

IFRS

First Impressions: Fair value measurement

June 2011

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Unified fair value measurement guidance for IFRS

The issue of fair value in financial reporting was a matter of great discussion and some controversy in the recent financial crisis. Concerns were expressed in a number of areas, including the fair value measurement in the absence of active markets and the use of market prices below an entity's estimate of the long-run intrinsic value of an instrument. Broadly, these issues relate to the fair value measurement and the requirement to use fair value for recognition or disclosure.

The IASB's project on fair value measurement pre-dates the financial crisis and applies broadly to the measurement of financial and non-financial assets, liabilities and equity. The project sought to consolidate fair value measurement guidance dispersed across different standards into a single standard.

The IASB published IFRS 13 *Fair Value Measurement* on 12 May 2011. IFRS 13 does not establish new requirements for *when* fair value is required but provides a single source of guidance on *how* fair value is measured; this guidance should be applied when fair value is required or permitted under other IFRSs.

IFRS 13 provides a framework for determining fair value, i.e. it clarifies the factors to be considered in estimating fair value in accordance with IFRSs. While it includes descriptions of certain valuation approaches and techniques, it does not establish valuation standards on how valuations should be performed. However, it identifies the key principles in estimating fair value consistent with the IASB's measurement objective. IFRS 13 will facilitate preparers in applying and users in better understanding the fair value measurements applied in financial statements and will help to improve consistency in the application of fair value measurement.

IFRS 13 was developed in a convergence effort with the FASB and the resulting IASB and FASB standards are largely identical. Differences remain in relation to scope, the measurement of the fair value of investments in some investment entities, recognition of gains or losses at initial recognition of financial instruments, disclosures and certain wording differences.

Fair value measurement will remain an area of significant judgement when prices in active markets are not available. In such circumstances, there is inherent uncertainty about the price that would occur in the hypothetical transaction that is assumed in a fair value measurement; after all, market participants might use different valuation techniques and assumptions. IFRS 13 seeks to reduce the subjectivity of these measurements by requiring that relevant observable inputs be maximised and unobservable inputs minimised. In addition, IFRS 13 requires more extensive disclosures to be provided, particularly when fair value measurements rely on unobservable inputs. Although many fair values will remain inherently uncertain, IFRS 13 is an important step forward in establishing consistent fair value measurement and disclosure guidance across IFRSs.

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1. How this could affect you

IFRS 13 provides a revised definition of fair value and related application guidance as well as an extensive disclosure framework. It replaces fair value measurement guidance that was previously dispersed throughout IFRSs. This publication focuses on those aspects that are most likely to have an impact on practice.

Sections	Key requirements
Fair value principles (see section 4)	<ul style="list-style-type: none"> • Concepts and principles behind fair value are expanded and more articulated than before, including a number of new concepts. Entities should assess the IFRS 13 fair value principles and compare them to current valuation processes for items measured at fair value or for which fair value is disclosed • New concepts include the 'principal market' and 'highest and best use' for non-financial assets • New guidance may result in a different price being used within a bid-ask spread for financial instruments • An entity may need to reconsider how it measures own credit risk in the fair value of liabilities, in particular for derivative liabilities • The guidance on valuing offsetting market positions in IAS 39 <i>Financial Instruments: Recognition and Measurement</i> is eliminated. However, under specific conditions, an exception may apply that allows the exposure of certain groups of financial assets and financial liabilities to be measured on a net basis • Adjustments for premiums and discounts may only be included in certain circumstances. Blockage factors are not permitted
Valuation techniques (see section 6)	<ul style="list-style-type: none"> • Appropriate valuation techniques should be used, maximising the use of relevant observable inputs and minimising the use of unobservable inputs • A three-level fair value hierarchy is applied that prioritises the use of relevant observable inputs in valuation techniques. This fair value hierarchy is already applied to financial instruments under IFRS 7 <i>Financial Instruments: Disclosures</i> and is now extended to all fair value measurements
Comprehensive disclosure framework (see section 7)	<ul style="list-style-type: none"> • Fair value hierarchy disclosures are required for both financial and non-financial assets, liabilities and equity measured at or based on fair value and items not measured at fair value but for which fair value is disclosed • More detail in interim financial reports is required for the fair values of financial instruments measured at fair value • Disclosure requirements are more extensive for so-called Level 3 measurements that are recurring • Disclosure of transfers between levels of the hierarchy is required, along with the accounting policy choice made in relation to timing of such transfers

2. Overview of IFRS 13

IFRS 13 defines fair value, establishes a framework for measuring fair value and sets out related disclosure requirements. IFRS 13 does not give rise to any new requirements as to when fair value measurements are required, but instead provides guidance on how fair value should be measured and disclosed when required or permitted under other IFRSs. It replaces the sometimes inconsistent fair value measurement guidance currently included in individual IFRSs, with a single source of authoritative guidance on how to measure fair value. IFRS 13 has an effective date of 1 January 2013. It can be adopted early and is applied prospectively.

2.1 General principles

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, i.e. it is an 'exit price'. Fair value takes into account characteristics of the asset or liability that would be considered by market participants and is not based on the entity's specific use or plans. Such characteristics may include the condition and location of an asset or restrictions on an asset's sale or use.

The standard includes a fair value hierarchy concept that prioritises the inputs to valuation techniques used to measure fair value. The fair value hierarchy gives the highest 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). The concept of a fair value hierarchy was already included in IFRS 7 and the definitions of the three levels have not changed from what currently exists in IFRS 7.

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, maximising the use of relevant observable inputs and minimising the use of unobservable inputs. While IFRS 13 includes descriptions of valuation approaches and techniques, it does not establish valuation standards.

An entity values assets, liabilities and its own equity instruments 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 maximise the amount that would be received to sell an asset or minimise the amount that would be paid to transfer a liability, taking into account transport and transaction costs. In either case, the entity must have access to the market on the measurement date. Absent evidence to the contrary, the market in which the entity would normally sell the asset or transfer the liability is assumed to be the principal market or most advantageous market.

Transaction costs are not a component of a fair value although they are considered in determining the most advantageous market.

2.2 Application issues

The fair value of a non-financial asset is based on the perspectives of market participants of its highest and best use, which may be on a stand-alone basis or in combination with complementary assets or liabilities.

IFRS 13 gives guidance on when market prices may not be indicative of fair value if there has been a significant decrease in the volume or level of activity or because transactions may not be orderly, e.g. because transactions are forced or distressed. In such cases an adjustment to market prices or an alternative valuation technique may be necessary.

IFRS 13 generally does not specify the unit of account for measurement. This is established instead under the specific IFRS that requires or permits the fair value measurement or disclosure. For example,

the unit of account in IAS 39 or IFRS 9 *Financial Instruments* generally is an individual financial instrument whereas the unit of account in IAS 36 *Impairment of Assets* often is a group of assets or group of assets and liabilities comprising a cash-generating unit.

Inputs used in measuring fair value are consistent with the characteristics of the asset or liability that a market participant would take into account. A premium, e.g. a control premium, or a discount, e.g. a discount for lack of control, may be an appropriate input to a valuation technique. However, a premium or discount should not be applied if it is inconsistent with the relevant unit of account. For example, a control premium is not applied if the unit of account is an individual share. Blockage factors are regarded as a characteristic of an entity's holding rather than of the asset and therefore cannot be applied. When a Level 1 input is available for an asset or liability, it is used without adjustment except in specific circumstances.

IFRS 13 allows an entity to apply an exception to measure the fair value of certain groups of financial assets and financial liabilities on the basis of the price that would be received to sell a net asset position or paid to transfer a net liability position for a particular risk exposure.

The valuation of liabilities is performed using a transfer notion, i.e. the item is not assumed to be settled with the counterparty or otherwise extinguished on the measurement date. This is different from the settlement notion that is included in the current definition of fair value in IAS 39. The fair value of a liability is based on quoted prices in a market for transfers of an identical or similar liability, when available. When such pricing is not available and the liability is held by another entity as an asset, the liability is valued from the perspective of a market participant that holds the asset. Failing that, other valuation techniques are used to value the liability from the perspective of a market participant that owes the liability. A similar approach is also used when valuing an entity's own equity instruments.

Non-performance risk, including own credit risk, is considered in measuring the fair value of a liability, but separate inputs to reflect restrictions on the transfer of a liability or an entity's own equity instruments are not considered.

2.3 Disclosures

The IFRS 13 disclosure objective is to help users of financial statements assess the valuation techniques and inputs used in fair value measurements. Fair value disclosures are based on the level within which a measurement falls in the fair value hierarchy; this is on the basis that there is greater subjectivity about fair value measurements that use inputs that are lower in the fair value hierarchy, and so increased disclosure is required. Furthermore the disclosures differentiate fair value measurements that are recurring from those that are non-recurring.

For recurring fair value measurements using significant unobservable inputs, the disclosures are also intended to help users understand the effect of the fair value measurement on profit or loss or other comprehensive income for the period. More extensive disclosures are required for Level 3 measurements, including a description of valuation processes applied, quantitative information about significant unobservable inputs, and narrative disclosure of the sensitivity of the fair value measurement to significant reasonably possible alternative unobservable inputs. IFRS 13 retains the quantitative sensitivity analysis from IFRS 7 for Level 3 financial assets and financial liabilities.

Fair value hierarchy disclosures for financial instruments measured at fair value are required for interim financial reports prepared in accordance with IAS 34 *Interim Financial Reporting*.

3. Scope

IFRS 13.IN2-IN4

IFRS 13 applies to fair value measurements that are required or permitted by other IFRSs.

The IASB assessed each IFRS that requires or permits fair value measurement to determine whether a particular use of fair value should be within the scope of IFRS 13, considering:

- whether each use of fair value in IFRSs was consistent with an entry price or an exit price notion; and
- whether the measurement guidance in each IFRS was consistent with the measurement guidance being developed in the fair value measurement project.

IFRS 13.6

As a result of this assessment, IFRS 13 does not apply to the following transactions:

- share-based payment transactions within the scope of IFRS 2 *Share-based Payment*;
- leasing transactions within the scope of IAS 17 *Leases*; and
- measurements that are similar to fair value but that are not fair value, e.g. net realisable value in IAS 2 *Inventories* or value in use in IAS 36.

IFRS 13.5

The measurement and disclosure requirements do apply to measurements based on fair value, e.g. fair value less costs to sell in IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.

