g., there may be transactions that are not orderly), an adjustment to the transactions or quoted prices will be necessary if it uses those prices as a basis for measuring fair value and that adjustment may be significant to the fair value measurement in its entirety.

820-10-35-16D
[IFRS 13.B38]

Adjustments also may be necessary in other circumstances (e.g., when a price for a similar asset requires significant adjustment to make it an appropriate price for the comparable asset being measured or when the price is stale).

820-10-35-54G
[IFRS 13.B41]

Even when there has been a significant decrease in the volume or level of activity for the asset or liability, the objective of a fair value measurement remains the same. However, the characteristics of market participants may change. For example, hedge funds and private-equity firms (and similar entities) may become the only potential buyers for certain types of assets, while financial institutions may have been the primary market participants before the significant decrease. A fair value measurement contemplates the rate of return required by current market participants.

820-10-35-54F
[IFRS 13.B40]

If there has been a significant decrease in the volume or level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate (e.g., the use of a market approach and an income approach).

820-10-35-54F
[IFRS 13.B40]

If multiple valuation techniques are used, the different indications of fair values are weighted relative to each other to arrive at the estimated exit price for the asset or liability (see Section F). There is no particular methodology for weighting the different indications of fair value. However, when an entity weights different indications of fair value, it should consider the reasonableness of the range of the different fair value indications. The objective of the weighting process is to determine the point within the range that is most representative of fair value under current market conditions. A wide range of fair value estimates may be an indication that further analysis is needed.

M30. What are the characteristics of a transaction that is forced or not orderly?

820-10-20
[IFRS 13.A]

An orderly transaction is not a forced transaction (e.g., a forced liquidation or distress sale).

820-10-35-54I
[IFRS 13.B43]

Generally, a transaction is forced if it occurs under duress or the seller otherwise seller otherwise is forced to accept a price that a willing market participant would not accept. Whether a transaction is forced is based on the specific facts and circumstances of the transaction and the parties participating. Forced transactions are considered not orderly. See Question G80 for measurement considerations when an entity determines that a transaction is not orderly.

820-10-35-54I
[IFRS 13.B43]

Circumstances that may indicate that a particular transaction is not orderly include the following:

- There was not adequate 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 under current market conditions.
- There was a usual and customary marketing period, but the seller marketed the asset or liability to a single market participant.
- The seller is in, or near, bankruptcy or receivership (i.e., is distressed).

- The seller was required to sell to meet regulatory or legal requirements (i.e., was forced to sell).
- The transaction price is an outlier when compared with other recent transactions for the same or a similar asset or liability.

820-10-35-54I
[IFRS 13.B38, B43]

A decrease in the volume or level of activity for an asset or liability on its own may not indicate that a transaction or a quoted price is not representative of fair value, or that a transaction in that market is not orderly. It is not appropriate to presume that all transactions in a market in which there has been a decrease in the volume or level of activity are not orderly.

820-10-35-54I(a)
[IFRS 13.B43(a)]

An orderly transaction assumes sufficient time to market the asset or liability in the usual and customary manner. For certain types of assets such as liquid financial instruments (e.g., actively traded stock) the usual and customary market exposure may be short. In other situations (e.g., real estate assets), a longer market exposure would be required to complete due diligence, generate interest, contact potential buyers, conduct negotiations, and complete legal agreements. Therefore, the customary time will depend on the type of asset or liability.

M40. How extensive is the analysis expected to be to determine whether a transaction is orderly?

820-10-35-54J
[IFRS 13.B44]

An entity is not required to undertake exhaustive efforts to determine whether a transaction is orderly, but it cannot ignore information that is reasonably available. An entity is presumed to have sufficient information to conclude whether a transaction is orderly when it is party to the transaction.

820-10-35-54D
[IFRS 13.B38]

A transaction should not be considered not orderly based on current general market conditions. If transactions are occurring between market participants in a manner that is usual and customary under current market conditions, those transactions generally should be considered orderly. It would not be appropriate to assume that all transactions in a market, even a relatively illiquid market, are forced.

N. Disclosures

Overview

The disclosure requirements of the Codification Topic are split into two categories.

- Disclosures for assets and liabilities measured at fair value in the balance sheet after initial recognition. These disclosures are more extensive and distinguish between recurring and nonrecurring fair value measurements.
- Disclosures of fair value measurements that are required or permitted to be disclosed by other Codification Topics/Subtopics, but are not included in the balance sheet.

N10. What is the difference between recurring and nonrecurring fair value measurements?

820-10-50-2(b)
[IFRS 13.93(a)]

Recurring fair value measurements arise from assets and liabilities measured at fair value at the end of each reporting period (e.g., trading securities). Nonrecurring fair value measurements are fair value measurements that are triggered by particular circumstances (e.g., an asset being classified as held-for-sale or an impaired asset resulting in the need for fair value measurement under the applicable codification subtopics).

820-10-50-2(b)
[IFRS 13.93(a)]

A nonrecurring fair value measurement also may occur during the reporting period. The disclosures required for a nonrecurring fair value measurement are applicable in the financial statements for the period in which the fair value measurement occurred.

N20. What disclosures are required?

The disclosure requirements, which are most extensive for recurring Level 3 measurements, are summarized in the following table.

820-10-50-8
[IFRS 13.99]
820-10-50-2F
825-10-50-3

R	Disclosure required for all entities, in tabular format.
X	Disclosure only required for public entities.
Y	Disclosure required for public entities, and for financial instruments of nonpublic entities with either total assets of more than $100 million or that have instruments that are accounted as derivative instruments (other than commitments to originate mortgage loans held for sale).

Reference		FV recognized in the balance sheet						FV only disclosed		
		Recurring			Nonrecurring					
	Requirement	L1	L2	L3	L1	L2	L3	L1	L2	L3
820-10-50-2(a) *[IFRS 13.93(a)]*	Fair value at end of reporting period[12]	R	R	R	R	R	R			
820-10-50-2(a) *[IFRS 13.93(a)]*	Reasons for the measurement				R	R	R			
820-10-50-2(b), 50-2E *[IFRS 13.93(b), 97]*	Level within hierarchy	R	R	R	R	R	R	Y	Y	Y
820-10-50-2(bb) *[IFRS 13.93(c)]*	All transfers within hierarchy	X	X	R						
820-10-50-2(bbb), 50-2E *[IFRS 13.93(d), 97]*	Description of valuation technique		R	R		R	R		Y	Y[13]
820-10-50-2(bbb), 50-2E *[IFRS 13.93(d), 97]*	Changes to valuation technique and reasons		R	R		R	R		Y	Y
820-10-50-2(bbb) *[IFRS 13.93(d)]*	Quantitative information about significant unobservable inputs			R			R			
820-10-50-2(c) *[IFRS 13.93(e)]*	Reconciliation of opening and closing balance (including information on transfers in or out)			R						
820-10-50-2(d) *[IFRS 13.93(f)]*	Unrealized gains/losses from remeasurement			R						
820-10-50-2(f) *[IFRS 13.93(g)]*	Description of valuation processes and policies			R			R			
820-10-50-2(g) *[IFRS 13.93(h)(i)]*	Sensitivity to changes in unobservable inputs (narrative)			X						
820-10-50-2(h), 50-2E *[IFRS 13.93(i), 97]*	If highest and best use differs from actual, then reasons why	R	R	R	R	R	R	X	X	X

12 For nonrecurring measurements, see Question N40.

13 A description of the valuation techniques should be disclosed, except that an entity is not required to provide quantitative disclosures about significant unobservable inputs for Level 3 measurements under the Financial Instruments Codification Topic.

IFRS different from U.S. GAAP

[IFRS 13.93]

Unlike U.S. GAAP, these disclosures are required for all entities regardless of their public status.

[IFRS 13.93(h)(ii)]

Unlike U.S. GAAP, if financial assets and financial liabilities are categorized as recurring Level 3 fair value measurements, there is a requirement to disclose quantitative sensitivity information if changing one or more unobservable inputs to reflect reasonably possible alternative assumptions would change fair value significantly.

Example N20: Example Disclosures

Sensitivity to Changes in Unobservable Inputs for Nonfinancial Assets

820-10-50-2(g)
[IFRS 13.93(h)(i)]

The significant unobservable inputs used in the fair value measurement of Company N's livestock assets are growth rates and mortality rates. The inputs used for growth and mortality are 12% and 5%, respectively. Significant decreases in growth rates, or increases in mortality rates, in isolation would result in a significantly lower fair value measurement. Generally, a change in the assumption used for growth rates should be accompanied by a change in the assumption for mortality rates in the same direction as excessively fast growth increases the risk of mortality. Therefore, the effects of these changes partially offset each other.

Asset Used Differently from its Highest and Best Use

820-10-50-2(h)
[IFRS 13.93(i)]

Company N operates a brewery on a piece of land in an area that has recently been rezoned to allow both residential and industrial use. The highest and best use of the land and buildings of the brewery, based on current land prices at the end of the reporting period, would be to demolish the factory and build residential property. Company N is using the land and buildings in a manner that differs from its highest and best use to continue its current manufacturing operations. This is consistent with the long-term strategy and core operations of Company N, which is not in a position to carry out a conversion because the brewery is integral to its operations.

N30. Are all of the disclosures required in interim financial reports?

ASU 2011-04 Transition

Yes. The disclosures are required for both interim and annual periods.

[IAS 34.15B(h), 15B(k), 16A(j), IFRS 13.91–93(h), 94–96, 99]

IFRS different from U.S. GAAP

Unlike U.S. GAAP, an entity is only required to disclose certain information about the fair value of financial assets and financial liabilities in its interim financial report including:

- the fair value measurement at the end of the interim reporting period;
- for non-recurring fair value measurements, the reasons for the measurement;
- the level of the hierarchy in which the measurement is categorized;
- for recurring fair value measurements, any transfers between Level 1 and Level 2, the reasons for those transfers, as well as the policy for the timing of recognizing transfers between levels of the fair value hierarchy;
- a description of the valuation technique and the inputs used in the fair value measurements for Level 2 and Level 3 measurements;
- if a change in the valuation technique has been made, then the reasons for the change;
- quantitative information about significant unobservable inputs for Level 3 measurements;
- a reconciliation of Level 3 balances from opening to closing balances, including the amount of unrealized gains or losses related to assets or liabilities held at the end of the reporting period;
- for Levels 2 and 3:
  - a description of valuation processes for Level 3 measurements;
  - a quantitative sensitivity analysis for recurring Level 3 measurements; and
  - if an accounting policy is made to measure offsetting positions on a net basis, then that fact;
- the existence of an inseparable third party credit enhancement issued with a liability measured at fair value and whether it is reflected in the fair value measurement;
- with limited exceptions, fair value of each class of instruments;
- day one gain or loss information as required by IFRS 7; and
- information about instruments for which fair value cannot be measured reliably.

[IAS 34.15–16]

Therefore, subject to the general requirements to provide disclosures about significant events and transactions and of information whose omission would be misleading, an entity is not required to provide disclosures about the following information in its interim financial report:

- Nonfinancial assets and nonfinancial liabilities (except as may be required if a business combination has occurred in the interim period); and
- Classes of assets and liabilities not measured at fair value but for which fair value is disclosed.

N40. Which fair values should be disclosed if the measurement of a nonrecurring item occurs at a date that is different from the reporting date?

The requirements for nonrecurring fair value measurements require the disclosure of amounts as of the reporting date. However, a nonrecurring fair value measurement may have occurred prior to the reporting date. In our view, the fair value measurement disclosures should be based on the fair value at which the item is measured at the end of the reporting period, even if that fair value was determined as of an earlier date.

For example, if a loan is determined to be impaired at November 15 and the entity's year end is December 31, the year-end financial statement disclosures apply to the fair value determined on November 15.

N50. At what value should transfers into or out of the levels of the fair value hierarchy be presented?

820-10-50-2(c)
[IFRS 13.95]

It depends. An entity is required to make an accounting policy choice, to be applied consistently, to determine what value to use when transfers between levels of the fair value hierarchy have occurred. The same accounting policy should be applied for transfers into or out of each level.

820-10-50-2(c)
[IFRS 13.95]

The following are three examples of policies that may be used to disclose transfers into or out of the levels of the fair value hierarchy:

- At the fair value on the date the event causing the transfer occurs;
- At the fair value measurement at the beginning of the reporting period during which the transfer occurred; or
- Using the fair value at the end of the reporting period during which the transfer occurred.

If the end-of-period value is used, the SEC staff recommends disclosure in the MD&A of the realized gains and losses for the period that were excluded from the roll-forward disclosures as a result of using the end-of-period amount.

N60. Does the guidance on how to measure fair value apply to assets and liabilities that are not measured at fair value but for which fair value is disclosed?

820-10-50-2E

Generally, yes. The guidance on how to measure fair value applies to assets and liabilities for which fair value is disclosed even if those assets and liabilities are not recognized at fair value in the statement of financial position, unless the item is specifically scoped out of the Codification Topic.

IFRS different from U.S. GAAP

[IFRS 13.5]

Like U.S. GAAP, the guidance on how to measure fair value applies to assets and liabilities for which fair value is disclosed even if those assets and liabilities are not recognized at fair value in the statement of financial position, unless the item is specifically scoped out of the Standard.

For example, an entity that applies the cost model to measure investment properties is required to disclose the fair values of those investment properties. Similarly, an entity discloses the fair values of financial assets and financial liabilities if the carrying amount is not a reasonable approximation of fair value. In such circumstances, the fair values for disclosure purposes are measured under IFRS 13.

N70. Is there a disclosure-related practical expedient for measuring the fair value of loan receivables that are not part of a homogeneous category of loans?

825-10-50

Yes. In disclosing the fair value of loan receivables that are not part of a homogeneous category of loans (e.g., residential mortgages, credit card receivables, and other consumer loans), the fair value of the loans for disclosure purposes may be estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and the same maturities. This practical expedient, often referred to as an entry-price technique, can be used for disclosure purposes only, and is restricted to loan receivables that are not part of a homogeneous category of loans.

If an entity uses this practical expedient, in our view disclosure that this amount does not represent an exit price is appropriate.

IFRS different from U.S. GAAP

Unlike U.S. GAAP, there is no practical expedient for the measurement of fair value of any assets or liabilities for disclosure purposes.

N80. For the purpose of disclosures about recurring Level 3 measurements, how should an entity calculate the amount attributable to the change in unrealized gains or losses that is recognized as part of the total gains or losses for the period?

820-10-50-2(d)
[IFRS 13.93(f)]

In practice, meeting this disclosure requirement may be straightforward for some types of instruments; however, identifying the change in unrealized gains or losses included in profit or loss for the period may be difficult for those instruments that are subject to periodic cash settlements. In many situations, periodic cash settlements constitute both a realization of gains or losses arising in prior periods (i.e., settlement of the initial carrying amount) and a realization of gains or losses arising in the current period.

In our view, an entity may define the change in unrealized gains or losses as those gains or losses included in earnings for the current period relating to assets and liabilities held at the end of the reporting period *exclusive* of settlements received or paid in the current period for movements in fair value that occurred in the period. In that case, an entity develops a reasonable method to allocate cash settlements received or paid during the period to:

- the unrealized gain or loss as of the beginning of the period or the initial carrying amount (which would not affect the realized gains or losses in the period); and
- the change in fair value during the period (which would constitute realization of gains or losses in the period).

To facilitate this separation, these guidelines may be useful in determining the appropriate amount to disclose:

- The total change in fair value, comprising both realized and unrealized gains or losses, is calculated by comparing the beginning of the period fair value of the applicable asset or liability, adjusted for all cash flows received or paid for the asset or liability during the current reporting period, to the end of period fair value for the asset or liability.
- Cash flows received or paid during the current reporting period that relate to changes in fair value that occurred in a prior reporting period or settlement of the initial carrying amount do not represent either realized or unrealized gains or losses in the current reporting period. They represent an adjustment to the related balance sheet account.
- Cash flows received or paid during the current reporting period that relate to changes in fair value that occurred in the current reporting period represent realized gains or losses in the current reporting period.
- Unrealized gains or losses for the current period for the applicable asset or liability generally are equal to the difference between the total change in fair value and the amount of realized gains or losses for the current period calculated above.

Some have suggested that, as an alternative to the methodology described above, either (a) the periodic amount of cash settlements should be considered to be a realization of the current period gain or loss, or (b) that periodic cash settlements should be excluded in their entirety from the determination of realized gains and losses in the current period (because they are considered to be attributable entirely to the unrealized gain or loss at the beginning of the period). Use of either alternative approach may not effectively isolate the unrealized gain or loss included in earnings that relate to assets or liabilities still held at the reporting date.

Example N80: Determination of Unrealized Gains and Losses

Company N executes an at-the-money receive fixed-pay floating interest rate swap with Counterparty C on January 22, 20X1. The swap has a term that ends at December 22, 20X4 and a transaction price of zero. The swap requires periodic settlements, which occur on December 22 of each year that the swap is outstanding, beginning in the second year (i.e., December 22, 20X2, 20X3, and 20X4).

Company N uses an income approach to measure the fair value of the swap by calculating the present value of the cash flows expected to occur in each year based on current market data.

Amount of total fair value (FV) of the derivative liability that relates to the individual settlement period				
	FV of expected payment to be made on December 22:			
As of December 31	20X2	20X3	20X4	Total FV
20X1	$300	$350	$350	$1,000
20X2		$500	$600	$1,100
20X3			$800	$800
20X4				$0

Actual periodic cash settlements by year:

December 22, 20X2: $375 paid

December 22, 20X3: $580 paid

December 22, 20X4: $750 paid

Based on this information, Company N discloses the following.

	20X1	20X2	20X3	20X4
FV at beginning of reporting period	0	1,000	1,100	800
Purchases	0	0	0	0
Sales	0	0	0	0
Issues	0	0	0	0
Settlements	0	(375)	(580)	(750)
Total (gains) or losses in period	1,000	475	280	(50)
FV at end of reporting period	1,000	1,100	800	0

However, Company N must also determine the disclosures required for the change in unrealized gains or losses. Therefore, Company N analyzes all settlements paid or received during the year to determine whether they relate to gains or losses originating in the current period or in a prior reporting period.

For the reporting period ended December 31, 20X1, no cash flows were received or paid on the swap; therefore, any gain or loss would be entirely attributable to the change in unrealized gains or losses for the period (i.e., $1,000).

For the reporting period ended December 31, 20X2, Company N performs the following calculation.

For the reporting period ended December 31, 20X2	
FV attributed to the expected cash outflow of the period	300
Actual cash outflow in the period (i.e., settlement)	(375)
Over/(under) estimate, representing the change in FV in the current year	(75)
Total (gain)/loss in the period	475
Amount attributable to the change in unrealized (gains) or losses in the current year	400

Similarly, Company N also performs these calculations at the next two reporting periods.

For the reporting period ended December 31, 20X3	
FV attributed to the expected cash outflow of the period	500
Actual cash outflow in the period (i.e., settlement)	580
Over/(under) estimate, representing the change in FV in the current year	(80)
Total (gain)/loss in the period	280
Amount attributable to the change in unrealized (gains) or losses in the current year	200

For the reporting period ended December 31, 20X4	
FV attributed to the expected cash outflow of the period	800
Actual cash outflow in the period (i.e., settlement)	750
Over/(under) estimate, representing the change in FV in the current year	50
Total (gain)/loss in the period	(50)
Amount attributable to the change in unrealized (gains) or losses in the current year	0

As expected, the change in unrealized gains or losses in the final year of the swap would be $0 as the liability is no longer recognized at the end of the reporting period.

Therefore, using this analysis of cash flows, Company N would disclose the following information about the change in unrealized gains or losses.

	Reporting period ended December 31:			
	20X1	20X2	20X3	20X4
Total (gain) or loss in current period (see above)	$1,000	$475	$280	($50)
Amount attributable to the change in unrealized (gains) or losses relating to those assets and liabilities held at the end of the reporting period	$1,000	$400	$200	$0

O. Application Issues: Derivatives and Hedging

Overview

- The general principles discussed throughout this publication apply equally to derivative instruments.
- This Section explores some of the specific application questions that arise in relation to derivative instruments, and also the effect of the fair value measurement Codification Topic on hedging.

O10. For derivative instruments that are recognized as liabilities, what should an entity consider in measuring fair value?

820-10-35-3, 35-16A – 35-16B
[IFRS 13.9, 34, 37]

The fair value of a liability is defined as the price that would be paid to transfer the liability in an orderly transaction between market participants at the measurement date (see Question K20). Although the fair value measurement objective of a derivative liability is to estimate the price that would be paid to transfer the liability, generally there is no quoted price for this transfer. However, because a derivative liability is a contract between market participants, generally it is held by another party as an asset. Therefore, an entity measures the fair value of a derivative liability from the perspective of a market participant that holds the derivative as an asset.

820-10-35-41
[IFRS 13.77, 79]

For derivatives that are exchange traded, the price used for fair value measurement is usually the market exchange price on the measurement date which is considered a Level 1 input if the market is active.

820-10-55-5
[IFRS 13.B10]

The fair value measurement of nonexchange traded derivatives (e.g., OTC derivatives) generally is based on an income approach. Under this approach, future cash flows are converted to a single amount through discounting. A fair value measurement based on an income approach may include adjustments for liquidity, credit risk, or any other adjustments if these are based on assumptions that market participants would use.

820-10-35-17 – 35-18, 35-37A
[IFRS 13.42–43, 73]

Some derivatives, such as forwards and swaps, may be liabilities or assets at different points in time and at different interest rates on the yield curve. This adds complexity to the measurement of fair value because the credit-risk adjustments may include both the counterparty's credit risk and the entity's own nonperformance risk (see Question K30). In addition, the credit-risk adjustment may be affected by whether and how the nonexchange traded derivative is collateralized (see Questions C80 and O30). Whether the fair value measurement is categorized within Level 2 or Level 3 of the fair value hierarchy depends on whether the measurement includes unobservable inputs that are significant to the entire measurement (see Question H20).

820-10-35-18D, 35-18L
[IFRS 13.48–49, 53, 56]

For a group of financial assets and financial liabilities, including derivatives, an entity is permitted, if certain conditions are met, to measure the fair value of a group of derivatives based on a price that would be received to sell or paid to transfer the net risk position (portfolio measurement exception) (see Question L10). If an entity elects to apply the portfolio measurement exception for a particular market or counterparty's credit risk, it may affect the liquidity and credit-risk adjustments for the instruments in the portfolio because they are measured based on the characteristics of the entity's net risk position rather than on the characteristics of the individual derivatives (see Section L).

For a discussion of the effect of the inclusion of credit-risk adjustments in measurements of fair value on hedge accounting, see Question O70.

O20. How do the requirements to include counterparty credit risk and an entity's own nonperformance risk affect the fair value measurement of derivative instruments?

820-10-35-2, 35-16 – 35-17
[IFRS 13.9, 34, 42]

The fair value of derivative assets should consider the effect of potential nonperformance of the counterparty. In addition, the fair value of derivative liabilities also considers the entity's own nonperformance risk, which is assumed to remain the same before and after the transfer (see Question K30).

820-10-35-16B
[IFRS 13.37]

In principle, and assuming no differences in the unit of valuation (see Section C), the credit-risk adjustments made in the fair value measurement by both counterparties to the financial instrument should be the same.

820-10-35-17
[IFRS 13.42]

The fair value of many derivative instruments (e.g., swaps, and forwards) is affected by the risk of nonperformance of both the counterparty and the entity because the derivatives can be liabilities or assets at different points in time and at different interest rates on the yield curve.

820-10-35-2B, 35-17 – 35-18
[IFRS 13.11, 42]

For such derivatives, an entity should consider both counterparty credit risk and its own nonperformance risk if market participants would do so in measuring the fair value of these instruments. Therefore, an entity should design and implement a method for appropriately considering credit-risk adjustments in valuing these derivatives.

820-10-35-2B, 35-17 – 35-18
[IFRS 13.11, 42]

If market participants would consider both the counterparty credit risk and the entity's own nonperformance risk and an entity uses a method that considers only the current classification of the derivative (as either an asset or liability) and calculates the credit-risk adjustment based on its current classification, it would determine whether additional credit-risk adjustments are necessary based on the potential for the other classification.

O30. What discount rates are used in practice to measure the fair value of collateralized and uncollateralized derivative instruments?

820-10-35-2B, 55-11
[IFRS 13.11, B19]

Generally, the fair value of a collateralized derivative is different from the fair value of an otherwise identical but uncollateralized derivative because the posting of collateral mitigates risks associated with credit and funding costs (see Question C80).

Before the 2008-09 financial crisis, unsecured interbank borrowing rates, such as LIBOR, were commonly used to discount cash flows of both collateralized and uncollateralized derivative instruments. However, as a result of the widening of spreads, changes in banks' funding costs, and the increased use of collateral in OTC derivative trading since the financial crisis, market participants have moved towards using multiple curves for collateralized and uncollateralized trades when valuing derivatives.

For valuing collateralized derivatives, our recent experience suggests that the majority of derivative market participants agree that the estimated cash flows should be discounted at the rate agreed for cash collateral posted under the respective derivative's Credit Support Annex (CSA), which typically is an overnight benchmark rate in the respective currency (e.g., Sterling Overnight Index Average (SONIA), Euro Overnight Index Average (EONIA), or Federal Funds rate). The overnight index swap (OIS) market reflects assumptions by market participants about the overnight rate.

Additional complexities may arise when the contract terms include thresholds for posting collateral, permit the currency of the collateral to be different from the currency of the derivative cash flows, or references a currency without an active market for overnight lending rates.

Entities should monitor developments in valuation techniques to ensure that their own valuation models appropriately reflect the types of inputs that market participants would consider.

For uncollateralized transactions, in our recent experience, there is no clear market consensus as to the most appropriate discount rate to apply in a valuation model.

One alternative that has developed is that estimated cash flows should be discounted using an entity's own cost of funding, but it is unclear how Funding Valuation Adjustments (FVA) should be determined and included in a derivative valuation model. Entities would need to ensure that any funding cost risk adjustment used in measuring fair value is consistent with the cost that market participants would take into account when pricing an instrument rather than being only an entity-specific estimate.

A challenge of the alternative view is the potential for overlap in a valuation model between the funding rate of an entity and its own credit spread, which is often taken into account through the application of a debit valuation adjustment (DVA). Funding cost discounting techniques usually incorporate both liquidity and credit components, because these are difficult to separate. In addition, there also is a potential overlap between FVA and CVA. However, the relationship is less direct than between FVA and DVA because a bank's funding spread is not dependent on a single borrower but on the quality of the entire portfolio.

Whatever method is used, an entity needs to ensure that any adjustment applied to the discount rate is consistent with the definition of fair value (see Section A).

O40. For a derivative contract between a dealer and a retailer, if the dealer has a day one difference, does the retailer have the same difference?

820-10-55-46 – 55-50
[IFRS 13.9]

It depends. The difference between the fair value and the transaction price for the retail counterparty is not necessarily the same as for the dealer counterparty. The measurement of fair value should be based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants.

820-10-30-3A
[IFRS 13.B4(d)]

As discussed in Question I10, a difference between the transaction price and the fair value at initial recognition may arise if an entity transacts in a market that is different from its principal (or most advantageous) market. An entity (e.g., a dealer) may transact in the retail market with a retail counterparty, while the principal market to which the entity has access for the specific financial instrument is different (e.g., the dealer market). In this case, the fair value measured by reference to transactions in the dealer market may be different from the transaction price in the retail market, which is often zero.

820-10-55-46 – 55-50
[IFRS 13.B4(d)]

If the dealer's retail counterparty does not have access to the dealer market, the difference between the transaction price and the fair value at initial recognition will not be the same for the dealer counterparty (for which the principal market is the dealer market) and for the retailer counterparty (for which the principal market is the retail market).