IFRS 13.7

Additionally, the disclosure requirements of IFRS 13 do not apply to:

- plan assets measured at fair value in accordance with IAS 19 *Employee Benefits*;
- retirement benefit plan investments measured at fair value in accordance with IAS 26 *Accounting and Reporting by Retirement Benefit Plans*; and
- assets for which recoverable amount is fair value less costs to sell in accordance with IAS 36.

IFRS 13.D5, D59

IFRS 2 and IAS 17 still use the words 'fair value'. However, a consequential amendment to those standards states that this term as used in those standards differs in some respects from the definition of fair value in IFRS 13. Therefore, fair value measurements under those standards should be based on that guidance and not IFRS 13.

IFRS 13.D1-D148

IFRS 13 makes a large number of consequential amendments to other IFRSs. These primarily include:

- aligning terminology with IFRS 13, e.g. changing 'market value' to 'fair value';
- improving consistency in describing fair value measurements, e.g. 'determining' or 'estimating' fair values is changed to 'measuring' fair values;
- deleting fair value guidance and instead cross-referencing to IFRS 13;
- adding new disclosures in IAS 36 to reflect additional fair value measurement disclosures when entities measure recoverable amount using fair value less costs to sell; and
- articulating differences between fair value less costs to sell (note that this term has been modified to fair value less costs of disposal by IFRS 13) and value in use in IAS 36.

4. Fair value principles

IFRS 13.9, A

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This is an exit price as opposed to an entry price, e.g. the price paid to purchase an asset. See 4.1 and 4.2 for further detail on the components of this definition.

4.1 The asset or liability being measured

IFRS 13.11

A fair value measurement considers those characteristics of the asset or liability that market participants would consider. In the case of an asset, these characteristics include its condition and location, and any restrictions on its sale or use.

IFRS 13.14, BC47

IFRS 13 generally does not specify the unit of account, e.g. a single asset or liability or a group of assets and/or liabilities, for measuring fair value. Rather, the unit of account used for fair value measurement is determined under the particular standard applicable to the asset or liability or group of assets and/or liabilities.

It is important to distinguish a characteristic of an asset or liability from a characteristic arising from an entity's holding of the asset or liability. For example, an entity may enter into an agreement that limits its ability to dispose of shares that it holds that would not apply to a purchaser of the shares. In another example, a discount to the market price that might result from an actual sale of a large block of shares because an entity's holding is large relative to daily trading volumes in the asset (i.e. a blockage factor) is a characteristic of the entity's holding rather than of the asset. See 6.6.1 for further discussion on blockage factors.

Illustrative example – Restrictions on the use of an asset

Company B acquired a factory as part of a business combination in 2010. As a condition of the acquisition B is not allowed to change the use of the land and buildings from operation as a factory for a period of 5 years. However, the area in which the property is located has recently been re-zoned and other land and buildings nearby have been re-developed as residential properties. B has received legal advice that although it is restricted under the terms of the acquisition from changing the use of the land and buildings from operating as a factory, it is able to sell the land and buildings to a third party who would not be bound by the restriction. Because the restriction is a characteristic of the current holder rather than of the asset itself, the fair value of the land and buildings is the higher of its value as a factory and its value as a site for residential development.

4.2 The hypothetical transaction assumption

IFRS 13.2

Fair value is a market-based measurement, rather than an entity-specific measurement. Fair value is measured using the assumptions that market participants would use when 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 when measuring fair value. For example, it is not relevant if the entity asserts that prices in orderly transactions are too low relative to its own value expectations and accordingly that the entity would be unwilling to sell at such prices.

IFRS 13.A, BC181

An *orderly transaction* is a transaction that assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction, e.g. a forced liquidation or distress sale.

In a transaction that is not orderly, there is insufficient time to create competitive tension and/or potential buyers may reduce the price that they are willing to pay for the asset. In a distress transaction, a seller is forced to accept the best price offered in the shortened time available. For example, when a failing bank is seized by a regulator and transferred to a new owner, this may occur in a very compressed timeframe, e.g. over a weekend, without adequate time to market the asset or for potential acquirers to perform due diligence, resulting in distress pricing.

As discussed in 6.7, it is not appropriate to conclude that all transactions in a market in which the volume or level of activity has significantly decreased are not orderly. In a depressed market, prices may be below levels that may have applied in the past or an entity's opinion of value. However, given sufficient time to market an asset, competitive tension among market participants and an ability to provide information about the asset would result in fair value being achieved.

4.2.1

Principal and most advantageous markets

IFRS 13.16, 19

Fair value measurement assumes that the transaction to sell the asset or transfer the liability takes place in the principal market for the asset or liability, i.e. the market with the greatest volume and level of activity. In the absence of a principal market, the transaction is assumed to take place in the most advantageous market. This is the market that maximises the amount that would be received to sell the asset or minimises the amount that would be paid to transfer the liability, after considering transaction costs and transport costs. In many instances, the principal market and the most advantageous market would be the same. In either case, the entity must be able to access the market in which the transaction is assumed to occur at the measurement date. The concepts of principal market and most advantageous market are considered from the perspective of the 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 only has access to retail markets.

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 account of all information that is reasonably available. For example, if reliable information about volumes transacted is available in trade magazines, then it may be appropriate to take this information into account to determine the principal market. Absent evidence to the contrary, the principal (or most advantageous) market is presumed to be the market in which an entity normally enters into transactions for the asset or liability.

IFRS 13.25

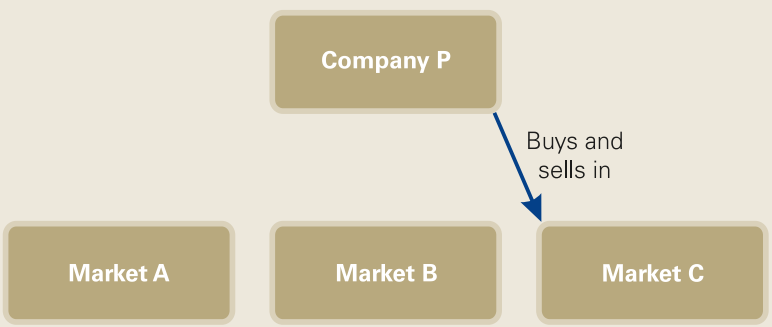
Although transaction costs are taken into account in *identifying* the most advantageous market, the price used to *measure* the fair value of an asset or a liability is not adjusted for transaction costs. This is because they are not a characteristic of the asset or liability and are, instead, characteristics of a transaction.

IFRS 13.26, BC62

If location is a characteristic of an asset, e.g. crude oil held in the Arctic circle, then the price in the principal (or most advantageous) market is adjusted for the costs that would be incurred to transport the asset to that market, e.g. costs to transport the crude oil from the Arctic circle to the appropriate market.

Illustrative example – Principal market

Company P holds an asset that is traded in three different markets as 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
Transport costs	(3)	(3)	(4)
Possible fair value	47	45	49
Transaction costs	(1)	(2)	(2)
Net proceeds	46	43	47

The principal market for the asset in this example is Market A because it has the highest volume and level of activity. The most advantageous market is Market C because it has the highest net proceeds.

P bases its fair value on prices in Market A when information about the volume and level of activity of each market is reasonably available and P is able to access Market A. Pricing is taken from this market even though P does not normally transact in that market and it is not the most advantageous market. In this case, fair value would be 47, considering transport costs but not transaction costs, even though P normally transacts in Market C and could maximise net proceeds in that market.

If P is unable to access Market A and B, or information allowing a conclusion on what market has the greatest volume and level of activity is not reasonably available, then P would use Market C and net proceeds would be 47. In this case, fair value would be 49.

The above example highlights that the presumption that the principal market is the market in which the entity usually transacts will not always be appropriate. In this example, the fact that P has information about Market A that it cannot ignore means that Market A is the principal market and not Market C.

4.2.2**Market participants**

IFRS 13.22, A

Fair value is based on assumptions that market participants would use in pricing the asset or liability. Market participants are buyers and sellers in the principal (or most advantageous) market who have all of the following characteristics:

- they are independent of each other;
- they are knowledgeable;

- they are able to enter into a transaction for the asset or liability; and
- they are willing to enter into a transaction, i.e. motivated but not forced.

IFRS 13.BC58, BC59

Market participants are assumed to be knowledgeable. If a market participant was willing to enter into a transaction for an asset or a liability, then it would undertake efforts, such as normal due diligence, to become knowledgeable about the asset or liability and would factor any remaining uncertainty after such efforts into its pricing of the asset or liability. To reduce the price adjustment that would otherwise arise from a lack of information, a market participant selling an asset or transferring a liability has an incentive to cooperate with its counterparty's knowledge gathering effort.