820-10-30-6

If there is a difference between the transaction price and the fair value at initial recognition for the dealer and/or the retail counterparties, the resulting day one gain or loss is recognized in earnings (see Question I20).

IFRS different from U.S. GAAP

[IFRS 9.B5.1.2A, B5.2.2A, IAS 39.AG76–76A]

Unlike U.S. GAAP, if there is a difference between the transaction price and the fair value at initial recognition for the dealer and/or the retail counterparties, recognition of a day one gain or loss depends on the observability condition (see Question I20).

O50. How does a day one gain or loss due to a bid-ask spread affect hedging relationships?

815-10-30-1
[IFRS 13.70]

The transaction price to acquire a derivative hedging instrument is an entry price, while a fair value measurement is based on an exit price. When the pricing of a derivative is subject to a bid-ask spread, there could be a difference between the entry and exit price of the derivative and the price that is most representative of fair value may be at a different point within the bid-ask spread from the entry transaction price (see Question G110). For example, an entity might enter into a derivative at the ask price and measure fair value using the bid price. Therefore, a derivative entered into at then current market terms and with a transaction price of zero may have a fair value other than zero at initial recognition. An entity may designate such a derivative as a hedging instrument at initial recognition.

820-10-30-3A, 55-46

As discussed in Question I20, the Codification Topic permits the recognition of a day one gain or loss when an entity's measurement of fair value is different from the transaction price. The effect of the day one gain or loss due to a bid-ask spread will depend on the type of hedging relationship as described below.

Shortcut Method

815-20-25-102, 25-104 – 25-106, 815-20-55-71, 820-10-35-9B

The Derivatives and Hedging Codification Topic requires, among other things, that the fair value of the hedging instrument (the interest rate swap) at the inception of the hedging relationship be zero to apply the shortcut method. Therefore, the issue is whether an interest rate swap with a non-zero fair value due to a bid-ask spread meets this criterion and can be used as a hedging instrument in a hedging relationship accounted for under the shortcut method.

The Derivatives and Hedging Codification Topic clarifies that this criterion would be met for an interest rate swap with all of the following characteristics:

- It is entered into at the inception of the hedging relationship;
- It has a transaction price of zero (exclusive of commissions and other transaction costs as described in Question E40) in the entity's principal (or most advantageous) market; and
- The difference between the transaction price and fair value is attributable solely to differing prices within the bid-ask spread between the entry transaction and a hypothetical exit transaction.

Therefore, assuming that an interest rate swap designated as the hedging instrument in a hedging relationship that qualifies for the shortcut method meets these criteria, the day one gain or loss on the interest rate swap would not in itself preclude the use of the shortcut method.

Critical-Terms Match in Cash Flow Hedging Relationships

815-20-25-84(b), 25-104

The Derivatives and Hedging Codification Topic requires, among other things, that the fair value of the hedging instrument at the inception of the hedging relationship be zero to apply a critical-terms match. Therefore, the issue is whether a derivative instrument with a non-zero fair value due to a bid-ask spread meets this criterion and can be used as a hedging instrument in a hedging relationship accounted for under a critical-terms match.

In our view, a derivative instrument having a non-zero fair value at inception of the hedging relationship solely due to a bid-ask spread under the Codification Topic would not preclude an entity from applying critical-terms match, assuming that all of the other criteria in the Derivatives and Hedging Codification Topic are met as well as criteria similar to those discussed above for the shortcut method.

815-20-25-84(b)

If the initial non-zero fair value of the hedging instrument is attributable to other factors (e.g., the terms of the derivative do not reflect current market pricing at the time it is designated), the initial non-zero fair value reflects a source of potential future ineffectiveness that is not consistent with the assumption of high effectiveness that the critical-terms match approach involves.

Other Hedging Relationships

815-20-25-79
[IAS 39.AG105]

A day one gain or loss on a derivative instrument that is attributable solely to the difference in the bid-ask spread under the Codification Topic and recognized in earnings at the transaction date is not considered to be a change in the fair value of the derivative instrument as contemplated in the Derivatives and Hedging Codification Topic. Therefore, this gain or loss would not affect the assessment of effectiveness and the measurement of ineffectiveness.

However, subsequent to day one, changes in the fair value of the derivative instrument would incorporate the changes in the bid-ask spread and in the relative position of the price within the bid-ask spread. Therefore, these changes would affect the assessment of effectiveness and the measurement of ineffectiveness.

IFRS different from U.S. GAAP

[IFRS 9.B5.1.2A, B5.2.2A, IAS 39.AG76–76A]

Unlike U.S. GAAP, as discussed in Question I20, the recognition of a day one gain or loss when an entity's measurement of fair value is different from the transaction price depends on the observability condition.

Shortcut Method

Unlike U.S. GAAP, the shortcut method is not allowed under IFRS.

[IAS 39.AG108, IG.F.4.7]

Critical-Terms Match – Fair Value or Cash Flow Hedging Relationships

Unlike U.S. GAAP, prospective effectiveness only may be demonstrated on a qualitative basis if the critical terms of the hedging instrument and the hedged item match exactly at inception and in subsequent periods.

However, if the critical terms of a hedging instrument and a hedged item do match exactly, in our view, for a derivative instrument that has a non-zero fair value at inception of the hedging relationship solely due to a bid-ask spread, an entity would not be precluded from applying a qualitative approach for assessing prospective effectiveness, like U.S. GAAP.

Unlike U.S. GAAP, an entity that uses critical-terms match for prospective effectiveness assessment should also use a long-haul method for assessing retrospective effectiveness and measuring ineffectiveness.

O60. Does the principal market guidance affect the assessment of effectiveness or the measurement of ineffectiveness for hedging relationships?

815-25-35-1

It depends. In a fair value hedge, an entity applies the fair value measurement concepts of the Codification Topic in measuring the fair value of the hedging instrument and the changes in overall fair value or fair value attributable to a specific hedged risk of the hedged item. Therefore, the principal market requirements may affect the assessment of effectiveness and the measurement of ineffectiveness in a fair value hedge (see Section E).

820-10-35-5, 35-9C

For example, if the hedged item is a nonfinancial asset or nonfinancial liability, the principal market requirements may result in a change in fair value that reflects a location different from the principal market. Therefore, transportation costs from the actual location of the hedged item to the principal market need to be considered.

815-30-35-10

A cash flow hedge is a hedge of the exposure to variability in cash flows. Measurement of the variability of cash flows is not within the scope of the Codification Topic. Therefore, the principal market requirements do not affect assessment of the effectiveness or the measurement of ineffectiveness of a cash flow hedge if they are based on comparing changes in the present value of the cash flows on the hedged item with changes in the present value of the cash flows on the hedging instrument.

815-30-35-10

However, an entity may apply a method that uses the hedging instrument's fair value to assess effectiveness and to measure ineffectiveness. In that case, assessment and measurement may be affected by the requirements of the Codification Topic about the principal market in which a transaction is assumed to take place in measuring the hedging instrument's fair value.

815-30-35-10

Furthermore, the entity may assess effectiveness and measure ineffectiveness based on changes in the fair value of the hedged cash flows, including, for example, by measuring the fair value of a hypothetical derivative as a proxy for changes in the hedged cash flows. In this case, the principal market requirements also may affect the assessment of effectiveness.

Example O60: Wheat Futures and Market Location

Company O purchases wheat futures contracts (for delivery in Amsterdam) to hedge its exposure to the changes in overall fair value of its wheat inventory (fair value hedge) or changes in overall cash flows associated with the forecasted sale of wheat (cash flow hedge).

Company O typically sells its wheat in Amsterdam, but based on the Codification Topic, the principal market for the wheat is in Frankfurt. The market in which a transaction for the wheat futures is assumed to take place or the location in which delivery would be required under the futures contract is Amsterdam.

Fair Value Hedge

In assessing the effectiveness and measuring the ineffectiveness of a fair value hedge, Company O uses a method based on comparing changes in the fair value of the hedged inventory with changes in the fair value of the futures contract for delivery in Amsterdam.

In this example, although Company O sells its wheat in Amsterdam, the principal market is Frankfurt. Therefore, under the Codification Topic, the adjustment to the carrying amount of the wheat inventory is based on the price of wheat in Frankfurt less the costs to transport the wheat from its current location to Frankfurt. This would affect the assessment of effectiveness and the measurement of ineffectiveness because the location of the principal market of the inventory is different from the principal market of the futures contract.

Cash Flow Hedge

If Company O assesses effectiveness based on changes in the present value of cash flows (e.g., a statistical model such as a linear regression technique that determines how much of the change in the cash flows of the dependent variable is caused by a change in the cash flows of the independent variable), its effectiveness assessment is not affected because of the application of the principal market guidance.

Even if Company O applies a method that uses the hedging instrument's fair value change to assess effectiveness, the principal market requirements do not affect the market in which a transaction for the wheat futures is assumed to take place, and nor the cash flows of the hedged item.

However, if Company O assesses the effectiveness of the hedge based on changes in the fair value of the hedged cash flows or of a hypothetical derivative, the principal market requirements may affect the assessment of effectiveness. This occurs even though the delivery location of the perfectly effectively derivative would be the delivery location of the hedged sales rather that the principal market of the inventory.

IFRS different from U.S. GAAP

Question O60 and Example O60 are reproduced in the context of IFRS to both highlight the differences from U.S. GAAP, and to emphasize potential transitional issues on the adoption of the Standard (effective for annual periods beginning on or after January 1, 2013).

Does the principal market guidance affect the assessment of effectiveness or the measurement of ineffectiveness for hedging relationships?

[IAS 39.89]

It depends. Like U.S. GAAP, in a fair value hedge, an entity applies the fair value measurement concepts of the Standard in measuring the fair value of the hedging instrument and the changes in overall fair value or fair value attributable to a specific hedged risk of the hedged item (see Section E).

Unlike U.S. GAAP, prior to the Standard coming into effect, the fair value of a financial instrument that was quoted in an active market was based on the quoted price in the most advantageous market to which the entity has immediate access and the fair value of a financial instrument that was not quoted in an active market was based on market data in the same market where the instrument was originated or purchased.

[IFRS 13.16]

In many cases, the market used for pricing the hedging instrument will not change as a result of the introduction of the principal market guidance in the Standard because the principal and the most advantageous market are often the same. However, if the market used for pricing the hedging instrument does change, the fair value measurement of the hedging instrument also may change. Therefore, the change in the fair value of the hedging instrument used in the assessment of effectiveness and the measurement of ineffectiveness may be affected.

[IFRS 13.16]

Similarly, in many cases the market used for pricing the hedged item will not change as a result of the introduction of the principal market guidance in the Standard. However, if the market used for pricing the hedged item does change, the fair value measurement of the hedged item in a fair value hedge also may change. Like U.S. GAAP, the fair value of the hedged item is based on the principal market, even if the hedged item is transacted in a different market. Therefore, the change in the fair value of the hedged item used in the assessment of effectiveness and measurement of ineffectiveness may be affected.

[IFRS 13.26]

Like U.S. GAAP, if the hedged item is a nonfinancial asset or nonfinancial liability, a change in the market used for pricing the hedged item due to the introduction of the principal market guidance may result in a change in fair value that reflects a location different from the principal market. Therefore, transportation costs from the actual location of the hedged item to the principal market need to be considered.

[IFRS 13.5]

Like U.S. GAAP, a cash flow hedge is a hedge of the exposure to variability in cash flows. Measurement of the variability of cash flows is not within the scope of the Standard. Therefore, the principal market requirements do not affect the assessment of the effectiveness or the measurement of ineffectiveness of a cash flow hedge, if they are based on comparing changes in the present value of the cash flows on the hedged item with changes in the present value of the cash flows on the hedging instrument.

[IFRS 13.16, IAS 39.AG107]

However, like U.S. GAAP, entities may apply a method that uses the hedging instrument's fair value to assess effectiveness and to measure ineffectiveness. In that case, such assessment and measurement may be affected if the Standard changes the market in which a transaction is assumed to take place in measuring the hedging instrument's fair value.

[IFRS 13.16, IAS 39.AG107]

Furthermore, like U.S. GAAP, the entity may assess effectiveness and measure ineffectiveness based on changes in the fair value of the hedged cash flows, including, for example, by measuring the fair value of a hypothetical derivative as a proxy for changes in the hedged cash flows. In this case, changes in the markets by reference to which changes in the fair value of the hedged cash flows or hypothetical derivative are measured, compared to the markets previously used for pricing, also may affect the assessment of effectiveness.

Qualitative Effectiveness Assessment

[IAS 39.AG108]

A qualitative approach to assessing prospective effectiveness is based on a conclusion that there is a match between the critical terms of the hedging instrument and those of the hedged item. If the Standard changes the market in which a transaction is assumed to take place in measuring the fair value of the hedging instrument, the hedged item or both, a qualitative prospective effectiveness assessment will no longer be appropriate if that change means that the critical terms of the hedging instrument and the hedged item are no longer considered to exactly match.

[IAS 39.AG108]

In many cases, a change in the market in which a transaction is assumed to take place in measuring the fair value of the hedging instrument, the hedged item or both may not impact whether the critical terms match. For example, if an entity designates an interest rate swap as a hedge of fair value changes of a fixed-rate bond attributable to changes in a benchmark interest rate, the match would be based on the contractual terms of the bond and the swap and whether the interest rate index underlying the swap matches the hedged risk, and these may not be affected by a change in the market in which a transaction in the bond or the swap would be assumed to take place for fair value measurement purposes.

[IFRS 13.16, IAS 39.AG108]

However, the prospective effectiveness assessment may be affected and may no longer be appropriate for a fair value hedge if a difference arises between the market in which the fair value of the hedged item is priced for the purposes of determining fair value changes attributable to the hedged risk and the underlying of the hedging instrument.