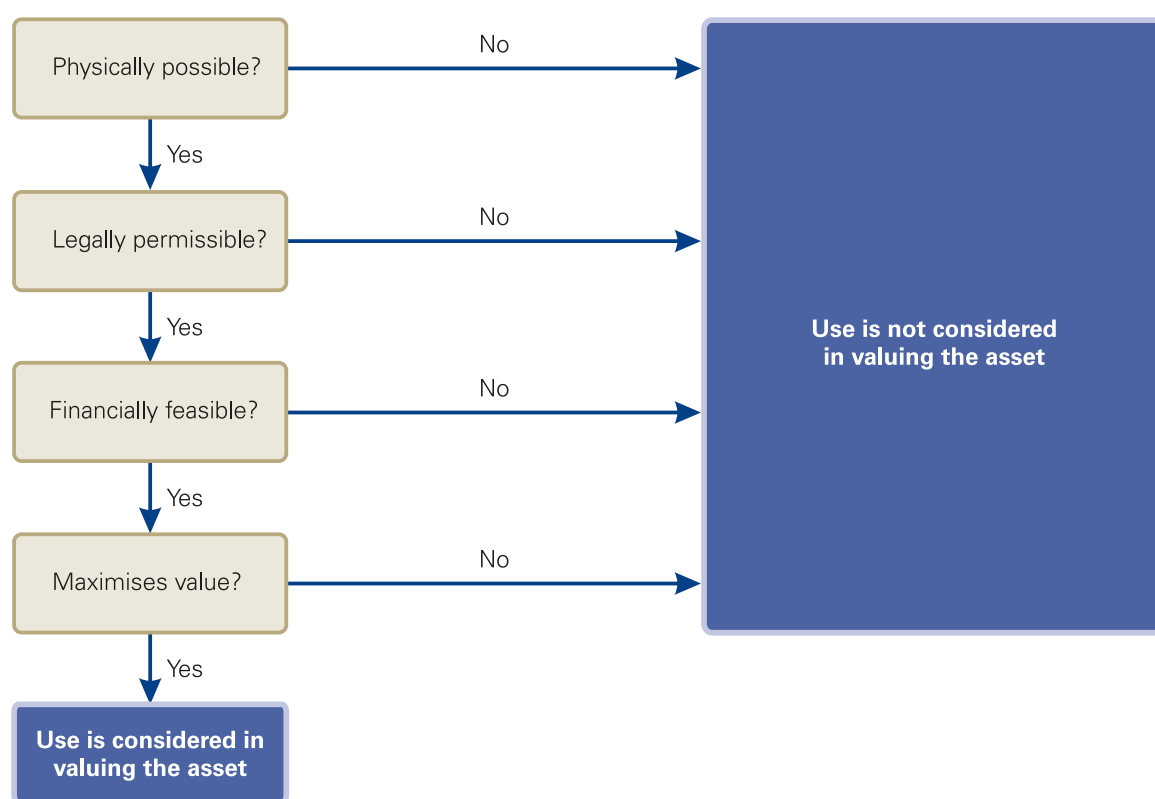
5. Application issues

5.1 Application to non-financial assets

5.1.1 Highest and best use

IFRS 13.27, 28, A

A fair value measurement considers a market participant's ability to generate economic benefits by using a non-financial asset or by selling it to another market participant who will use the asset in its highest and best use. *Highest and best use* refers to the use of a non-financial asset by market participants that would maximise the value of the asset or the group of assets and liabilities with which the asset would be used. The following diagram illustrates the factors to be considered in identifying the highest and best use.



IFRS 13.BC69

In relation to 'legally permissible', the potential use of a non-financial asset must not be legally prohibited. For example, in measuring the fair value of land and buildings, a fair value measurement assumes a different zoning if market participants would do so; the fair value measurement would incorporate the cost to convert the asset and obtain a different zoning permission, including the risk and uncertainty that such permission would not be granted. However, an entity could not assume a use that could not be permitted under current law.

IFRS 13.30

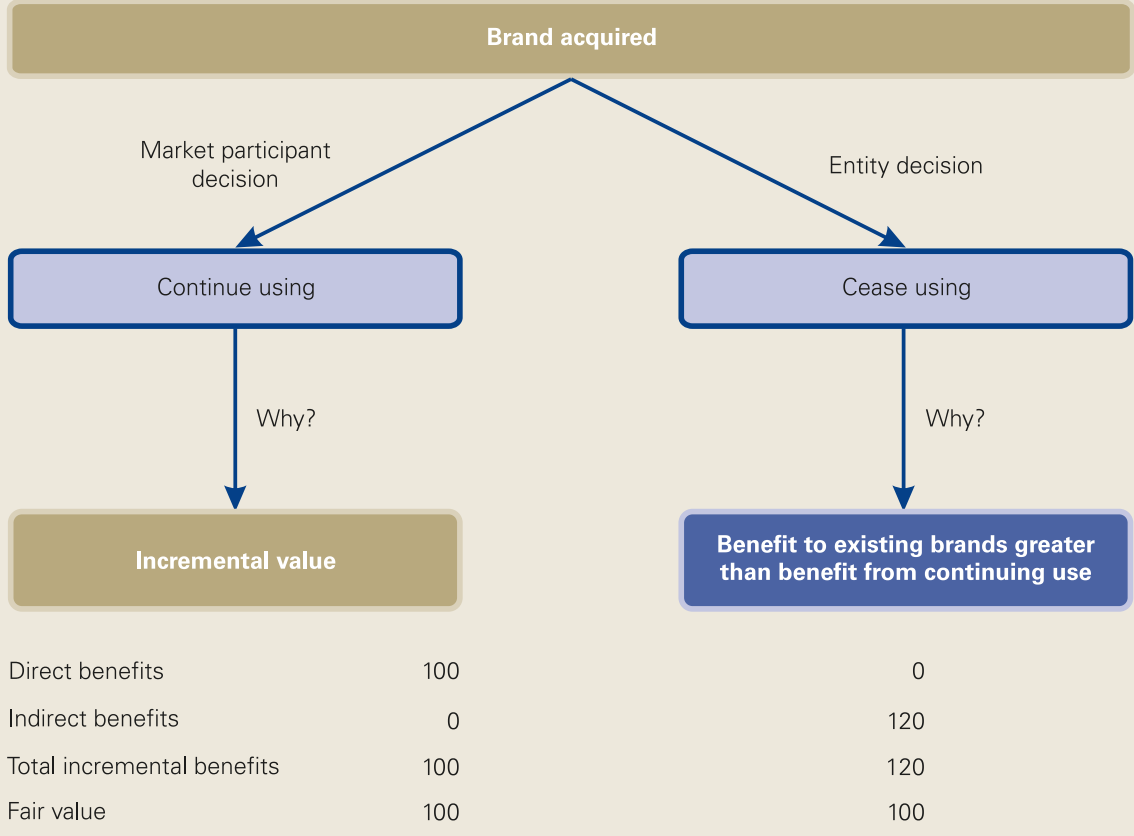
Because of overlap with its existing assets or for other reasons, an entity may intend not to use an acquired non-financial asset. However, consistent with the definition of fair value as a market participant-based measure, the fair value of an asset is measured assuming its highest and best use by market participants.

IFRS 13.IE9

Illustrative example – Purchase of a brand

Company B acquires a brand in a business combination. B decides not to use the brand on the assumption that its removal from the market will generate greater incremental value to B as a result of increased revenues from its existing brands. However, a market participant would choose to continue to use the brand, since it would not hold the other brands that B does. As a market participant would choose to continue actively using the brand, the fair value of the brand would be based on that as the highest and best use to a market participant. This is despite the fact that B’s decision not to use the brand results in higher benefits to B.

The following diagram illustrates this example.



As the example illustrates, the highest and best use of a non-financial asset is determined from the perspective of market participants and is not influenced by the individual entity’s decision.

IFRS 13.29

Absent evidence to the contrary, the entity’s use of an asset is assumed to be its highest and best use, i.e. it is not necessary to engage in exhaustive efforts to identify other potential highest and best uses. However, readily available evidence should not be ignored.

Insight – Highest and best use

Measuring the fair value of an asset for which market prices are not available will be more challenging when the entity’s use (including defensive use) differs from that of market participants. Inputs to the valuation in such circumstances will be particularly difficult as the assumptions cannot be anchored in either market prices or the entity’s actual plans.

5.1.2

Valuation premise

IFRS 13.31(a)

Fair value measurement of a non-financial asset is based on its use either on a stand-alone basis or in combination with other assets or group of assets and liabilities.

The valuation premise depends on which use is consistent with the perspectives of market participants of the non-financial asset's highest and best use.

Illustrative example – Fair value measurement on an in-combination basis

Company B acquired contractual customer relationships and technology assets as part of a business combination. In considering whether the highest and best use of the customer relationships would be on a stand-alone basis or in combination with complementary assets, B noted that the relationships with customers arose in the context of the sale of a product incorporating the technology. A market participant without complementary technology would likely realise lower value from the customer relationships because of the probability of lower expected sales and would consider this in pricing the customer relationships on a stand-alone basis. However, a market participant with access to the complementary technology would likely realise higher sales and profits than on a stand-alone basis and would consider this in valuing the customer relationships based on their use in combination with other assets. A similar analysis would apply to the technology, i.e. the technology is more valuable as a result of its use with the customer relationships. Therefore, the fair value measurement is based on an in-combination premise.

IFRS 13.31(a)(i), 32, BC79

When highest and best use would be to use a non-financial asset in combination with other assets, it is assumed that the other assets would be available to market participants and that this would be considered in pricing the asset. However, the fair value measurement assumes that the asset is sold consistent with the unit of account specified in other IFRSs.

IFRS 13.31(a)(iii)

When the highest and best use is to use the asset in combination with other assets, the same valuation premise is used for the other assets with which it would be used. In the example above, the fair value measurements of the technology and contractual customer relationship assets would both assume that they are used in combination, rather than the customer relationships being measured assuming use in combination and the technology assets being measured on a stand-alone basis.

Insight – Fair value measurement on an in-combination basis

A conclusion on whether an asset is best used on a stand-alone basis or in combination with other complementary assets may influence the selection of an appropriate valuation technique. For specialised assets, there is often a significant difference between the value of the asset on a stand-alone basis and its value in its specialised application, in combination with other assets. This is because a stand-alone value would price the asset based on other lower-value uses.

For example, it is unlikely in practice that an entity will be able to use a market approach (see 6.2) to measure the fair value of specialised tangible assets that would be used in combination with other assets or with other assets and liabilities. Market prices for individual used specialised tangible assets often represent stand-alone lower-use values as such assets are not often sold on their own except as a result of business failure. Prices in such transactions generally reflect an expectation that the asset will be used in a different application to the one for which it was specifically developed, often resulting in a significantly lower price.

A market approach is often used to value tangible assets that are not specialised because such assets have a variety of uses and possible changes in use reflected in sale prices may not cause a major value decrement.

An income approach is not generally used to value tangible assets that are not specialised. This is because the excess returns in the expected cash flows from the operation of a business are generally not attributable to tangible assets but to the intangible assets, goodwill and activities of the business.

5.2 Application to liabilities and an entity's own equity instruments

5.2.1 Quoted price for transfer of a liability or an entity's own equity instruments

IFRS 13.34, 35

A fair value measurement of a financial or non-financial liability or an entity's own equity instrument assumes that it 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. The transfer notion is conceptually consistent with the exit price concept. However, in many cases in practice there is no observable market to provide pricing information about the transfer of a liability. The highest and best use concept does not apply to liabilities and an entity's own equity instruments as they do not have alternative uses.

IFRS 13.BC81

The expected cost to an entity to fulfil an obligation may be lower than the price to transfer it to a market participant because of the entity's greater efficiency relative to a market participant transferee and the profit margin that a market participant would require to assume the liability. The entity's relative advantage in fulfilling the obligation appears in profit or loss over time as the entity settles its obligation through performance using its own internal resources. It is not reflected in the fair value of the liability.