[IFRS 13.26, IAS 39.AG108]

Similarly, the prospective effectiveness assessment may be affected and may no longer be appropriate if the hedged item in a fair value hedge is of a nonfinancial nature and the location of the hedged item is a characteristic of the hedged item that is relevant to determining its fair value. In other words, the fair value of the hedged item is determined based on the price in the principal (or most advantageous) market adjusted for the costs that would be incurred to transport the item from its current location to the principal market. In that case, the underlying of the hedging instrument may no longer exactly match the hedged item due to differences in location.

Example O60: Wheat Futures and Market Location

Company O purchases wheat futures contracts (for delivery in Amsterdam) to hedge its exposure to the changes in overall fair value of its wheat inventory (fair value hedge) or changes in overall cash flows associated with the forecasted sale of wheat (cash flow hedge). Company O typically sells its wheat in Amsterdam, but based on the Standard, the principal market for the wheat is in Frankfurt.

Before adopting the Standard, Company O calculated adjustments to the carrying amount of wheat inventories subject to a fair value hedge based on an assumed sale taking place in Amsterdam. The Standard does not change the market in which a transaction for the wheat futures is assumed to take place or the location in which delivery would be required under the futures contract (Amsterdam).

Fair Value Hedge

In assessing the effectiveness and measuring the ineffectiveness of a fair value hedge, Company O uses a method based on comparing changes in the fair value of the hedged inventory with changes in the fair value of the futures contract for delivery in Amsterdam.

In this fact pattern, although Company O sells its wheat in Amsterdam, its principal market is Frankfurt. Therefore, under the Standard, the adjustment to the carrying amount of the wheat inventory is based on the price of wheat in Frankfurt less the costs to transport the wheat from its current location to Frankfurt. Although the Standard did not change the market in which a transaction for the wheat futures is assumed to take place, the assessment of effectiveness and measurement of ineffectiveness now produces different results.

Cash Flow Hedge

If Company O assesses effectiveness based on a changes in the present value in cash flows (e.g., a statistical model such as a linear regression technique that determines how much of the change in the cash flows of the dependent variable is caused by a change in the cash flows of the independent variable), its effectiveness assessment is not affected because of the application of the principal market guidance.

Even if Company O applies a method that uses the hedging instrument's fair value change to assess effectiveness, then the assessment of effectiveness before and after the introduction of the Standard remains the same because it did not change the market in which a transaction for the wheat futures is assumed to take place, and nor does it change the cash flows of the hedged item.

However, if Company O assesses the effectiveness of the hedge based on changes in the fair value of the hedged cash flows or of a hypothetical derivative, changes in the markets by reference to which changes in the fair value of the hedged cash flows or hypothetical derivative are measured, compared to the markets previously used for pricing, may affect the assessment of effectiveness. This occurs even though the delivery location of the perfectly effectively derivative would continue to be the delivery location of the hedged sales.

O70. Do the requirements to include counterparty credit risk and an entity's own nonperformance risk in measuring the fair values of derivative instruments affect hedging relationships?

820-10-35-17
[IFRS 13.42, IAS 39.AG109, IG.F.4.3]

It depends. The requirements to include counterparty credit risk and an entity's own nonperformance risk in the fair value measurement of derivative instruments may affect hedging relationships.

820-10-35-17
[IFRS 13.42, IAS 39.AG109, IG.F.4.3]

For all hedges, changes in both counterparty credit risk and an entity's own nonperformance risk affect the measurement of changes in the fair value of a derivative hedging instrument. These changes likely will have no offsetting effect on the measurement of the changes in the fair value of the hedged item attributable to the hedged risk.

815-20-25-102 – 25-106
[IAS 39.AG109, IG.F.4.3, IG.F.5.2]

The effectiveness assessment of cash flow hedges also may be affected by changes in counterparty credit risk and an entity's own nonperformance risk even if effectiveness is not assessed based on a method that uses the hedging instrument's fair value change. Therefore, the effectiveness assessment and the measurement of ineffectiveness may be affected by the inclusion of counterparty credit risk or an entity's own nonperformance risk and may lead to a conclusion that the hedging relationship has not been and/or is not expected to be highly effective.

815-20-25-102 – 25-117, 35-9 – 35-11

The Derivatives and Hedging Codification Topic provides guidance related to cash flow hedges, hedges of net investments in foreign operations, and other specific exceptions for hedges based on the shortcut method or critical-terms match that allow an entity to assume perfect effectiveness and thereby ignore the effect of counterparty credit risk in the assessment of effectiveness and/or measurement of ineffectiveness.

815-20-35-14 – 35-18

Under this guidance, the requirement to include counterparty credit risk and the entity's own nonperformance risk in the fair value of derivative assets and liabilities would:

- Not affect the assessment of effectiveness and measurement of ineffectiveness in cash flow hedges, hedges of net investments in foreign operations, and fair value hedges applying the shortcut method, unless it is no longer probable that the derivative counterparty or the entity itself will not default; and
- Affect the assessment of effectiveness and measurement of ineffectiveness in fair value hedges (excluding those applying the shortcut method).

815-20-35-1

However, an entity with derivative instruments that are part of cash flow hedging relationships or hedges of net investments in foreign operations needs to determine the amount of the change in the fair value of the derivative instrument related to changes in counterparty credit risk and the entity's own nonperformance risk that will be recorded in accumulated other comprehensive income (AOCI) or cumulative translation adjustment (CTA). An entity with derivative instruments that are in a fair value shortcut method hedging relationship will need to determine the amount of the change in the fair value of the derivative instrument related to changes in counterparty credit risk and the entity's own nonperformance risk that will need to be recorded as part of the basis of the hedged item.

The following is a summary of hedge relationships and how each is affected by counterparty credit risk and an entity's own nonperformance risk in the assessment of effectiveness and measurement of ineffectiveness.

Cash Flow Hedges – Accounted for under Long Haul

815-20-35-14 – 35-18

A general concept in the Derivatives and Hedging Codification Topic related to cash flow hedges is that the hedging relationship must be highly effective in achieving offsetting changes in the cash flows for the risk being hedged. Therefore, one of the items that an entity must analyze and monitor is whether the counterparty to the derivative will default by failing to make contractually required payments to the entity as scheduled in the derivative contract. Concluding that the counterparty will not default is integral for an entity to determine that the hedging relationship will be highly effective in achieving offsetting changes in the cash flows for the risk being hedged.

The Derivatives and Hedging Codification Topic further clarifies this general concept by stating that for cash flow hedges an entity must consider the likelihood of the counterparty's compliance with the terms of the derivative contract, and analyze the affect of counterparty credit risk on the assessment of effectiveness. Although a change in the counterparty's creditworthiness would not necessarily indicate that it would default on its obligation, the change would warrant further evaluation. Also, if the likelihood that the counterparty will not default ceases to be probable, an entity would be unable to conclude that the cash flow hedging relationship is expected to be highly effective in achieving offsetting cash flows.

In our view, based on this general concept of cash flow hedges, as long as the likelihood of the counterparty not defaulting is assessed as being probable, changes in counterparty credit risk would not affect the assessment of effectiveness. Therefore, if there is a change in counterparty credit risk, but it is still probable that the counterparty will not default, the change in counterparty credit risk would not cause the contractual cash flows related to the derivative instrument to change. We also believe that it is appropriate for an entity to ignore the effect of (a) an entity's own nonperformance risk in the assessment of effectiveness, and (b) counterparty credit risk and an entity's own nonperformance risk in the measurement of ineffectiveness, assuming that the likelihood of the counterparty or the entity not defaulting is assessed as being probable.

Therefore, changes in counterparty credit risk and an entity's own nonperformance risk would not affect the assessment of effectiveness or the measurement of ineffectiveness for cash flow hedges as long as it is still probable that the derivative counterparty or the entity will not default. Assuming that there are no other sources of ineffectiveness, the total changes in the fair value of the derivative instrument (including changes in counterparty credit risk and an entity's own nonperformance risk) would be included in AOCI. However, if the likelihood of the counterparty or the entity not defaulting is assessed as no longer probable, the entity must measure the amount of ineffectiveness to be recognized currently in earnings and assess whether the hedging relationship has been and is expected to continue to be highly effective. The Derivatives and Hedging Codification Topic presumes that the high effectiveness criterion would not be met under those circumstances. Therefore, the entity would be expected to have strong evidence supporting why the hedging relationship has been and is expected to continue to be highly effective.

Cash Flow Hedges – Critical-Terms Match

815-20-35-10, 35-14

Under the Derivatives and Hedging Codification Topic, if an entity uses the critical-terms match in a cash flow hedge, it must assess whether there have been adverse developments related to the risk of counterparty default. If there are no such developments and critical terms continue to match, the entity can conclude that there is no ineffectiveness.

In our view, this guidance could be analogized to allow an entity to ignore its own nonperformance risk in the assumption of no ineffectiveness. The degree of change in the risk of default should be consistent with that under the long-haul method. Therefore, assuming that the likelihood of the counterparty or the entity not defaulting is assessed as probable, changes in counterparty credit risk and the entity's own nonperformance risk will not affect the assessment of effectiveness or the measurement of ineffectiveness and the changes in the fair value of the derivative instrument due to changes in counterparty credit risk and an entity's own nonperformance risk would be included in AOCI.

However, if the likelihood of the counterparty or the entity not defaulting is assessed as no longer probable, the critical terms no longer match and the entity must measure the amount of ineffectiveness to be recognized currently in earnings. The entity would be expected to have strong evidence supporting why the hedging relationship has been and is expected to continue to be highly effective.

Fair-Value Hedges – Accounted for under Long Haul or Critical-Terms Match

815-20-35-17
[IAS 39.AG109, IG.F.4.3]

The Derivatives and Hedging Codification Topic states that a change in the counterparty's creditworthiness of a derivative instrument in a fair value hedging relationship would have an immediate effect on the assessment of effectiveness and the measurement of ineffectiveness. Therefore, changes in either the counterparty's creditworthiness or the entity's own nonperformance risk would need to be included in the assessment of effectiveness and measurement of ineffectiveness each period and would be recognized in earnings.

In our view, the application of the Codification Topic effectively precludes the use of critical-terms match for fair value hedges. This is because fair value hedging focuses on offsetting the changes in the fair values of the derivative instrument and hedged item for the risk being hedged, and changes in counterparty credit risk and the entity's own nonperformance risk have a direct effect on the fair value of the derivative hedging instrument but do not affect the fair value of the hedged item.

Shortcut – Fair Value or Cash Flow Hedging Relationships

815-20-25-102 – 25-104, 35-18

The Derivatives and Hedging Codification Topic states that if a hedging relationship qualifies for the shortcut method, a change in the creditworthiness of the counterparty of the swap would not require recognition of ineffectiveness in earnings or preclude the continued use of the shortcut method.

In our view, this guidance could be analogized to allow an entity to ignore its own nonperformance risk in the assumption of no ineffectiveness.

Therefore, consistent with the Codification Topic, no ineffectiveness would be recognized and the shortcut method may continue to be used as long as the likelihood that the counterparty or the entity will not default continues to be probable. Therefore, changes in counterparty credit risk and the entity's own nonperformance risk would not affect the assessment of effectiveness or measurement of ineffectiveness. The changes in the fair value of the derivative instrument related to counterparty credit risk and an entity's own nonperformance risk would be included either in AOCI for cash flow hedging relationships or in earnings. The same amount would be used as a basis adjustment to the hedged item for fair value hedging relationships.

However, if the likelihood of the counterparty or the entity not defaulting is assessed as no longer probable, the use of the shortcut method must be discontinued.

However, the hedging relationship may be able to be redesignated using the long-haul method, if the entity has strong evidence supporting that the new hedging relationship is expected to be highly effective.

Hedges of Net Investments in Foreign Operations

815-35

Net investment hedges are subject to the criteria of the Foreign Currency Transactions Codification Subtopic, which requires the hedging instrument to be designated and effective as an economic hedge of the net investment.

Assuming that the likelihood of the counterparty or the entity not defaulting is assessed as probable, in our view, changes in counterparty credit risk and an entity's own nonperformance risk would not affect the assessment of whether the hedging instrument is effective as an economic hedge of the net investment and the related measurement of ineffectiveness.

Assuming that there are no other sources of ineffectiveness and that the entity has elected to measure ineffectiveness based on forward rates, the total changes in the fair value of the derivative instrument (including changes in counterparty credit risk and an entity's own nonperformance risk) would be included in CTA.

However, if the likelihood of the counterparty or the entity not defaulting is assessed as no longer probable, the entity must (a) measure the amount of ineffectiveness in the current period to be recorded in earnings, and (b) assess whether the hedging relationship has been and is expected to continue to be effective as an economic hedge. In this situation, the entity would be expected to have strong evidence supporting why the hedging relationship has been, and is expected to continue to be, effective as an economic hedge.

Interaction with the Application of the Portfolio Measurement Exception

820-10-35-18D, 35-18F
[IFRS 13.48, 50, IAS 39.AG109, IG.F.4.3]

If an entity has a group of derivative assets and liabilities with a particular counterparty and the entity applies the portfolio measurement exception to that counterparty's credit risk (see Section L), 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 may result in a portfolio level credit-risk adjustment.

However, for assessing hedge effectiveness and recognizing ineffectiveness, an entity needs to determine the individual credit risk adjustments to arrive at the fair values of the individual hedging derivatives or the appropriate credit-risk adjustment for a group of derivatives that have been designated together as the hedging instrument in a single hedging relationship.

In our view, the entity should adopt a reasonable and consistently applied methodology for allocating credit-risk adjustments determined at a portfolio level to individual derivative instruments for the purpose of measuring the fair values of individual hedging instruments that are used in assessing effectiveness and measuring hedge ineffectiveness.

IFRS different from U.S. GAAP

Cash Flow Hedges – Long Haul Method

[IAS 39.96, 102, AG109, IG.F.4.3, IG.F.5.2]

Unlike U.S. GAAP, the effectiveness assessment of cash flow hedges may be affected by the inclusion of counterparty credit risk or an entity's own nonperformance risk in the fair value measurement of derivative hedging instruments, even if the likelihood of the counterparty or the entity not defaulting is assessed as being probable.