5.2.2 Value from perspective of market participant that holds the asset

IFRS 13.37, 39

When there is no quoted price for the transfer of an identical or similar liability or an entity's own equity instrument, and another party holds the identical liability or equity instrument as an asset, an entity measures the fair value of the item based on the perspective of a market participant that holds the identical instrument as an asset. The entity adjusts quoted prices for features that are present in the asset but not present in the liability or the entity's own equity instrument, or *vice versa*.

IFRS 13.39

A factor that indicates that the quoted price of an asset should be adjusted is when the unit of account for the asset is not the same as for the liability or equity instrument. Consider for example a liability that is issued with an inseparable third-party credit enhancement, e.g. a guarantee. The individual financial instrument from the perspective of the holder is the combined security containing both the amount due from the issuer and the guarantee. However, from the issuer's point of view, the measurement of a liability follows the unit of account of the liability for financial reporting purposes. If that unit excludes the guarantee, then the fair value of the obligation takes into account only the credit standing of the issuer and not the credit standing of the guarantor.

IFRS 9 BCZ5.34-BCZ5.34B, 13.39, BC98, IAS 39.BC92

However, neither IAS 39 nor IFRS 9 state explicitly whether the guarantee is or is not part of the liability's unit of account and IFRS 13 does not amend either of those other standards in this regard. The Basis for Conclusions to both IAS 39 and IFRS 9 note that the fair value of a financial liability guaranteed by a third party is generally unaffected by changes in the issuer's creditworthiness. However, IFRS 13 has supplemented this discussion with the observation that this is not the case when the unit of account excludes the guarantee and appears to envisage that separate accounting for third-party credit enhancements is possible.

IFRS 13.BC97, ASC 820-10-35-18A, ASC 825-10-25-13

The above requirements for the issuer's measurement of the fair value of a liability issued with an inseparable third-party credit enhancement are consistent with FASB Accounting Standards Codification Topic 820 *Fair Value Measurements and Disclosures* (Topic 820). Additionally, US GAAP explicitly states that the issuer of a liability issued with an inseparable third-party credit enhancement generally excludes the inseparable third-party credit enhancement from the unit of account when measuring the liability. However, exclusion is not required if the enhancement is granted to the issuer of the liability,

e.g. deposit insurance provided by a government or government agency, or is provided between a parent and a subsidiary or between entities under common control. IFRSs do not contain such explicit guidance.

5.2.3

Other valuation technique from perspective of market participant that owes liability or issued equity instrument

IFRS 13.40, 41,
B31-B33

If there is no quoted price for the transfer of an identical or similar liability or the entity's own equity instrument and there is no corresponding asset, as may be the case for a decommissioning liability, for example, then 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. When using a present value technique, an 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.

Insight – Risk adjustment

The risk adjustment will often be the most difficult factor to quantify in a calculation of the fair value of a non-financial liability. Estimation of the risk adjustment, as well as other inputs, may be especially difficult when an entity has an obligation with a unique or unusual risk as opposed to situations in which there are a number of obligations with similar risks. In the latter case there is generally more experience with the range of possible outcomes and the price that a market participant might require to assume an obligation may reflect possible portfolio diversification effects. For example, when outcomes are not perfectly correlated, negative outcomes may be at least partially offset by positive outcomes so that a market participant may demand a lower risk premium. We would expect that the more uncertain the inputs that are included in the calculation of the fair value of a liability, the greater the risk adjustment would be.

An entity may estimate those future cash outflows by taking the following steps:

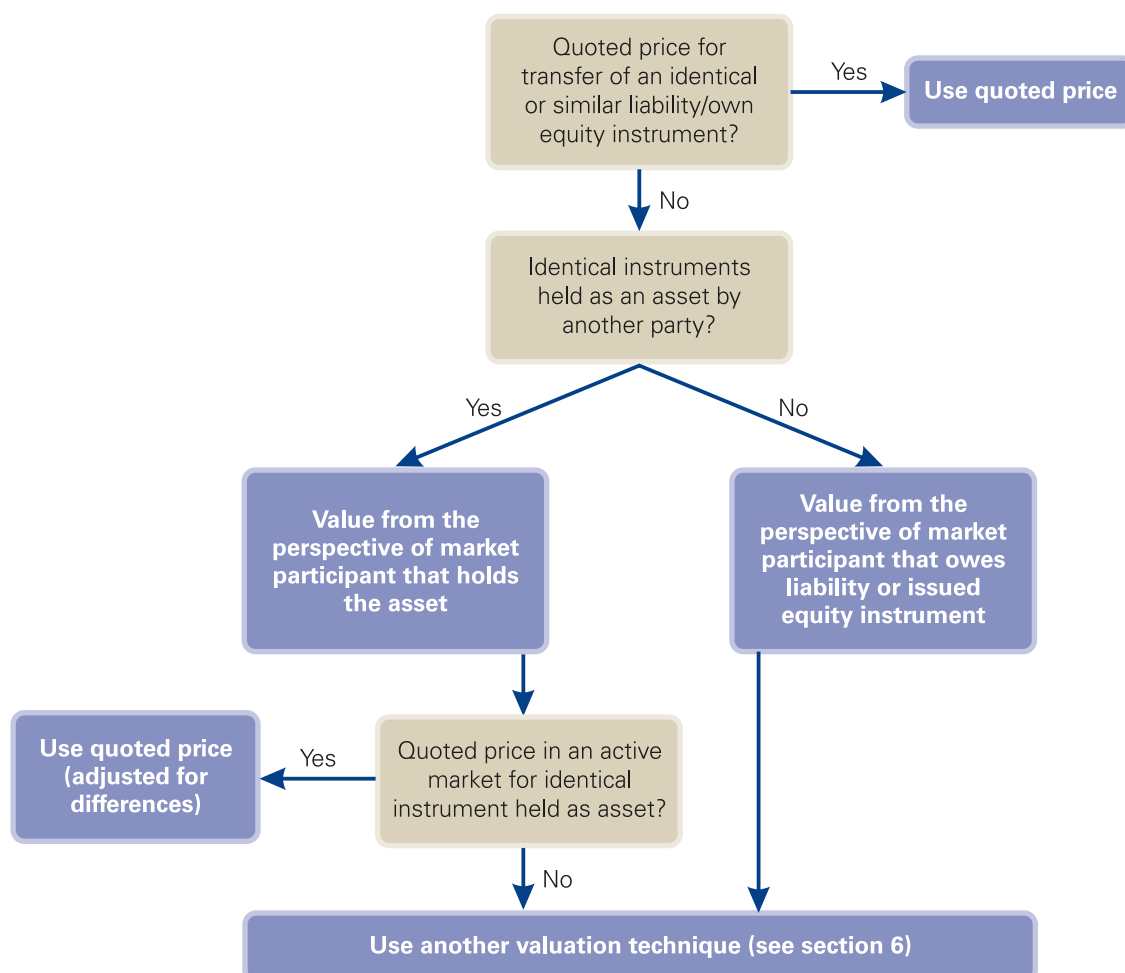
- (1) estimate the cash flows that the entity would incur in fulfilling the obligation;
- (2) exclude the cash flows that other market participants would not incur;
- (3) include the cash flows that other market participants would incur but that the entity would not incur; and
- (4) estimate the profit margin that a market participant would require to assume the obligation.

IFRS 13.B31

An entity need not undertake exhaustive efforts to determine (1) and (2). However, it should not ignore information about market participant assumptions that is reasonably available.

IFRS 13.37-40, 79(c)

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



5.2.4 Non-performance risk of a liability

IFRS 13.42, A, BC92

The fair value of a liability reflects the effect of *non-performance risk*, which is the risk that an entity will not fulfil an obligation. Non-performance risk is assumed to be the same before and after the transfer of the liability. Non-performance risk includes, but may not be limited to, an entity's own credit risk.

IFRS 13.43, 44

The effect of non-performance risk may differ depending on the liability, e.g. whether the liability is an obligation to deliver cash (a financial liability) or an obligation to deliver goods or services (a non-financial liability), and the terms of credit enhancements related to the liability, if any, e.g. a pledge of assets against default. The fair value of a liability would reflect the effect of non-performance risk on the basis of its unit of account. Therefore, the issuer of a liability does not include the effect of an inseparable third-party credit enhancement in the liability's fair value measurement if it accounts separately for the liability and the credit enhancement. Consequently, the fair value of the liability reflects the effect of non-performance risk based on the issuer's own credit standing. See also 5.2.2, which discusses the unit of account related to liabilities issued with inseparable third-party credit enhancements from the issuer's perspective.

IFRS 13.BC92, BC93

Insight – Own credit risk in the fair value of financial instruments

Currently the definition of fair value in IAS 39 and IFRS 9 refers to the price at which a liability could be 'settled'. Some commentators have observed that there is diversity in practice regarding whether and how entities make adjustments for their own credit risk in measuring the fair values of financial liabilities, particularly derivative liabilities, under IAS 39. In some cases, this may be influenced by a belief that little if any discount for own credit risk would be obtained in a negotiated early settlement of the liability with the counterparty. As a result, an adjustment for own credit risk in measuring a derivative liability under IAS 39 might be lower than the adjustment for credit risk in measuring the corresponding asset recognised by the counterparty to the instrument.

By contrast, the definition of fair value in IFRS 13 instead refers to the (exit) price at which a liability would be transferred to a market participant on the assumption that the non-performance risk, including the effect of the entity's own credit risk, remains the same before and after the transfer. In addition, in the absence of a quoted market price for the transfer of a liability, the liability's fair value should be measured from the perspective of a market participant that holds the liability as an asset. This would imply greater consistency in practice between the calculation of own credit risk adjustments and counterparty credit risk adjustments in measuring derivative assets and liabilities.

In principle, and assuming no differences in the unit of account, the credit risk adjustments made in the fair value measurement of a financial instrument should be the same for both counterparties to the instrument. It should also be noted that the credit risk of both counterparties may be relevant to measuring the fair value of an instrument that may change from being an asset to a liability or *vice versa*, e.g. an interest rate swap.

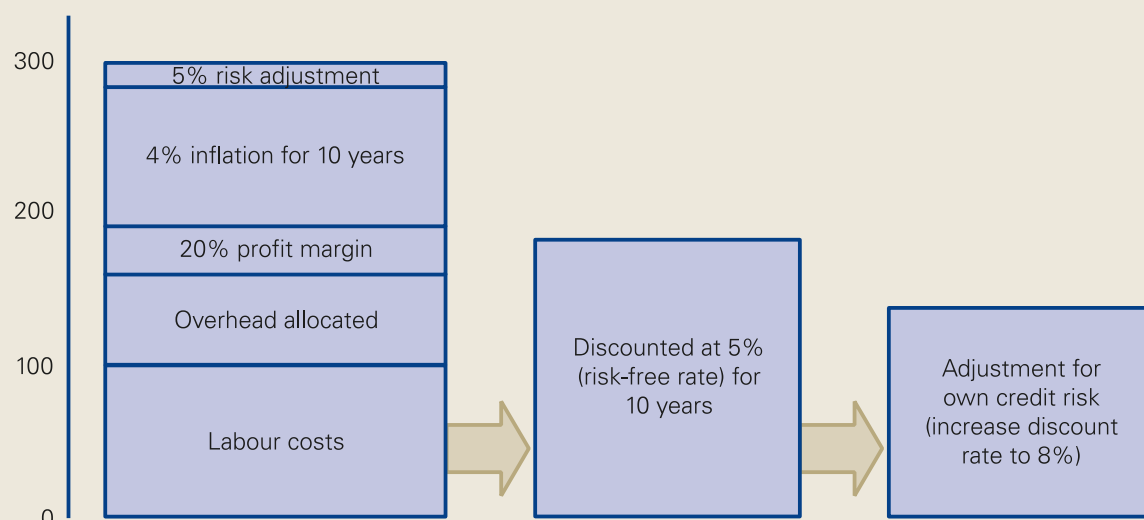
IFRS 13.IE35-IE39

Illustrative example – Decommissioning liability

On 1 January 2011 Company B assumes a decommissioning liability in a business combination and is therefore required to measure the liability at fair value, as opposed to a best estimate measurement required by IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. B is legally required to remediate a mine pit at the end of its useful life, which is estimated to be in 10 years. B uses a present value technique to measure the fair value of the decommissioning liability. If B were contractually allowed to transfer its decommissioning liability to a market participant, then B concludes that a market participant would use all of the following inputs when estimating the price:

- labour costs of 100;
- allocated overhead and equipment costs of 60 percent of labour costs (60);
- a third-party contractor margin of 20 percent ($160 \times 20\% = 32$), based on margins that contractors in the industry generally receive for similar activities;
- annual inflation rate of 4 percent based on market data for the applicable jurisdiction ($192 \times 4\%$ compounded for 10 years = 92);
- a 5 percent 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 ($284 \times 5\% = 14$);
- a risk-free rate of 5 percent based on 10-year government bonds in the applicable jurisdiction; and
- a 3 percent adjustment to the discount rate to reflect B's non-performance risk.

The following diagram shows the make-up of these costs to give a fair value of the decommissioning liability of 138 (present value at 8% of 298 in 10 years).



The adjustment for the time value of money is shown separately from the credit risk adjustment to illustrate the directionality of the adjustment. In practice only one discount rate calculation would be undertaken.

As the example above shows, the adjustment for own credit risk has reduced the liability, just as higher credit risk reduces the value of a financial asset.

5.2.5

IFRS 13.45, 46

Restrictions

A separate input or adjustment to reflect a restriction on an entity's ability to transfer a liability or an entity's own equity instrument to another party is not applied in a fair value measurement of the liability or the entity's own equity instrument. This is because the restriction is assumed to be reflected implicitly or explicitly in the other inputs used by market participants to price such instruments. As the effect of a restriction is included in the other inputs, an additional input or adjustment to reflect a restriction on transferability would double count the effect.

IFRS 13.39, BC99

However, when using the quoted price of a liability or an entity's own equity instrument held by another party as an asset, the entity should ensure that the price of the asset does not reflect the effect of a restriction preventing the sale of that asset. In the view of the IASB and the FASB (the Boards), restrictions on the transfer of an asset relate to the marketability of the asset.

5.3 Application to financial instruments

IFRS 13.5

IFRS 13 applies to all financial instruments for which IAS 32 *Financial Instruments: Presentation*, IAS 39, IFRS 7 and IFRS 9 require or permit fair value measurements or disclosures about fair value measurements. Furthermore, IFRS 13 contains specific requirements for the application of the fair value measurement framework to liabilities including financial liabilities, an entity's own equity instruments, and certain groups of financial assets and financial liabilities with offsetting positions in market risks or counterparty credit risk. When IFRS 13 becomes effective, most of the requirements and application guidance related to fair value measurement and disclosure will be deleted from the financial instruments standards.

5.3.1 Gains or losses at initial recognition

IFRS 9.B5.1.2A, B5.2.2A, 13.60, IAS 39.AG76, AG76A

IFRS 13 does not substantively change the threshold for recognising a gain or loss at initial recognition of a financial asset or liability that arises from a difference between the transaction price and the fair value at initial recognition, i.e. day one gains or losses, and the amended requirements remain in IAS 39 and IFRS 9. See also 9.3.2 and 9.3.3 for detail on the impact of consequential amendments to IAS 39 and IFRS 9.

5.3.2 Financial liabilities with a demand feature

IFRS 13.47, BC26(a)

IFRS 13 carries forward from IAS 39 the guidance that the fair value of a liability with a demand feature cannot be less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.

5.3.3 Investments in equity instruments

IFRS 9.B5.4.14-B5.4.17, BC5.18

Under IFRS 13 the guidance in IFRS 9 on when cost may be the most appropriate measure of fair value is retained. This may be the case if insufficient recent information is available to determine fair value, or if there is a wide range of possible fair value measurements and cost represents the best estimate of fair value within that range. However, in the Basis for Conclusions to IFRS 9, the IASB notes that such circumstances are not applicable to equity investments held by particular entities such as financial institutions and investment funds.

5.3.4 Groups of financial assets and financial liabilities – net exposures

IFRS 13.48

An entity holding a group of financial assets and financial liabilities is exposed to the market risks of the instruments as well as to the credit risks of each counterparty with whom it entered into a financial asset. The portfolio also is impacted by the entity's own credit risk.

IFRS 13.BC108

Financial institutions and other entities may manage instruments based on their net exposure to a specific market risk (or risks) or the credit risk of a particular counterparty.

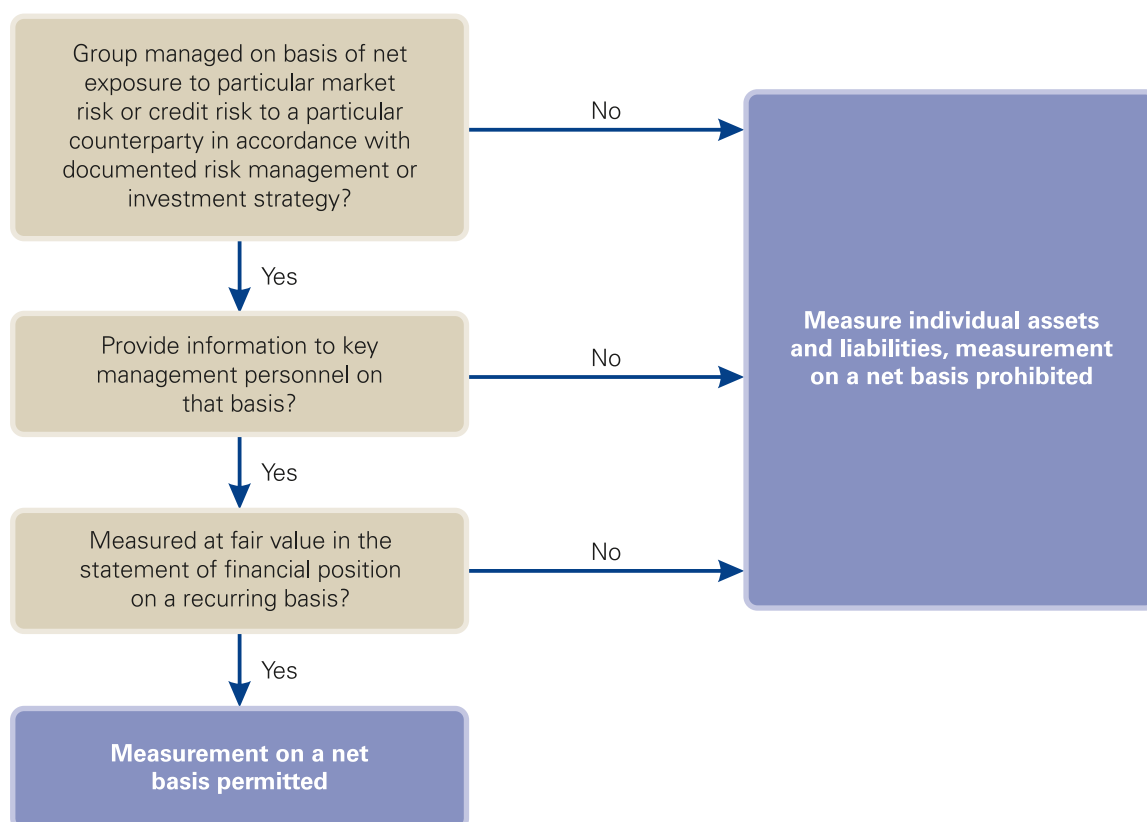
IFRS 13.48, 52, BC115, BC116

An optional exception is introduced in IFRS 13 for the measurement of the fair value of financial assets and financial liabilities, if certain criteria are met, primarily related to whether an entity manages the financial assets and financial liabilities on the basis of its net exposure to either of these risks. The scope of the exception is limited to financial assets and financial liabilities within the scope of IAS 39 or IFRS 9. The exception allows an entity to measure the fair value of a group of financial assets and financial liabilities on the basis of the price that would be received to sell a net asset position or transfer a net liability position for a particular risk exposure in an orderly transaction between market participants at the measurement date. This exception is permitted because the measurement of financial instruments in a group by market participants is considered to be a market-based measurement.

IFRS 13.49, BC118, BC119, BC127

The application of the exception is permitted only if an entity can provide evidence that it consistently manages the group of financial instruments on the basis of the net exposure to a specific market risk (or risks) or credit risk of a particular counterparty. It is noted that the group of financial assets and financial liabilities for which an entity manages its net exposure to a particular market risk (or risks) could differ

from the group for which an entity manages its net exposure to the credit risk of a specific counterparty. Measuring on a net exposure basis is permitted, if the entity meets the following conditions:



Exposure to market risks

*IFRS 13.54, 55,
BC122, BC125*

The market risks to which an entity is exposed within the portfolio of financial instruments and that may be offset in determining the net exposure should be substantially the same as regards both their nature and duration. For example, Company C could not combine the interest rate risk associated with a specific financial asset with the commodity price risk associated with a financial liability. These risks would not qualify as being substantially the same and therefore would not qualify for the exception.