Unlike U.S. GAAP, in a cash flow hedge, even when the likelihood of the counterparty or the entity not defaulting is assessed as being probable, the inclusion of counterparty credit risk or an entity's own nonperformance risk in the fair value measurements of derivative hedging instruments results in ineffectiveness being recognized in profit or loss. However, this only occurs if the cumulative gain or loss on the hedging instrument is greater than the cumulative change in fair or present value of the expected future cash flows on the hedged item.

If it becomes probable that a counterparty will default, an entity would be unable to conclude that the hedging relationship is expected to be highly effective in achieving offsetting cash flows. As a result, hedge accounting would be discontinued.

Fair Value or Cash Flow Hedges – Critical-Terms Match

[IAS 39.AG108, IG.F.4.7]

Unlike U.S. GAAP, applying a critical-terms match approach can only be made for assessing prospective effectiveness. Under this approach, if it is concluded that there is no change in any critical term, then such a test would be sufficient to satisfy the prospective effectiveness testing requirements. However, the effect of credit risk should be considered.

Unlike U.S. GAAP, an entity that uses critical-terms match for prospective effectiveness assessment also should use a long-haul method for assessing retrospective effectiveness and measuring ineffectiveness.

Shortcut – Fair Value or Cash Flow Hedging Relationships

Unlike U.S. GAAP, the shortcut method is not allowed under IFRS.

[IAS 39.AG109, IG.F.4.3]

Hedges of Net Investments in Foreign Operations

Unlike U.S. GAAP, even when the likelihood of the counterparty or the entity not defaulting is assessed as being probable, the inclusion of counterparty credit risk or an entity's own nonperformance risk in the fair value measurements of derivative hedging instruments would affect the assessment of effectiveness and may result in ineffectiveness.

P. Application Issues: Investments in Investment Funds

Overview

- The general principles discussed throughout this publication apply equally to investments in investment funds.
- This Section explores some of the specific application questions that arise in relation to investments in investment funds (including a fund-of-funds).
- For a discussion of the practical expedient available for investments in investment companies that meet certain criteria, see Section Q.

P10. What items should an entity consider in measuring the fair value of an investment in an investment fund?

820-10-35-59 – 35-62
[IFRS 13.9, 61]

The fair value guidance in the Codification Topic also applies to investments in investment funds. These considerations include exit price, principal markets, market-based measurements, and maximizing the use of observable inputs. Considerations specific to measuring the fair value of an investment in an investment fund include:

- The nature of the investment fund (open-ended versus closed-end funds);
- The underlying assets and liabilities of the fund;
- Whether net asset value (NAV) may be representative of fair value;
- Actual transactions in units with the fund and in the secondary market; and
- Other rights and obligations inherent in the ownership interest.

Because the instrument held by the entity is an ownership interest in the fund and not an interest in the underlying assets of the fund, any fair value measurement should consider the rights and obligations inherent in that ownership interest (e.g., requirements to meet possible future cash calls). Any adjustments for rights or obligations should be reflective of the unit of account (see Section C).

820-10-35-60
[IFRS 13.61, 67]

In many situations, NAV may be an appropriate input in the fair value measurement of the investment. An entity should consider any rights or obligations not reflected in the NAV measurement for the fund and adjust the NAV measurement to arrive at fair value. If NAV is used as an input in an entity's measurement of fair value (with or without further adjustments), the entity should understand how NAV is calculated, including the key inputs and valuation techniques used by the fund to value the underlying assets and liabilities.

P20. When is the NAV of an investment fund representative of fair value?

The evaluation of whether NAV is representative of fair value encompasses two steps.

- The first step is to assess whether the NAV (or another price) is representative of a quoted price in an active market.
- If there is not a quoted price in an active market, the second step is to assess whether the NAV is otherwise representative of the fair value of the investment in the investment fund.

820-10-20
[IFRS 13.A]

To assess whether the NAV is representative of a quoted price in an active market, an entity should consider the manner in which the fund is traded. Often units in open-ended funds are traded only with the fund or its agent at a published price, either NAV or NAV plus or minus an adjustment. Depending on the trading volume at these prices, the published prices may represent a quoted price in an active market.

820-10-35-41, 35-41C
[IFRS 13.77, 79]

If there is a quoted price in an active market for an investment in a fund (i.e., a Level 1 input), the quoted price is determinative of fair value, whether or not it is equal to the NAV. However, in some circumstances an open-ended fund may suspend redemptions in which case the published NAV would not represent a quoted price in an active market.

In some circumstances, units in open-ended investment funds may be traded both with the fund at NAV and in a secondary market, which occurs with exchange-traded funds. Units or shares in a fund may trade in secondary markets at a premium or discount to NAV because of supply and demand or other factors specific to the fund. For example, units or shares may trade at a discount because a market participant considers an investment in the fund less attractive than a direct investment in the underlying assets of the fund due to the risk of future investment management changes, the loss of control over portfolio management decisions or due to lack of liquidity or marketability of the investment. Conversely, market participants may be willing to pay a premium to invest in a fund managed by a specific investment manager.

820-10-35-54I
[IFRS 13.B44]

Although secondary market trading may not be sufficient to constitute an active market, it is still important to consider any secondary market transactions and transaction prices because, regardless of the level of market activity and trading volume, transaction prices that do not represent distressed or forced transactions should not be ignored in measuring fair value.

820-10-35-60, 50-6A
[IFRS 13.B44]

Even in the absence of an active market (see Section M), NAV may represent the fair value of the investment in the investment fund. However, the following situations may indicate that NAV may not be representative of fair value:

- NAV is not dated as of the entity's measurement date;
- NAV is not calculated in a manner consistent with the fair value measurement principles of the Codification Topic;

- The investment cannot currently be redeemed at NAV (some open-ended funds may suspend redemptions); and
- There are other terms attached to the investment (e.g., a commitment to make future investments).

820-10-35-60, 35-62

It also may be important to consider the nature and reliability of the evidence that supports the calculation of NAV.

P30. If open-ended redeemable funds do not allow daily redemptions at NAV, is NAV representative of fair value?

It depends. If an open-ended redeemable fund does not allow daily redemptions at NAV, but allows, and actually has, periodic subscriptions and redemptions at NAV, their existence may provide evidence that NAV approximates fair value.

820-10-20

In our experience, NAV would usually be representative of the fair value of investments in open-ended investment funds that are open to new investors and allow redemptions at NAV. In such cases, it is not expected that a market participant would be willing to pay more than the NAV because it is possible to invest directly in the fund or to redeem the investment at NAV.

In addition, new subscriptions to a fund at its reported NAV on or near the entity's measurement date may provide evidence that market participants are currently not requiring a discount to NAV or paying a premium above NAV.

Similarly, redemptions from the fund at its reported NAV on or near the entity's measurement date may provide evidence that market participants are currently not demanding a premium over NAV or selling at a discount to NAV. If both subscriptions and redemptions have occurred at NAV near the entity's measurement date for its investment in the fund, evidence may exist that NAV approximates fair value.

820-10-35-54J(b)
[IFRS 13.B44(b)]

When determining whether NAV approximates fair value, the weight placed on the evidence provided by subscriptions and redemptions should consider:

- Market changes since the transaction activity occurred;
- The volume of both subscriptions and redemptions;
- The extent to which subscriptions were received from new investors; and
- Limitations or expected limitations on the entity's ability to redeem in the future.

However, if no subscriptions and redemptions have occurred close to the end of the reporting period, an assertion that fair value approximates NAV may be more difficult to support.

P40. Does the sale or purchase of an investment in the fund at a discount to NAV indicate that the transaction is not orderly?

820-10-35-54I – 35-54J
[IFRS 13.14]

It depends. When an entity carries its investment in a fund at fair value, it considers all of the inherent rights and obligations in measuring its fair value. This may result in a fair value measurement that differs from the NAV of the investment in the fund.

820-10-35-60
[IFRS 13.A, B43]

Therefore, the existence of a discount between the NAV reported by a fund and an entity's transaction price to sell or purchase the investment does not, in and of itself, result in the transaction being considered not orderly. For example, if the transaction occurred with adequate exposure to the market, with a customary marketing period, and did not occur under duress, it is likely that the transaction would be considered orderly.

For a discussion of inactive markets, see Section M.

P50. What does an entity consider in determining the level of the fair value hierarchy in which an investment in a fund should be categorized?

820-10-35-2E
[IFRS 13.14]

When the interest in the fund, not the underlying investments, is the unit of account, the characteristics of the interest in the fund, not the underlying investments, should be considered when determining its level in the fair value hierarchy. Therefore, the measurement of fair value takes into account the rights and obligations inherent in that ownership interest (e.g., an obligation by the entity to meet future cash calls made by the fund). The entity considers any such obligations inherent in the ownership interest in its measurement of fair value.

820-10-35-41C
[IFRS 13.77, 79]

The fair value measurement for an investment in a fund in which ownership interests in the fund are publicly traded in an active market should be based on the quoted price of the fund, a Level 1 input, if this price is available and accessible.

820-10-35-41C
[IFRS 13.A, 79]

The units in open-ended redeemable funds are often bought and sold but only by or to the fund or fund manager; the units are not traded on an exchange and cannot be sold to third parties. Because the fund is not listed, the fund calculates the price of the units only at a specific time each day to facilitate the daily subscriptions and redemptions of units. These transactions also may only take place at a specific time on each day and at the price determined by the fund manager. The fair value of the units may be the price calculated by the fund manager. Whether this is a Level 1 measurement will depend on whether the market is considered active and whether there were significant events that took place after the time of calculation on the measurement date.

820-10-20, 35-40
[IFRS 13.A, 76]

Daily pricing is likely to constitute evidence of an active market. If the number of trades occurring is sufficient for the market in these units to be considered an active market, notwithstanding that the units are being purchased and sold by the fund and are not being traded between unrelated third-party market participants, a fair value measurement of the units using the unadjusted daily price for the reporting date would be categorized as a Level 1 measurement. However, if there is a quoted price but the number of trades occurring is not sufficient for the market in these units to be considered active, a fair value measurement of the units using the unadjusted price for the reporting date would not be categorized as Level 1 in the fair value hierarchy.

820-10-35-54B – 35-54C
[IFRS 13.73, 75]

If NAV does not represent a quoted price, it may continue to be used as an appropriate input for fair value measurement purposes. The appropriate categorization of the resulting fair value measurement within the fair value hierarchy will be within Level 2 or Level 3 based on the observability and significance of:

- The fair values of the underlying investments; and
- Any adjustments for rights and obligations inherent within the ownership interest held by the entity, including the frequency with which an investor can redeem investments in the fund.

820-10-35-53
[IFRS 13.75]

Because many of the NAV adjustments mentioned above will be based on unobservable inputs, the resulting fair value measurements that are subject to such adjustments generally are Level 3 measurements unless those inputs are not significant to the measurement as a whole.

Q. Application Issues: Practical Expedient for Investments in Investment Companies

Overview

The Codification Topic allows an entity to use NAV as a practical expedient to estimate the fair value when:

- The investment does not have a readily determinable fair value; and
- The investment is in an investment company within the scope of the Investment Companies Codification Topic, or is an investment in a real estate fund for which it is industry practice to measure investment assets at fair value on a recurring basis and to issue financial statements that are consistent with the measurement principles of the Fair Value Measurement Codification Topic (as amended by ASU 2013-08).[14]

IFRS different from U.S. GAAP

Unlike U.S. GAAP, IFRS does not include an exception that allows the use NAV as a practical expedient. Under IFRS, an entity may only measure investments on the basis of NAV when NAV is representative of fair value (see Questions P20 and P30). Therefore, the questions in this section are only relevant to U.S. GAAP.

Q10. For the purpose of using NAV as a practical expedient, what is the definition of *readily determinable*?

ASC Master Glossary, 820-10-15-5

An equity security has a readily determinable fair value if it meets any of the following conditions:

(1) Sales prices or bid and ask quotations are currently available on a securities exchange registered with the SEC or in the OTC market, provided that those prices or quotations for the OTC market are publicly reported by the National Association of Securities Dealers Automated Quotations systems or by OTC Pink. Restricted stock meets that definition if the restriction terminates within one year.

For restrictions expiring after one year, the use of NAV as a practical expedient is prohibited if the investment would otherwise have a readily determinable fair value except for that restriction.

(2) For an equity security traded only in a foreign market, that foreign market is of a breadth and scope comparable to one of the U.S. markets referred to in (1).

14 The amendment is effective for interim and annual reporting periods in fiscal years that begin after December 15, 2013; early application is prohibited. The amendment is outside the scope of this publication.

(3) For a mutual fund, the fair value per share (unit) is determined and published and is the basis for current transactions.

Q20. What should an entity consider in determining whether NAV reported by the investee may be relied on?

Determining that reliance on the reported NAV as a practical expedient is appropriate requires professional judgment. All factors relevant to the value of equity investments for which market quotations are not readily available should be considered.

820-10-35-59

Before concluding that the reported NAV is calculated in a manner consistent with the measurement principles of the Investment Companies Codification Topic, the entity should consider whether the investee fund's policies and procedures for estimating fair value of underlying investments, and any changes to those policies or procedures, follow the guidelines of the Codification Topic.

If the last reported NAV is not as of the entity's measurement date, see the general discussion in Questions G130 to G150.

820-10-35-59 – 35-62

When the entity invests in a fund-of-funds (i.e., the investee fund invests in other funds) that does not have readily determinable fair values, the entity might conclude that the NAV reported by the fund-of-funds manager is calculated in a manner consistent with the Investment Companies Codification Topic. This conclusion can be made by assessing whether the fund-of-funds manager has a process that considers the previously listed items in the calculation of the NAV reported by the fund-of-funds, and considering whether the fund-of-funds manager has obtained or estimated NAV from underlying fund managers in a manner consistent with the Codification Topic as of the measurement date.