Furthermore, the duration of the entity's exposure to the market risk should be substantially the same. For example, if Company B has a 12-month futures contract to offset 12 months' worth of interest rate risk exposure on a five-year financial instrument, then the exposure to 12 months of interest rate risk may be measured on a net basis but the interest rate risk exposure from year two to five needs to be measured on a gross basis.

Exposure to the credit risk of a particular counterparty

IFRS 13.56, BC123

When measuring the fair value of a group of financial assets and financial liabilities entered into with a specific counterparty, the exception allowing net measurement of credit risk exposure can only be applied when a market participant would take into account an existing arrangement that mitigates credit risk in the event of default. For example, an entity would take into account a master netting agreement only if and to the extent that market participants would do so, e.g. considering expectations as to legal enforceability in the event of default. Net credit risk exposure refers to either the entity's net exposure to the credit risk of the counterparty or the counterparty's net exposure to the entity's own credit risk.

IFRS 13.48, 53,
BC119

If an entity applies the exception, then it measures the fair value of a group of financial assets and financial liabilities consistently with how market participants would price the net position at the measurement date. It uses the price within the bid-ask spread that is most representative of fair value in the circumstances and includes a credit risk adjustment based on its net credit exposure. The resulting measurement represents the fair value of the net risk exposure and not of an individual financial instrument.

IFRS 9.5.4.2, B5.4.4,
13.BC108, BC110,
IAS 39.AG70, AG72

Insight – Current practice under IAS 39

IAS 39 allows measurement of the fair value of financial assets and financial liabilities with offsetting market risks through measuring the offsetting risk position at mid-market prices and the application of bid or ask prices to the net open position. Although IAS 39 does not contain specific guidance on the measurement of the fair value of financial assets and financial liabilities with offsetting credit risk, many entities apply a similar approach for measuring financial instruments with offsetting credit risk.

The IFRS 13 qualifying requirements for measurement on a net basis are more detailed than under IAS 39. There are other differences including that net measurement is an accounting policy choice under IFRS 13 and is restricted to items measured at fair value on a recurring basis. However, to the extent that net measurement is applied under IFRS 13 the approach would appear to be similar to IAS 39 except that the net open risk position would be measured based on the price within the bid-ask spread that is most representative of fair value rather than on the bid or ask price.

IFRS 13.50, BC129

The exception in IFRS 13 does not change the presentation requirements for financial assets and financial liabilities. If an entity applies the exception, then the basis of measurement of a group of financial instruments might differ from the basis of presentation. If the presentation of a group of financial instruments in the statement of financial position is gross, but fair value is measured on a net exposure basis, then the bid-ask or credit adjustments are allocated to the individual assets and liabilities on a reasonable and consistent basis.

IFRS 13.51, BC121

An entity makes an accounting policy choice, to be applied consistently from period to period, whether or not to apply the exception for a particular portfolio if the conditions are met. However, an entity is not required to maintain a static portfolio in order to apply the exception.

5.4 Fair value at initial recognition

IFRS 13.57, 58, BC42

When an asset is acquired (or a liability assumed), the transaction price paid for the asset (or received to assume a liability) normally reflects an *entry* price. IFRS 13 requires fair value measurements to be based on an *exit* price. Although conceptually different, in many cases the exit price and entry price are equal and therefore fair value at initial recognition generally equals the transaction price.

IFRS 13.B4

However, entities are required to take into account factors specific to the transaction and the asset or liability that would indicate that the transaction price and initial fair value measurement may differ. These may include:

- the transaction is between related parties;
- the transaction takes place under duress, e.g. this might be the case if the seller is experiencing financial difficulty;
- the unit of account represented by the transaction price differs from the unit of account of the asset or liability measured at fair value, e.g. if the transaction price represents the purchase of multiple items; and
- the market in which the transaction takes place is different from the principal (or most advantageous) market.

IFRS 13.BC133

The presence of one or more of these factors does not automatically result in a fair value measurement that differs from the transaction price. For example, the price in a related party transaction may be used as an input into a fair value measurement if the entity has evidence that the transaction was entered into at market terms.

IFRS 13.60

A day one gain or loss arises when the transaction price for an asset and/or liability differs from the fair value used to measure it at initial recognition. IFRS 13 requires day one gains or losses to be recognised in profit or loss unless another IFRS specifies otherwise.

IFRS 13.BC137

The IASB decided that determining whether to recognise day one gains or losses was out of the scope of IFRS 13 and should be addressed in the IFRSs requiring fair value measurement. As a result, there are no substantive changes to accounting for day one gains and losses following the release of IFRS 13.

IFRS 9.B5.1.2A,
IAS 39.76

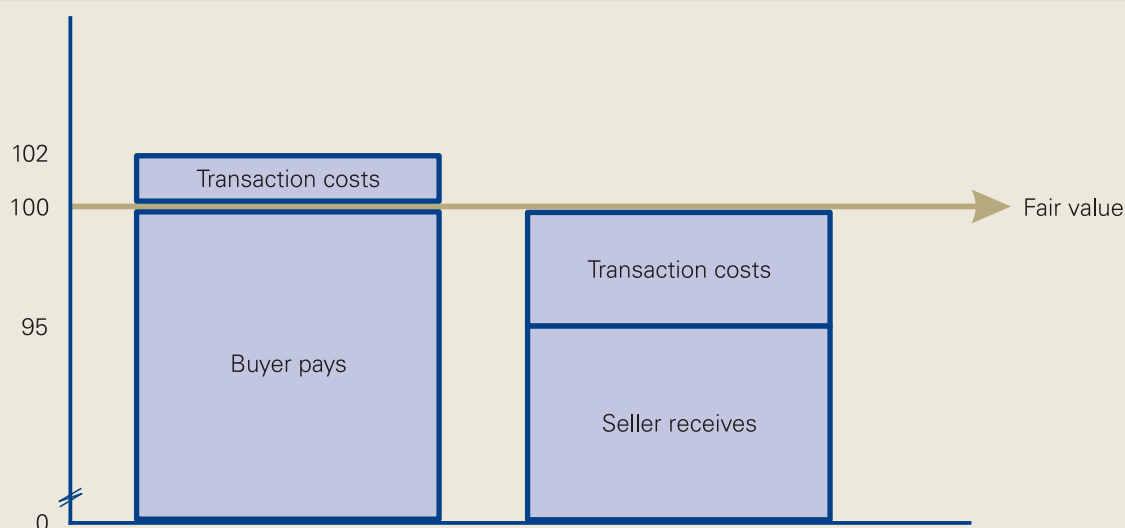
IAS 39 and IFRS 9 continue to prohibit the recognition of a day one gain or loss unless fair value is evidenced by a quoted price in an active market for an identical asset or liability or is based on a valuation technique whose variables include only data from observable markets. See 5.3.1 and 9.3.2 for more detail on gains or losses at initial recognition.

IFRS 3 *Business Combinations* (in relation to goodwill or gain on a bargain purchase) and IAS 41 *Agriculture* require the recognition of day one gains and losses even when fair value is measured using unobservable inputs.

IFRS 13.BC33

Because transaction costs are not a component of a fair value measurement, a difference between an exit price and an entry price is unlikely.

Illustrative example – Effect of transaction costs



For example, a seller sells an asset in an orderly transaction at a price of 100. The seller pays broker commission of 5 percent out of the proceeds of the sale. However, the fair value or exit price would be 100 and not 95 (100 exit price less 5 transaction cost). From the buyer's perspective, the fair value is the same, i.e. 100. The buyer's transaction costs of 2 are also not part of the fair value measurement.

IFRS 13.BC164,
BC165

Bid-ask spreads may represent a difference between entry and exit price in markets for financial instruments or when an intermediary is necessary to bring together a buyer and seller. See 6.6.2 for further information on bid-ask prices.

6. Valuation techniques

6.1 General principles

IFRS 13.61

When determining the fair value of an asset or a liability, an entity selects those valuation techniques that are appropriate in the circumstances and for which sufficient data is available to measure fair value. The technique used should maximise the use of relevant observable inputs and minimise the use of unobservable inputs.

IFRS 13.63

IFRS 13 does not establish requirements for specific valuation technique(s) to be used unless there is a quoted price in an active market for an identical asset or liability. In some cases only a single valuation technique will be appropriate to assess fair value, in other cases, however, using more than one valuation technique will be more appropriate. An example of a situation in which multiple valuation techniques might be used is when measuring the fair value less costs to sell of a cash-generating unit for the purpose of impairment testing. In such cases an entity may evaluate the indications of fair value resulting from multiple valuation techniques and weigh them considering the reasonableness of the range of values indicated by those results. The fair value measurement when using multiple valuation techniques is the point within the range that is most representative of fair value in the circumstances.

Insight – Valuation techniques for cash-generating units

In practice, an entity estimating the fair value less costs to sell of a cash-generating unit may conclude that it is appropriate to use the guideline public company method, a technique under the market approach that uses valuation multiples such as EV/EBITA¹ taken from the share prices of public entities that are similar to the subject cash-generating unit. Another method it could use is the discounted cash flow (DCF) method, a method that falls under the income approach.

Consideration of both techniques may increase the reliability of the resulting value conclusion. For example, if the DCF estimate is significantly greater than the value indication based on market multiples under the guideline public company method, then this may lead to further scrutiny of the forecast cash flows or discount rate in the DCF method or of the suitability of the comparable entities used in the guideline public company method, resulting in an improved estimate.

The weightings attached to the estimates arrived at using the guideline public company method and the DCF method are a matter of judgement, based on an evaluation of the reliability of the resulting values, the similarity of the selected comparables etc.

IFRS 13.62

IFRS 13 refers to a 'valuation approach' as a broad category of techniques whereas a 'valuation technique' refers to a specific technique such as a particular option pricing model. Valuation techniques used to measure fair value fall into three approaches:

- market approach (see 6.2)
- income approach (see 6.3)
- cost approach (see 6.4).

¹ EV = Enterprise Value, EBITA = Earnings before interest, taxes and amortisations

Insight – Multiple approaches

Any, or a combination, of the three approaches discussed in IFRS 13 could 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, the standard does not prescribe a mathematical weighting scheme, rather it requires the application of judgement. Entities should consider, among other things, the reliability of the valuation techniques and the inputs that are used in the techniques. If a particular valuation technique falling under the market approach relies on higher level inputs, e.g. observable market prices, compared to a valuation technique falling under the income approach that relies heavily on projections of income, then the entity may conclude that it is appropriate to apply greater weight to the measurement of fair value generated by the valuation technique falling under the market approach because it relies on higher-level inputs. Higher level measurements, e.g. Level 1 or 2 measurements, if available and relevant, should not be ignored.

6.2 Market approach

IFRS 13.B6

Valuation techniques that fall under the market approach often derive market multiples from a set of comparable assets. A market multiple expresses the value of a business or other asset in terms of its ratio to a financial, operating or physical metric. For example, a price to earnings ratio expresses an entity's per share value in terms of its earnings per share. The multiple can then be applied to the metric of an entity with similar characteristics but different scale, subject to adjustment for differences between the entity and the selected comparable. When multiples are derived from a number of comparable entities, there will typically be a range of multiples calculated. Selection within the range should be based on market participants' expectations. For example, in estimating the fair value of a cash-generating unit, the point in the range of multiples that is selected for the cash-generating unit would consider differences between the cash-generating unit and comparable cash-generating units in terms of size, growth, profitability, risk, investment requirements etc.

Insight – Market approach

When using quoted prices for similar assets, adjustments are often necessary for differences between the subject asset and the comparable assets. When there is a high degree of subjectivity in estimating the adjustment, e.g. because the asset differs in important respects from the closest comparable assets, the resulting value indication may be less reliable than when the range of possible adjustments is narrower because the subject asset is very similar to the comparable assets.

IFRS 13.B7

Matrix pricing is a valuation technique that is specifically referred to in the standard as an example of a valuation technique falling under the market approach. *Matrix pricing* is a mathematical technique used mainly to value debt securities without relying exclusively on quoted prices for the specific securities, but rather by relying on the securities' relationship to other benchmark quoted securities. Therefore, matrix prices are based on quoted prices for securities with similar coupons, ratings and maturities, rather than on actual prices for the asset being measured.

6.3 Income approach

IFRS 13.B10

The 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. The fair value measurement reflects current market expectations about those future amounts, discounted to their present value. The concept behind the income approach is that an asset is worth what it is expected to earn, discounted for the time value of money and associated risks.

IFRS 13.B11

Common valuation techniques falling under the income approach include present value techniques, option pricing models, the multi-period excess earnings method, and excess (or abnormal) earnings models.

6.3.1

Present value techniques

IFRS 13.B12

The application guidance in IFRS 13 describes two approaches to applying a present value technique: the discount rate adjustment technique and the expected present value technique (see 6.3.2). IFRS 13 does not prescribe a specific method; instead, the present value technique used to measure fair value depends on facts and circumstances specific to the asset or liability being measured and the availability of sufficient data such as cash flow estimates, risk premiums, discount rates and other factors that would be considered by market participants.

IFRS 13.B14

Present value techniques differ in how they capture these elements; however, there are some commonalities when determining the inputs into the valuation techniques.

- The assumptions used for the cash flows and discount rates should reflect market participants' views.
- The assumptions should consider only the factors attributable to the asset or the liability being measured.
- Discount rates should reflect assumptions that are consistent with those inherent in the cash flows to avoid double counting or omitting the effects of certain risk factors.
- Assumptions about cash flows and discount rates should be internally consistent. For example, if the cash flows include the effect of expected inflation, then the discount rate also includes the effects of inflation.

Insight – Cost of capital

In our experience, for some assets and liabilities it is rare that a discount rate can be observed directly from the market. In such circumstances, generally it will be necessary to build up a market participant discount rate that appropriately reflects the risks associated with the cash flows of the asset or liability being measured at fair value. Other IFRSs that deal with discount rates, such as IAS 36, refer to an entity's weighted average cost of capital (WACC) as the starting point in determining a possible appropriate discount rate.

6.3.2

Risk and uncertainty

IFRS 13.B15, B16

A valuation using present value techniques is based on assumptions that are inherently uncertain as they reflect estimates of the future rather than known amounts. Even contractual cash flows that may appear certain at first glance contain risk because of uncertainty about the ability of the counterparty to meet its contractual obligations. For example, contractual cash flows on a loan are subject to a risk of default. A risk premium is therefore included in order for the fair value measurement to reflect the amount that risk-averse market participants would demand to be compensated for the uncertainty of the cash flows.

IFRS 13.B17

Different options are available for making adjustments for risk in present value techniques. The discount rate adjustment technique uses a single estimate of cash flows and adjusts for risk in the discount rate. IFRS 13 notes two possible adjustments for risk in an expected present value technique, which is based on probability-weighted cash flows.

- Method 1 adjusts for risk in the expected cash flows, which are then discounted at the risk-free rate.
- Method 2 uses a risk-adjusted discount rate with expected cash flows.

IFRS 13.B17, B30

There is no preferred method for making adjustments for risk in a present value technique; it depends on facts and circumstances specific to the asset or liability being measured. The risk adjustment may

need to be considered in both cash flows and the discount rate. However, rates used to discount cash flows should not reflect risks for which the estimated cash flows have been adjusted as otherwise the effect will be double counted.

Insight – Certainty-equivalent cash flows

In order to use a risk-free rate when valuing an asset, the expected cash flows need to be adjusted to represent certainty-equivalent cash flows. This means that a market participant would be indifferent between investing in the risky asset and investing in a risk-free investment that generated those cash flows. In our view, although it is theoretically possible that expected cash flows from an asset could be adjusted to incorporate all relevant risks so that the investor was indifferent, the practical application of this approach would be very difficult outside of option pricing and certain derivative modelling.

The discussion in IFRS 13 is a useful clarification that expected cash flows are not necessarily risk adjusted, which is sometimes how they are incorrectly understood in practice. Expected cash flows include both positive as well as negative possible outcomes and, before risk adjustment, they represent only the probability-weighted average outcome.

Illustrative example – Expected present value

Company B owns an item of property, plant and equipment that it measures at fair value. The possible cash flows and associated probabilities from the item of property, plant and equipment are as follows:

Possible cash flows	Probability	Probability-weighted cash flows
700	15%	105 (700 x 15%)
1,000	60%	600 (1,000 x 60%)
1,500	25%	375 (1,500 x 25%)
Expected cash flows		1,080

For illustrative purposes this example has been simplified to show only one year's cash flows.

The risk-free interest rate for one year of cash flows is 5 percent and the risk premium for an asset with the same risk profile is assumed to be 3 percent.

Using *method 1*, the expected cash flows are adjusted for risk. If there are no market data available for the amount of the risk adjustment, then the adjustment can be derived using the concept of certainty equivalents. Using the risk premium of 3 percent, the calculation of the risk adjustment to calculate the certainty equivalent of 1,080 is as follows:

$$\text{Expected cash flows} - \left(\text{Expected cash flows} \times \frac{1 + r_f}{1 + r_m} \right) = 30$$

r_f = risk-free rate

r_m = market return

The certainty-equivalent cash flows of 1,050 (1,080 - 30) are then discounted at the risk-free rate of 5 percent, resulting in a fair value for the item of property, plant and equipment of 1,000.

Using *method 2*, the expected cash flows are not adjusted for risk. The risk adjustment is reflected in the discount rate. The expected cash flows are therefore discounted at the required rate of return of 8 percent, resulting in a fair value for the item of property, plant and equipment of 1,000.

6.3.3 Capital asset pricing model

One method to calculate the discount rate for a present value calculation is to start with the asset's or group of assets' WACC. In determining the cost of equity as an input to the WACC, it is common to use the capital asset pricing model (CAPM), which estimates the cost of equity by adding risk premiums to the risk-free rate. The formula for the CAPM is as follows:

$$r_e = r_f + \beta \times (r_m - r_f) + \alpha$$

r_e = cost of equity

r_f = risk-free rate

β = beta, which is a measure of the correlation between a share's return in relation to the market return

$(r_m - r_f)$ = market return less the risk-free rate or the equity risk premium. This risk premium reflects the average risk required for investing in equities

α = alpha, or unsystematic (entity-specific) risk premium

Risk-free rate. The risk-free rate generally is obtained from the yield on a government bond that is in the same currency and has the same or similar duration as the cash flows of the asset or group of assets being measured at fair value. For countries whose government bonds carry significant credit risk, basic interest rates may be determined by reference to the highest rated corporate bonds issued in the currency of that jurisdiction.

Beta factors. These reflect the risk of a particular industry relative to the market as a whole. Beta typically is calculated for individual listed entities using a regression analysis against an appropriate share index. When developing the cost of equity from the perspective of a market participant, the selected beta generally is based on comparable entities' betas, even if the subject entity is a listed entity.

Careful consideration is given to the period over which the beta is measured. Measurement over a period that is too short may mean that there is insufficient data. Another point to look out for is whether the beta may have been distorted by a particular period of volatility. Measurement over too long a period may mean that data includes periods when the comparable entities were less similar.

The beta calculated for an entity will be affected by not only the industry in which it operates, but also by its leverage because increased debt increases the variability of equity returns. The actual betas of comparable entities are unlevered to remove capital structure effects. The selected industry beta is subsequently re-levered based on the subject asset's expected long-term leverage.

Equity risk premium. The equity risk premium is a measure of the long-term required rate of return on equities above the risk-free rate. As a long-term measure, it should not be impacted significantly by short-term volatility. Various studies of equity risk premium based on historical, expected or implied equity returns are available and these give a range of results depending on the exact period of the data included in the study, the method of calculation etc.

Alpha factor. The alpha factor represents an asset-specific risk premium, and may need to be added to the cost of equity when an asset is determined to carry additional risk that may not be reflected in the beta, i.e. risk that cannot be attributed to market risk. Theoretically, non-systematic risk can be eliminated through diversification but in practice a discount rate that ignores alpha factors may overvalue an asset. An alpha factor may include some or all of the following elements:

Size risk. An additional premium that takes into account that historically smaller businesses have realised higher returns than larger organisations with similar betas.