Q30. Can the practical expedient be used when NAV is reported on a tax or cost basis?

820-10-35-59

No. Funds that use the tax or cost basis of reporting NAV would not satisfy the criteria to qualify for the practical expedient. Therefore, the use of an NAV would require an adjustment for non-GAAP measures.

Q40. Is the use of NAV to estimate fair value *required* when the criteria are met?

820-10-15-4 –15-5, 35-59

No. The practical expedient is not a required measurement technique. It is an optional alternative to measuring fair value for those investments that meet specified conditions. An entity decides on an investment-by-investment basis whether to apply the practical expedient. The practical expedient would be applied to the fair value measurement of the entity's entire position in a particular investment unless it is probable (see Question Q50) as of the measurement date that a portion of the investment will be sold at an amount other than NAV in a secondary market.

820-10-35

The Codification Topic does not address the circumstances and how often an entity can change between the practical expedient and fair value, once the measurement method is selected. In our view, it should be applied consistently for all periods in which the investment is held. However, if subsequent to management's election to apply the practical expedient to a particular investment, management determines that the investment, or a portion of the investment, is probable of being sold at an amount other than NAV, the practical expedient can no longer be applied to that investment (see Questions Q50 and Q60).

Q50. When is a sale for an amount other than NAV in a secondary market transaction considered *probable*?

820-10-35-62

A secondary market transaction includes all transactions in the normal course of business that could result in the sale of the interest (e.g., principal-to-principal transactions between private market participants). A sale for an amount other than NAV in a secondary market transaction is considered probable if all of the following conditions are present as of the entity's measurement date:

- Management commits to a plan to sell the investment and has the authority to approve the action;
- An active program to locate a buyer and other actions required to complete the plan to sell the investment have been initiated;
- The investment is available for immediate sale subject only to terms that are usual and customary for sales of such investments (e.g., a requirement to obtain the investee's approval of the sale); and
- Actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

360-10-45-9, 820-10-35-62

These criteria are similar to those used in assessing if long-lived assets are held for sale under the Property, Plant and Equipment Codification Topic, except there is no requirement to consider whether the sale will occur within a stated period or assess the reasonableness of the sales price compared to its fair value. Although the criteria under the Property, Plant and Equipment Codification Topic are not listed as conditions in the Fair Value Measurement Codification Topic, they may provide some evidence about whether the sale is probable by determining if significant changes to the plan to sell will be made or possibly withdrawn.

In our experience, the greater the current market sales price over the current estimated fair value or the greater the time period estimated to dispose of the investment, the greater the likelihood of significant changes to the plan or withdrawal of the plan. If these indicators exist, the investment may not meet the conditions of probable of being sold.

Q60. When a portion of an entity's investment is probable of being sold, how is the practical expedient applied?

820-10-35-61

When a portion of an investment is probable of being sold, the practical expedient may continue to be applied to the portion that is not probable of being sold. The portion to be sold is measured at fair value under the Codification Topic. As a result, the entity may have two different measurements for investments in the same investee.

In our view, for a group of investments that meet the criteria of probable-of-being-sold (see Question Q50), except that the individual investments in a group have not been identified (e.g., if an entity decides to sell 20% of its entire private equity portfolio and the probable-of-being-sold criteria would be met if the individual investments were identified), the practical expedient can continue to be used to the entire portfolio until the individual investments are identified and the individual investments meet the probable-of-being-sold criteria. However, when the individual investments have been identified, the entity must measure the fair value of the investments under the Codification Topic, excluding the NAV as a practical expedient.

Q70. If some of an entity's shares in a fund can be redeemed at NAV but others are locked up for an extended period of time, how should the shares be categorized in the fair value hierarchy when applying the practical expedient?

When the unit of account is a share of the fund instead of the entire interest in the fund, it may be appropriate to disclose the shares that are locked up in a level of the fair value hierarchy different from those shares that are not locked up.

Q80. Can an entity adjust the NAV reported by the investee?

820-10-35-59 – 35-60

It depends. The Codification Topic addresses two instances in which an adjustment to the NAV reported by the investee may be appropriate:

- When the investee's reporting date for NAV is different from the entity's reporting date; and
- When the NAV reported by the investee was not calculated in a manner consistent with the measurement principles of the Investment Companies Codification Topic.

Reported NAV is as of a Date Different from the Entity's Financial Reporting Date

820-10-35-60

An entity may use the practical expedient based on the latest NAV reported by the investee, adjusted for significant market events that have occurred between the date the investee last calculated NAV and the entity's reporting date. The nature of the investments held by the investee, the period of time from the last calculated NAV, and changes in both the broad economy and the market for similar investments will determine the extent of the entity's potential adjustments. In some cases, the entity may need to involve the management of the investee to determine possible changes in the NAV that have occurred since the investee's last NAV reporting date.

For example, funds investing in real estate may go longer than other funds without remeasuring fair value, but these investments typically will have less volatility in fair values over short periods of time. Therefore, significant adjustments may not be necessary unless specific events have occurred. In contrast, investees that hold significant underlying investments in debt and equity securities may experience substantial changes in market prices during short periods of time. The information needed to determine the adjustments may be obtained from market prices for those significant underlying investment positions held by the investee as of the entity's measurement date as well as analysis of market trends and changes in relevant indices.

Reported NAV Not Calculated in a Manner Consistent with Measurement Principles of ASC Topic 946

820-10-15-4 – 15-5, 35-60

If the entity has met the conditions to use the practical expedient under the Codification Topic, but the investee's reported NAV is not calculated consistent with the Investment Companies Codification Topic, the entity is required to adjust for all significant differences between the NAV calculated and reported by the investee and the NAV that would be calculated in accordance with the Investment Companies Codification Topic. Examples of possible adjustments to be recorded as of the reporting date may include:

- Recording investments at fair value;
- Changes in security positions on a trade-date basis;
- Reflecting shares outstanding due to sales and repurchases;
- Recognizing expenses, interest, and other income; and
- Other adjustments to reflect the financial statements on the accrual basis of accounting.

To calculate and apply the appropriate adjustments to the investee's reported NAV, the entity needs an understanding of the investee's significant accounting policies and must have sufficient information to conform those policies to the Investment Companies Codification Topic.

The entity also should consider the effect of the adjustments on its proportionate share of NAV to ensure the adjustments are appropriately applied to its investment interest. For example, if the entity's interest in a fund is part of a waterfall structure, the entity should determine that any necessary adjustments to the underlying assets to conform their measurements to the Investment Companies Codification Topic are appropriately considered in light of the waterfall rights and obligations.

Q90. What is the unit of account for investments in investment companies when the entity applies the practical expedient?

820-10-35-59

The unit of account is the share or its equivalent of the investee entity. An entity should not look-through to the investment assets and liabilities held by the investee entity to assess the categorization of the investment in the fair value hierarchy. Examples of share equivalents include members' units or partnership interest to which net assets can be proportionately allocated. The NAV per share multiplied by the number of shares represents the extended value of the investment.

In practice, NAV per share may not be specifically reported by an investee that otherwise meets the criteria (including reporting investments on a fair value basis) for the entity to elect the practical expedient. In our view, these cases do not preclude the entity from electing the practical expedient. The entity can calculate the NAV per share (essentially arriving at P in a PxQ relationship) using financial information reported by the investee.

Q100. How should an entity applying the practical expedient account for a purchase for an amount that is different from its currently reported NAV?

Topic 946

If the purchase price is different from NAV, an entity should evaluate whether the recorded NAV is consistent with the measurement principles in the Investment Companies Codification Topic. If it is, the entity should recognize the difference resulting from purchases at a discount or premium to NAV as an unrealized gain or loss in the period in which the investment is purchased.

Q110. How should investments to which the practical expedient is applied be categorized within the fair value hierarchy?

820-10-35-54B

The Codification Topic generally requires an entity to consider the redemption attributes of the investment in determining categorization in the fair value hierarchy. If the entity can redeem its investment on the measurement date at NAV without any type of restriction, the investment could be categorized within Level 1 or Level 2 of the hierarchy, depending on the nature and frequency of redemptions and subscriptions.

The Codification Topic does not address Level 1, but consistent with the guidance in Question P50 for redeemable funds in which there is not a readily determinable fair value but there are sufficient daily sales and redemptions of fund interests, Level 1 categorization may still be appropriate.

820-10-35-54B(c)

Investments in non-redeemable funds generally are categorized within Level 3 of the fair value hierarchy. If the investment is not redeemable with the investee on the measurement date due to the imposition of a gate or other contractual limitation (not including redemption notices discussed below), but will be redeemable at a future date, that timeframe is considered in determining categorization within Level 2 or Level 3. Generally, the longer the period until the investment is redeemable, the greater the likelihood the investment is categorized within Level 3.

Many investments require redemption notices to be prepared and provided to the fund manager for a period of time prior to the date of a requested redemption. Many funds require a 30-day notice, others a 60- or 90-day notice, and a few require six months or longer. Even though a redemption notice may not have been submitted on the measurement date, as long as the entity has the ability (both contractually and practically) to redeem the investment at NAV in the near term, the investment may be categorized within Level 2.

820-10-35-54B(c), TIS Section 2220.25

A redemption period of 90 days or less generally would be considered near term because any potential discount relative to the time value of money at the next redemption date would be unlikely to be considered a significant unobservable input.[15] Redemption at the reporting date also considers the notification requirement and the entity's ability to meet the requirement on redemption. The shorter the redemption notification period required to be provided (e.g., 30 days), the more

15 AICPA Technical Questions and Answers Section 2220.25, Long-Term Investment—Impact of "Near-Term" on Classification Within Fair Value Hierarchy.

likely the investment could be categorized within Level 2. When long redemption notification periods are required to be provided (e.g., six months), the investment generally should be categorized within Level 3.

Example Q110: Redemption Date

Company Q invests in a fund. The reporting date for both Company Q and the investee is December 31. The next redemption date is January 31, and there is a 30-day notice period (assuming no other redemption restrictions). The investment generally would be categorized within Level 2 of the fair value hierarchy.

Changing the example, assume that there is an annual redemption date of September 30, the investment generally would be categorized within Level 3 of the fair value hierarchy. Also, if a redemption restriction had been imposed and the date that the restriction will be lifted is unknown, the investment would be categorized within Level 3.

Q120. What disclosures are required when NAV is used as a practical expedient?

820-10-15-4-6A, 35-59

In addition to the disclosures required for fair value measurements (see Section N), further disclosures are required when NAV is used as a practical expedient. These disclosures are intended to inform the users of the nature and the risks of all investments that calculate NAV per share (or its equivalent).

320-10-50-1B

The disclosures include the significant investment strategies of the investees, information about redemption conditions, and the entity's unfunded commitments related to the investments.

820-10-50-6A

Because the practical expedient of using NAV is not the same as fair value, the carrying amounts of investments measured using the practical expedient should be described in the financial statement disclosures as being reported at NAV under the practical expedient for fair value.

820-10-50-2(bbb)

However, if the criteria for using NAV as a practical expedient are met and no adjustments have been made to the fair value measurement as of the reporting date, no disclosures are required other than those discussed in Question N20:

- the quantitative information about significant unobservable inputs; and
- information about the sensitivity of the fair value measurement to changes in significant unobservable inputs.

Appendix I: Index of Questions and Answers

Appendix II: Table of Concordance[16]

Previously Issued Guidance		This Publication	
Question	**Number**	**Number**	**Question**
Does ASC Topic 820 apply to the financial statements of defined benefit plans accounted for under ASC Topic 960, *Plan Accounting—Defined Benefit Pension Plans*?	A1	B60	Does the Codification Topic apply to the financial statements of an employee benefit plan?
Is market value as used in a lower of cost or market (LOCOM) measurement of inventory in ASC Topic 330, *Inventory*, different from fair value as defined in ASC Topic 820?	A2	B20	Does the Codification Topic apply to measurements that are similar to but not the same as fair value?
Are the fair value concepts under ASC Topic 820 applicable for the measurement of a hedged item in a fair value hedge under ASC Topic 815, *Derivatives and Hedging*?	A3	B70	Do the fair value concepts apply when measuring the change in the carrying amount of the hedged item in a fair value hedge?
How should an entity determine the appropriate unit to be used when measuring the fair value of an asset or liability?	B1	C10	How should an entity determine the appropriate unit of account (unit of valuation) when measuring fair value?
This question should be read in conjunction with Question B1. Does the in-use valuation premise apply to the valuation of financial assets?	B2	–	[Not used]
If quoted prices in an active market (i.e., Level 1 in the fair value hierarchy) are available and readily accessible, is it permissible for an entity to use a lower level input as a starting point for determining the measurement of fair value for an asset or liability?	B3	G10	If quoted prices in an active market are available and readily accessible, is it permissible for an entity to use a lower level input as a starting point for measuring fair value?
Can a blockage factor be considered when measuring the fair value of an asset or liability (including positions comprising a large number of identical assets or liabilities, such as financial instruments)?	B4	G30	Can a blockage factor be considered in measuring fair value?

16 New questions are not included in this table of concordance.

Previously Issued Guidance		This Publication	
Question	**Number**	**Number**	**Question**
When a Level 1 input is not available for a single asset or liability (including positions comprising a large number of identical assets or liabilities such as a portfolio of financial instruments), can certain premiums or discounts (other than blockage factors) be considered when measuring its fair value?	B5	G40	When a Level 1 input is not available for a single asset or liability, should certain premiums or discounts (other than blockage factors) be considered in measuring fair value?
		G50	How is a liquidity adjustment determined?
The definition of Level 1 inputs and the description of Level 2 inputs discuss the concept of an active market. What is considered an active market?	B6	M10	What is considered an active market?
How does a decrease in volume or level of activity for an asset or liability affect how its fair value is measured?	B7	M20	How does a decrease in volume or level of activity affect how fair value is measured?
What are the characteristics of an orderly transaction? What are the characteristics of a transaction that is forced or not orderly?	B8	M30	What are the characteristics of a transaction that is forced or not orderly?
How extensive is the analysis expected to be to determine whether a transaction is orderly or not orderly?	B9	M40	How extensive is the analysis expected to be to determine whether a transaction is orderly?
In instances when an entity determined that a transaction is either orderly or not orderly, or there is insufficient information to conclude whether or not the transaction was orderly, how is the price of that transaction used in measuring the fair value of a similar or identical asset?	B10	G80	How is the fair value measurement of an asset or liability affected by the transaction price for similar or identical assets or liabilities?
If the entity is unwilling to transact at a price provided by an external source (such as a quoted market price), is that a sufficient reason for disregarding that price in determining fair value?	B11	D40	If the entity is unwilling to transact at a price provided by an external source, can that price be disregarded?

Previously Issued Guidance		This Publication	
Question	**Number**	**Number**	**Question**
When measuring the fair value of a financial instrument, how should an entity consider the existence of an arrangement that mitigates credit-risk exposure in the event of default (e.g., an ISDA Master Netting Agreement (MNA)) with the counterparty or an agreement that requires the exchange of collateral on the basis of each party's net exposure to the credit risk of the other party?	B12	C70	In measuring the fair value of a financial instrument, how should an entity consider the existence of an arrangement that mitigates credit-risk exposure in the event of default?
		L80	In applying the exception, how should an entity consider the existence of an arrangement that mitigates credit-risk exposure in the event of default?
Does an instrument's requirement to post collateral affect the resulting fair value measurement of the instrument?	B13	C80	Does a requirement to post collateral affect the fair value measurement of the underlying instrument?
When measuring fair value for assets and liabilities that are traded on an exchange (e.g., equity securities, corporate debt) at the end of a reporting period, what time of the day should the security be priced to determine fair value on the measurement date?	B14	G130	In measuring the fair value of exchange-traded securities, at what time of the day should the security be priced?
When may a quoted price in an active market not be representative of fair value at the measurement date?	B15	G140	When might a quoted price in an active market not be representative of fair value at the measurement date?
How may an entity determine the adjustment amount to a quoted price in an active market when this price is not representative of fair value at the measurement date?	B16	G150	How might an entity determine the necessary adjustment when the quoted price is not representative of fair value at the measurement date?
The ASU clarifies that a principal market is, "The market with the greatest volume and level of activity for the asset or liability" and "the reporting entity must have access to the principal (or most advantageous) market at the measurement date." Does the clarification of the principal market guidance affect the assessment of effectiveness or measurement of ineffectiveness for hedging relationships under ASC Topic 815, *Derivatives and Hedging*?	B17	O60	Does the principal market guidance affect the assessment of effectiveness or the measurement of ineffectiveness for hedging relationships?

Previously Issued Guidance		This Publication	
Question	**Number**	**Number**	**Question**
When is it appropriate for an entity to measure the fair value of a group of financial assets and financial liabilities on a net portfolio basis?	B18	L10	When is it appropriate for an entity to measure the fair value of a group of financial assets and financial liabilities on a net portfolio basis?
		L20	When the portfolio measurement exception is applied, how does this affect the unit of account?
When considering whether a portfolio measurement exception applies for a group of financial assets and financial liabilities for a particular market risk or counterparty credit risk, what degree of offsetting risk is necessary to qualify for the exception?	B19	L30	When considering whether the exception applies for a group of financial assets and financial liabilities, what degree of risk offsetting is necessary?
What factors need to be considered when determining whether a particular market risk or counterparty credit risk within the group could be offset when measuring fair value on a net portfolio basis?	B20	L40	What factors need to be considered when determining whether a particular market risk within the group of financial assets and financial liabilities could be offset when measuring fair value on a net portfolio basis?
Does the exception that permits the measurement at fair value of a group of financial assets and financial liabilities with offsetting positions on a net portfolio basis also apply to financial statement presentation?	B21	L50	Does the portfolio measurement exception also apply to financial statement presentation?
How is a net portfolio basis adjustment resulting from the application of the measurement exception allocated for presentation and disclosure purposes to the individual financial assets and financial liabilities that make up the portfolio?	B22	L60	How is a net portfolio basis adjustment resulting from the application of the exception allocated to the individual financial assets and financial liabilities that make up the portfolio?
Are net portfolio basis adjustments that have been allocated to the individual financial assets and financial liabilities in the portfolio considered when determining the level of the fair value measurement fair value hierarchy for disclosures?	B23	L70	Are net portfolio basis adjustments that have been allocated to the individual financial assets and financial liabilities in the portfolio considered when determining the categorization in the fair value hierarchy for disclosure purposes?
How do the requirements to include counterparty credit risk and an entity's own nonperformance risk in the determination of fair value affect the valuation of derivative instruments?	B24	O20	How do the requirements to include counterparty credit risk and an entity's own nonperformance risk affect the fair value measurement of derivative instruments?

Previously Issued Guidance		This Publication	
Question	**Number**	**Number**	**Question**
How does the requirement to include counterparty credit risk and an entity's own nonperformance risk in the valuation of derivative instruments affect hedging relationships?	B25	O70	Do the requirements to include counterparty credit risk and an entity's own nonperformance risk in measuring the fair values of derivative instruments affect hedging relationships?
Under ASC Subtopic 946-10, *Financial Services—Investment Companies – Overall*, investment companies do not consolidate controlling interests in entities held for investment purposes. Instead, those investments are carried at fair value. When an investment company holds a controlling interest in an entity, should it include a control premium in its measurement of fair value of the underlying equity instruments?	B26	G60	When an investment company holds a controlling interest in an entity, should it include a control premium in its measurement of fair value?
Many entities routinely invest excess cash in short-term investments that meet the definition of a security in ASC Subtopic 320-10, *Investments—Debt and Equity Securities – Overall*. These investments also sometimes meet the definition of a cash equivalent. Are cash equivalents that meet the definition of a security in ASC Subtopic 320-10 subject to the measurement and disclosure guidance of ASC Topic 820?	B27	B30	Are cash equivalents that meet the definition of a security within the scope of the Codification Topic?
How are the concepts of *principal* and *most advantageous* markets different?	C1	–	[Not used]
If an entity determines that a principal market exists for the asset or liability, can the entity disregard the price in the principal market and instead use the price from the most advantageous market?	C2	E10	If an entity identifies a principal market for the asset or liability, can it disregard the price in that market and instead use the price from the most advantageous market?
How should an entity determine the principal market for an asset or a liability? How frequently should an entity re-evaluate its determination of whether a principal market exists for an asset or liability?	C3	E20	How should an entity determine the principal market, and how frequently should it re-evaluate its determination?
Can an entity have multiple principal or most advantageous markets for identical assets and liabilities within its consolidated operations?	C4	E30	Can an entity have multiple principal or most advantageous markets for identical assets and liabilities within its consolidated operations?

Previously Issued Guidance		This Publication	
Question	**Number**	**Number**	**Question**
An entity sells its loans to market participants that securitize these loans. In measuring the fair value of its loans, can an entity consider the market for securities issued by these market participants (securitization market) as the entity's principal market?	C5	E70	If an entity sells its loans to market participants that securitize them, can the market for securities issued by these market participants (securitization market) be the principal market?
When measuring the fair value of loans, can an entity consider the anticipated transaction price for the securities that would be issued by a market participant that securitizes the loans (securitization price)?	C6	G90	In measuring the fair value of loans, can an entity consider the current transaction price for the securities that would be issued by a market participant that securitizes the loans?
Should transaction costs be included in the fair value measurement of an asset or liability?	C7	E40	How are transaction costs and transportation costs treated in identifying the principal or most advantageous market and in measuring fair value?
Are transaction and transportation costs considered when determining the most advantageous market?	C8		
Under ASC Topic 946, *Financial Services, Investment Companies*, transaction costs (e.g., commissions and other charges that are part of securities purchase transactions) are included in the cost basis of investments to determine both realized and unrealized gains and losses. However, ASC Topic 820 states that transaction costs are not an attribute of the asset or liability and should be accounted for under other applicable standards. How should investment companies that are within the scope of ASC Topic 946 account for transaction costs?	C9	E80	How do transaction costs affect the initial measurement of a financial asset or financial liability?
For entities that are not within the scope of ASC Topic 946, how should transaction costs incurred for the purchase of debt and marketable equity securities be accounted for under ASC Topic 320, *Accounting for Certain Investments in Debt and Equity Securities Investments—Debt and Equity Securities*?	C10	–	[Not used]
How should an entity identify market participants, and how should it identify the characteristics of an appropriate group of market participants for fair value measurement?	D1	D10	Does an entity need to specifically identify market participants?
		D20	Can a market participant be a related party?

Previously Issued Guidance		This Publication	
Question	**Number**	**Number**	**Question**
How should an entity determine what assumptions a market participant would make in measuring the fair value of the asset or liability?	D2	D30	How should an entity determine what assumptions a market participant would make in measuring fair value?
		G20	If Level 1 inputs are not available, does that change the objective of the fair value measurement?
		D50	How should an entity adjust the fair value measurement for risk inherent in the asset or liability?
For derivative instruments that are recognized as assets on the financial reporting date, what should an entity consider when determining the fair value to be reported in the financial statements?	E1	O10	For derivative instruments that are recognized as liabilities, what should an entity consider in measuring fair value?
What items should an entity consider when measuring the fair value of an investment in an investment fund (including a fund-of-funds) when the practical expedient in U.S. GAAP (see Question E6) is not applied?	E2	P10	What items should an entity consider in measuring the fair value of an investment in an investment fund?
For an entity that reports and measures its investments in funds at fair value, does the sale or purchase of an investment in the fund at a discount to NAV indicate the transaction is not orderly?	E3	P40	Does the sale or purchase of an investment in the fund at a discount to NAV indicate that the transaction is not orderly?
In instances where open-ended redeemable funds do not allow daily redemptions at NAV, but instead allow periodic subscriptions and redemptions at NAV on prescribed dates, would NAV be representative of fair value?	E4	P20	When is the NAV of an investment fund representative of fair value?
		P30	If open-ended redeemable funds do not allow daily redemptions at NAV, is NAV representative of fair value?
What are the considerations for determining in which level of the fair value hierarchy an investment in a fund (or fund-of-funds) should be classified?	E5	P50	What does an entity consider in determining the level of the fair value hierarchy in which an investment in a fund should be categorized?
What are the criteria for using net asset value (NAV), or its equivalent, as a practical expedient to estimating the fair value of an investment?	E6	Q30	Can the practical expedient be used when NAV is reported on a tax or cost basis?

Previously Issued Guidance		This Publication	
Question	**Number**	**Number**	**Question**
What is the definition of readily determinable fair value for an equity security?	E7	Q10	For the purpose of using NAV as a practical expedient, what is the definition of *readily determinable*?
What should an entity consider when determining if NAV reported by the investee may be relied upon?	E8	Q20	What should an entity consider in determining whether NAV reported by the investee may be relied on?
Is the use of NAV to estimate fair value required for those investments that meet the conditions for use of the practical expedient? Can the election to apply the practical expedient be made to a portion of an investment in a particular fund or must it be made to the entire investment?	E9	Q60	When a portion of an entity's investment is probable of being sold, how is the practical expedient applied?
Can an entity adjust the NAV reported by the investee?	E10	Q80	Can an entity adjust the NAV reported by the investee?
ASC paragraph 820-10-35-62 prohibits the use of the practical expedient if it is probable as of the reporting date that an investment, or a portion of an investment, will be sold for an amount other than NAV, for example, in a secondary market transaction. A secondary market transaction includes all transactions in the normal course of business that could result in the sale of the interest (e.g., principal to principal transactions between private market participants). The entity would instead be required to measure the fair value of the investment in accordance with ASC Topic 820, exclusive of NAV as a practical expedient in ASC Section 820-10-35. When is a sale for an amount other than NAV in a secondary market transaction considered probable?	E11	Q50	When is a sale for an amount other than NAV in a secondary market transaction considered *probable*?
		Q60	When a portion of an entity's investment is probable of being sold, how is the practical expedient applied?
If an entity has elected to report and recognize its investments in funds at NAV under ASC Topic 820, how should it account for a purchase for an amount that is different than its currently reported NAV?	E12	Q100	How should an entity applying the practical expedient account for a purchase for an amount that is different from its currently reported NAV?

Previously Issued Guidance		This Publication	
Question	**Number**	**Number**	**Question**
If an entity applies the practical expedient in ASC paragraph 820-10-35-59 to its investments in funds, how should its investments be categorized within the fair value hierarchy disclosures?	E13	Q110	How should investments to which the practical expedient is applied be categorized within the fair value hierarchy?
If an entity has elected, or is required to measure its liabilities at fair value, is it required to consider its own risk of nonperformance in its measurement of fair value?	F1	K30	Does an entity consider its own risk of nonperformance in measuring the fair value of its liabilities?
How should an entity measure the fair value of a liability?	F2	K20	How should an entity measure the fair value of a liability or own equity instrument?
		K50	How should a restriction on transfer be taken into account in measuring the fair value of a liability or own equity instrument?
		K60	Should an inseparable third-party credit enhancement be included in the fair value measurement of a liability?
		K70	What is the fair value of a liability payable on demand?
For derivative instruments that are recognized as liabilities on the financial reporting date, what should an entity consider when determining the fair value to be reported in the financial statements?	F3	O10	For derivative instruments that are recognized as liabilities, what should an entity consider in measuring fair value?
ASC paragraph 820-10-35-17 (IFRS 13.42) states "the fair value of a liability reflects the effect of nonperformance risk. Nonperformance risk includes, but may not be limited to, an entity's own credit risk." What other factors (other than the entity's own credit risk) should be considered when determining nonperformance risk?	F4	K40	Other than the entity's own credit risk, what factors are considered in determining nonperformance risk?

Previously Issued Guidance		This Publication	
Question	**Number**	**Number**	**Question**
ASC Topic 820 defines fair value as "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." Therefore, the fair value of a liability is based on a transfer notion. How does a fair value measurement of a liability based on a transfer notion differ from a valuation based on a settlement notion?	F5	K10	How does a fair value measurement based on a transfer notion differ from a valuation based on a settlement notion?
How should an entity measure the fair value of instruments classified in shareholders' equity (its own equity instruments)?	G1	K20	How should an entity measure the fair value of a liability or own equity instrument?
Can there be a difference between the transaction price paid to acquire an asset (or received to assume a liability) and the fair value of the asset or liability at initial recognition?	H1	I10	Can there be a difference between the transaction price and fair value at initial recognition?
		I20	Is an entity required to recognize a day one gain or loss if the transaction price differs from the fair value measurement at initial recognition?
Can an entity recognize the difference between the transaction price and its own fair value measurement for a hybrid instrument if it has access to a market for the components of the hybrid that would result in a more advantageous measurement of the entire hybrid instrument? [1]	H2	I30	Can there be a day one difference for a hybrid instrument if the entity has access to a market for the components of the hybrid that would result in a more advantageous measurement of the entire hybrid instrument?
If, based on the principles of ASC Topic 820, *Fair Value Measurement*, a dealer has a day one gain or loss upon initial recognition of a derivative instrument, does the converse apply to the retail purchaser of that derivative instrument? Specifically, can a retail user of derivatives have a day one gain or loss attributable to the difference between the entry price and the exit price for the derivative?	H3	O40	For a derivative contract between a dealer and a retailer, if the dealer has a day one difference, does the retailer have the same difference?
How does a day one gain or loss due to a bid-ask spread under ASC Topic 820 affect hedging relationships under ASC Topic 815, *Derivatives and Hedging?*	H4	O50	How does a day one gain or loss due to a bid-ask spread affect hedging relationships?

Previously Issued Guidance		**This Publication**	
Question	**Number**	**Number**	**Question**
How do restrictions on the sale or transfer of a security affect its fair value measurement by the holder of the instrument?	I1	C30	Do restrictions on the sale or transfer of a security affect its fair value?
		C40	What are some common restrictions on the sale or transfer of a security?
SEC Rule 144 allows public resale of certain restricted or control securities if certain conditions are met. During the period before the restrictions lapse, should the fair value measurement of securities reflect the restrictions?	I2	C50	SEC Rule 144 allows the public resale of certain restricted or control securities if certain conditions are met. During the period before the restrictions lapse, should the fair value measurement reflect such restrictions?
ASC Topic 820, *Fair Value Measurement*, states that in some instances more than one valuation technique in one or more of the three approaches to value (market approach, income approach, and cost approach) may be required to develop the measurement of fair value. In these instances, what factors should an entity consider when weighting the indications of fair value produced by the different techniques?	J1	F20	When more than one valuation technique is used, what factors should an entity consider in weighting the indications of fair value produced by the different techniques?
Was Concepts Statement 7 amended to reflect certain clarifications made by ASC Topic 820 with respect to the definition of fair value?	J2	–	[Not used]
If an entity uses a pricing service to obtain inputs to its fair value measurements, what is management's responsibility for evaluating the appropriateness of those inputs?	J3	G160	If an entity uses a pricing service to obtain inputs to a fair value measurement, what is management's responsibility for evaluating the appropriateness of those inputs?
If an entity has adopted a pricing convention (e.g., mid-market pricing) but evidence exists that the price under the convention is not a price within the bid-ask spread that is representative of fair value, must the entity adjust its valuation?	K1	G110	If an entity has adopted a convention for prices subject to a bid-ask spread but evidence exists that the price under the convention is not representative of fair value, should the entity adjust its valuation?
ASC paragraph 820-10-35-41C(a) (IFRS 13.79(a)) provides an exception to the requirement to use Level 1 inputs. What criteria must be met to qualify for this exception?	L1	H30	When an entity uses the practical expedient in G70 to deviate from a Level 1 input, how is the resulting fair value measurement categorized in the hierarchy?
		G70	What criteria must be met to qualify for the practical expedient not to use Level 1 inputs?

Previously Issued Guidance		This Publication	
Question	**Number**	**Number**	**Question**
How would an adjustment for information occurring after the close of the entity's principal or most advantageous market affect determining the fair value hierarchy level and an entity's ability to make other adjustments to measure the fair value on the measurement date?	L2	H80	How does an adjustment for information occurring after the close of the market affect the categorization of the measurement in the hierarchy and an entity's ability to make other adjustments?
How should the fair value of a reporting unit be measured if an entity owns a 60 percent controlling interest of an investment and the remaining noncontrolling interest shares are publicly traded?	L3	G100	How should the fair value of a reporting unit that is a subsidiary be measured if the entity owns a 60% controlling interest and the remaining noncontrolling interest shares are publicly traded?
ASC Topic 820, *Fair Value Measurement*, states that when a fair value measurement is developed using inputs from multiple levels of the fair value hierarchy, the level in which the fair value measurement in its entirety falls is determined based on the lowest level input that is deemed significant to the fair value measurement in its entirety. How should an entity determine significance of the input for classifying a fair value measurement within the hierarchy?	L4	H20	If fair value is measured using inputs from multiple levels of the hierarchy, how should an entity determine the significance of an input for categorizing the fair value measurement within the hierarchy?
If an entity obtains prices from a third-party pricing service to use in its fair value measurement of an asset or liability (e.g., a debt instrument held as an investment), how should the entity categorize the resulting fair value measurement in the fair value hierarchy?	L5	H90	If an entity obtains prices from a third-party pricing service to use in its fair value measurement of an asset or liability, how should it categorize the resulting fair value measurement in the hierarchy?
When prices derived from consensus valuations are used for measuring fair value, where in the fair value hierarchy does the resulting measurement of fair value fall?	L6	H100	When prices derived from consensus valuations are used for measuring fair value, where in the hierarchy does the resulting measurement fall?
For assets or liabilities that have maturities longer than instruments for which market pricing information is available, could the fair value measurements be classified as Level 1 in the fair value hierarchy disclosures?	L7	H60	For assets or liabilities that have maturities longer than instruments for which market pricing information is available, how should the fair value measurement be categorized?

Previously Issued Guidance		This Publication	
Question	**Number**	**Number**	**Question**
At what level in the fair value hierarchy should an entity classify a fair value measurement of an investment in a privately held company for fair value hierarchy disclosures?	L8	H50	At what level in the hierarchy should an entity categorize a fair value measurement of an equity investment in a privately held company?
An entity-derived input can be considered a Level 2 input when used to measure fair value only if the entity corroborates it with market information. How should an entity determine whether inputs are correlated to observable market data?	L9	H70	How should an entity determine whether entity-derived inputs are corroborated by correlation to observable market data for the purpose of determining if they are Level 2 inputs?
Does the measurement guidance in ASC Topic 820 apply to disclosure-only standards?	M1	N60	Does the guidance on how to measure fair value apply to assets and liabilities that are not measured at fair value but for which fair value is disclosed?
What ASC Topic 820 disclosures apply when disclosing the fair value of loan receivables that are not part of a homogeneous category of loans?	M2	N70	Is there a disclosure-related practical expedient for measuring the fair value of loan receivables that are not part of a homogeneous category of loans?
What is the difference between recurring and nonrecurring fair value measurements?	M3	N10	What is the difference between recurring and nonrecurring fair value measurements?
		N40	Which fair values should be disclosed if the measurement of a nonrecurring item occurs at a date that is different from the reporting date?
What disclosures are required by the ASU for recurring and nonrecurring fair value measurements?	M4	N20	What disclosures are required?
ASC paragraphs 820-10-50-2(c) and 2(d) (IFRS 13.93(e) and 93(f)) require disclosure for recurring Level 3 fair value measurements of the total gains or losses for the period recognized in earnings (or changes in net assets) and gains or losses recognized in other comprehensive income. Additionally, disclosure must be made for the total gains or losses attributable to the change in unrealized gains and losses relating to those assets and liabilities held at the end of the reporting period. How should this change in unrealized gains or losses be calculated?	M5	N80	For the purpose of disclosures about recurring Level 3 measurements, how should an entity calculate the amount attributable to the change in unrealized gains or losses that is recognized as part of the total gains or losses for the period?

Previously Issued Guidance		This Publication	
Question	**Number**	**Number**	**Question**
At what value should transfers into or out of the levels of the fair value hierarchy be presented for disclosures required by ASC paragraphs 820-10-50-2(bb) and 2(c)(3) (IFRS 13.93))?	M6	N50	At what value should transfers into or out of the levels of the fair value hierarchy be presented?
Does the guidance in ASC Topic 820 apply to a sponsor's accounting for retirement plan assets under ASC Subtopic 715-30, *Compensation—Retirement Plans – Defined Benefit Plans – Pension*, and ASC Subtopic 715-60, Compensation—Retirement Plans – Defined Benefit Plans—Other Postretirement? How does ASC Topic 820 affect the disclosures required by ASC Subtopic 715-20, Compensation—Retirement Plans – Defined Benefit Plans—General?	M7	B50	In a plan sponsor's financial statements, does the Codification Topic apply to pension plan assets measured at fair value?
Do the fair value disclosures for deposit liabilities required under ASC Subtopic 825-10, *Financial Instruments – Overall*, change as a result of the implementation of the ASU?	M8	–	[Not used]
Are the disclosures of certain assets and liabilities at fair value required under ASC Subtopic 825-10 required to be included in the fair value hierarchy disclosures of ASC Topic 820?	M9	N20	What disclosures are required?
For financial instruments accounted for at fair value under standards other than ASC Subtopic 825-10 how should an entity determine what amount should be recorded in the income statement as interest income and what should be trading gains or losses. Could an entity use the approach described in ASC Subtopic 325-40, *Investments—Other – Beneficial Interests in Securitized Financial Assets*, to record the expected interest income in interest and the remaining adjustments in trading gains or losses?	M10	–	[Not used]
What disclosures are required by ASC Topic 820 when NAV is elected as a practical expedient?	M11	Q120	What disclosures are required when NAV is used as a practical expedient?

Previously Issued Guidance		This Publication	
Question	**Number**	**Number**	**Question**
If an entity sponsors a plan within the scope of ASC Topic 715, is the entity required to make the disclosures in ASC Topic 820?	M12	B50	In a plan sponsor's financial statements, does the Codification Topic apply to pension plan assets measured at fair value?
ASC Topic 820, *Fair Value Measurement*, states that transportation costs are different from transaction costs and should be included in an entity's measurement of fair value if location is an attribute of the asset under review. What type of transportation costs should be included?	N1	E40	How are transaction costs and transportation costs treated in identifying the principal or most advantageous market and in measuring fair value?
		E50	Can transportation costs be included in the entity's measurement of fair value using an identified basis differential?
If an asset requires installation in a particular location before it can be utilized, should an entity's measurement of fair value for the asset consider these costs? If so, what type of costs should be included in the measurement of fair value? Lastly, how should installation costs be reflected in the measurement of fair value (i.e., as an addition to the estimate of fair value or as a reduction to the estimate of fair value)?	N2	C20	If an asset requires installation in a particular location before it can be utilized, should the measurement of fair value of the installed asset consider these costs?
To measure fair value, can an entity assume a change in the legal use of a nonfinancial asset when determining the highest and best use for the asset?	N3	J10	Can an entity assume a change in the legal use of a nonfinancial asset when determining its highest and best use?
Can an entity use entity-specific assumptions about the entity's planned future use or non-use (i.e., retired or otherwise not used) of an acquired intangible asset in its determination of the fair value to be allocated to the asset in the purchase price allocation?	N4	J30	Can an entity use entity-specific assumptions about its future plans in measuring the fair value of an intangible asset acquired in a business combination?
When an acquirer in a business combination plans to use an acquired intangible asset defensively, how should market participants be defined and should financial buyers be included for fair value measurement as of the measurement date?	N5	J20	When an acquirer in a business combination plans to use an acquired intangible asset defensively, who are the market participants?

Previously Issued Guidance		This Publication	
Question	**Number**	**Number**	**Question**
Once the highest and best use of an asset or group of assets has been determined, how should the fair value of an intangible asset that is part of the group of assets acquired in a business combination be determined if the acquirer plans on retiring the intangible asset (or discontinuing its active use)?	N6	F40	How should the fair value of an intangible asset acquired in a business combination be measured if the acquirer plans to discontinue its active use?
Some assets recorded on an entity's books are the subject of executory contracts that directly affect the use of, and cash flows from, those assets. For example, a leasing company may have several airplanes recorded as fixed assets that are actually leased to third parties under operating leases. How should executory contracts be considered when measuring the fair value of an asset that is the subject of the executory contract?	N7	C60	How should executory contracts be considered when measuring the fair value of an asset that is the subject of an executory contract?
How does the ASU affect the accounting for asset retirement obligations (ARO) under ASC Subtopic 410-20, *Asset Retirement and Environmental Obligations – Asset Retirement Obligations?*	N8	K80	How is the fair value of an asset retirement obligation (ARO) measured?
What are some examples of nonfinancial assets and nonfinancial liabilities that are subject to ASC Subtopic 820-10, *Fair Value Measurement – Overall?*	N9	B10	What are some examples of assets and liabilities that are measured at fair value based on the Codification Topic?
When using the income approach (e.g., a discounted cash flow model) to measure the fair value of a nonfinancial asset or liability, what are some of the key components that will have the most significant effect on the overall fair value measurement?	N10	F30	In using the income approach to measure the fair value of a nonfinancial asset or nonfinancial liability, what are some of the key components that will have the most significant effect on the overall fair value measurement?
The highest and best use of a nonfinancial asset establishes the valuation premise used to measure the fair value of a nonfinancial asset. Is the entity able to use differing valuation premises for assets within a group of assets and liabilities?	N11	J40	Can an entity use differing valuation premises for nonfinancial assets within a group of assets and liabilities?
What is the effective date of ASU 2011-04 and related guidance?	O1	–	[Not used]

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