Country risk. An additional premium that takes into account the additional risk associated with generating and incurring cash flows in a particular country. While a country risk premium is often measured based on the additional premium paid on the sovereign debt of the government of the country in which the entity operates relative to the yield of debt in the same currency of a different low-

risk government, consideration may be required as to whether sovereign risk is a reasonable measure of enterprise risk.

Forecasting risk. An additional premium that takes into account the additional risk associated with achieving forecasts. In practice the need for such an additional risk factor often is identified when the valuation calculation is cross checked to other indications of value.

Illiquidity risk. An additional premium that takes into account the difficulty of being able to sell an investment.

6.3.4 Option pricing models

IFRS 13.B11(b)

Option pricing models such as the Black-Scholes-Merton formula or a binomial model can be used to calculate the fair value of options.

6.3.5 Multi-period excess earnings method

IFRS 13.B11(c)

The multi-period excess earnings method is commonly used in the valuation of intangible assets such as customer relationships or technology. The method is based on a DCF 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 exclude any value related to contributory assets.

Insight – Multi-period excess earnings method

IFRS 13 does not provide detailed guidance on the multi-period excess earnings method, which is complex to apply appropriately. A working group of the Appraisal Foundation² recently issued a document on contributory asset charges, a key component of the multi-period excess earning method, *Identification of Contributory Assets and Calculation of Economic Rents*. The document is non-authoritative but includes useful information on the application of this technique, for which there is limited information available elsewhere.

6.4 Cost approach

IFRS 13.B8

The concept behind the cost approach is that an investor will pay no more for an asset than the cost to purchase or construct a substitute asset of comparable utility.

Insight – Cost approach

The primary method used to calculate fair value under the cost approach is the depreciated replacement cost method. A depreciated replacement cost valuation considers how much it would cost to reproduce 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. The cost approach is not relevant for financial assets.

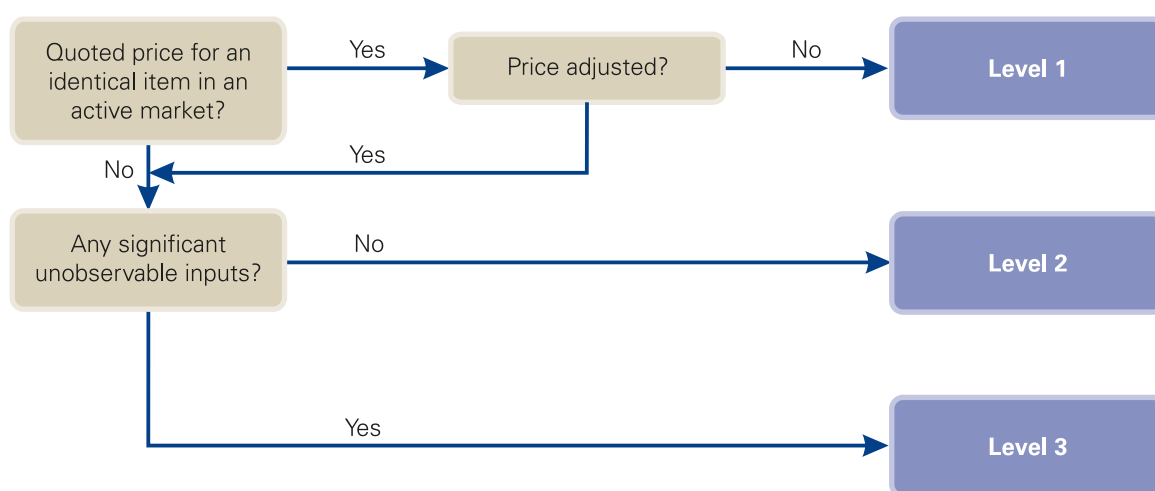
² The Appraisal Foundation regulates the appraisal profession in the US through its sponsoring of two boards: the Appraiser Qualifications Board, which sets education and experience requirements for appraisers, and the Appraisal Standards Board, which issues Uniform Standards of Professional Appraisal Practice (USPAP).

6.5 Fair value hierarchy

IFRS 13.72

IFRS 13 establishes a fair value hierarchy based on the inputs to valuation techniques used to measure fair value to increase consistency and comparability. The inputs are categorised into three levels, with the highest priority given to unadjusted quoted prices in active markets for identical assets or liabilities and the lowest priority given to unobservable inputs.

The diagram below outlines the approach to determining the classification of fair value measurements in the fair value hierarchy:



IFRS 13.73, 74

The level into which a fair value measurement is classified in its entirety is determined by reference to the observability and significance of the inputs used in the valuation model. Valuation techniques often incorporate both observable and unobservable inputs, however, the fair value measurement is classified into its entirety into either Level 2 or Level 3 based on the lowest level input that is significant to the fair value measurement.

IFRS 13.74

The classification into a level of the fair value hierarchy depends on the nature of the inputs into the valuation techniques used, not on the valuation techniques themselves. The classification into Level 1 can only be achieved through the market approach.

6.5.1 Level 1 inputs

IFRS 13.76, A

Level 1 inputs are unadjusted quoted prices in active markets for identical assets or liabilities. The entity needs to be able to access that market at the measurement date.

IFRS 13.A, BC169

An *active market* is a market in which transactions for the asset or liability take place with sufficient frequency and volume for pricing information to be provided on an ongoing basis (see 6.7).

IFRS 13.77, 79

Level 1 prices should generally not be adjusted. However, the standard provides limited circumstances in which an adjustment may be appropriate.

- 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 such as matrix pricing. This practical expedient is only appropriate when the following criteria are met:
 - the entity holds a large number of similar assets or liabilities that are measured at fair value; and
 - a quoted price in an active market is available but not readily accessible for each of these assets or liabilities individually.

- If a quoted price in an active market does not represent fair value at the measurement date, then an entity should establish a policy, to be applied consistently, for identifying such circumstances that may affect fair value. An example might be when a significant event takes place after the close of a market but before the measurement date, such as the announcement of a business combination.
- An entity may measure the fair value of a liability or an entity's own equity instruments using the quoted price of an identical instrument traded as an asset and there may be specific differences between the item being measured and the asset. An example may be when the identical instrument traded as an asset includes a credit enhancement that may be measured separately from the liability if the guarantee is considered to be excluded from the liability's unit of account.

Any adjustment to the quoted price will result in the fair value measurement being classified into a lower level of the fair value hierarchy.

Illustrative example – Adjustments to inputs

Company P invests in shares of Company T that are listed on the London Stock Exchange (LSE). On the reporting date, P obtains the closing price of the shares from the LSE. Subsequent to the closing time of the LSE, T makes a public announcement that has an impact on the fair value of its shares as evidenced by prices for a small number of aftermarket transactions in depositary receipts on the shares of T that are traded on the New York Stock Exchange. P therefore uses 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.

As the adjustment is derived from observed market prices, the resulting fair value measurement will be a Level 2 measurement.

6.5.2

Level 2 and Level 3 inputs

IFRS 13.72

The determination of whether a fair value measurement is categorised into Level 2 or Level 3 depends on whether the inputs used in the valuation techniques are observable or unobservable and their significance to the fair value measurement.

IFRS 13.A

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

IFRS 13.82, A

Inputs are *observable* if they are developed on the basis of publicly available information about actual events or transactions and reflect the assumptions that market participants would use when pricing the asset or liability. If the asset has a specified term, then the input needs to be observable for substantially the full term of the asset or the liability to be classified as Level 2.

IFRS 13.82, BC171

Level 2 inputs are quoted prices for similar assets or liabilities in active markets, or inputs that are based on or supported by observable market data. Examples of Level 2 inputs are interest rates, credit spreads or yield curves that are observed in the market.

IFRS 13.83, 84

Adjustments to Level 2 inputs may be necessary depending on the characteristics of the asset or liability being measured. If Level 2 inputs are adjusted, then an entity assesses whether the adjustment, if based on unobservable inputs, is significant to the entire measurement. If so, then the fair value measurement may be classified into Level 3.

IFRS 13.86, 87

Level 3 inputs are unobservable inputs for the fair value measurement of an asset or a liability. When measuring an asset or a liability, an entity minimises the use of unobservable inputs. However, situations may occur in which relevant inputs are not observable. In such situations unobservable inputs are used based on the best information available about the assumption that market participants would make when pricing the asset or liability.

IFRS 13.87

The general fair value principle introduced by IFRS 13 of using an exit price based on the perspective of a market participant does not change when measuring assets or liabilities using unobservable inputs. Therefore, an entity uses those unobservable inputs that reflect the assumptions that market participants would use when measuring the asset or liability, including assumptions about risk.

IFRS 13.89

When an entity has to use unobservable inputs, IFRS 13 does not preclude an entity from using its own data. However, entities should adjust that data if reasonably available information indicates that other market participants would use different information or there is something particular to the entity's operations or plans that is not available to other market participants, e.g. an entity-specific synergy.

Insight – Significance of inputs

Determining whether an adjustment is significant to a fair value measurement requires judgement, considering factors specific to the asset or liability. When a fair value measurement is developed 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 because the entity's decision to include the lower level input provides evidence that the entity considers the input to be significant to the overall fair value measurement. However, the final determination of whether inputs are significant is a matter of judgement that will require entities to consider the effect of the input on the overall fair value measurement, including alternative possible assumptions for the input. For example, a discount for the lack of marketability based on academic studies rather than being directly observable is likely to be significant both because of its size and the range of possible alternative assumptions.

When multiple unobservable inputs are used, in our view the unobservable inputs should be considered in total relative to the fair value of the asset or liability for purposes of determining their significance of the unobservable inputs on the fair value measurement. When factors such as volatility inputs are used, an entity could apply some form of comparability methodology, e.g. a stress test on an option's volatility input or a 'with and without' comparison, to assist in determining significance.

Illustrative example – Level 2 and Level 3 inputs

Company G is performing a fair value measurement of its investment properties. G measures fair value using prices per square metre derived from prices observed in transactions involving similar buildings in the same geographic areas. Since the inputs used for the fair value measurement are observable inputs and the assets in the observed transactions are sufficiently comparable so that no significant adjustments to the inputs are required, G classifies the fair value measurement as a Level 2 measurement.

6.6

Inputs to valuation techniques

IFRS 13.A

Inputs to valuation techniques are the assumptions that market participants would use when pricing 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, i.e. the pricing model, and the risk inherent in the inputs to the valuation technique.

IFRS 13.67, BC142

Entities select the valuation techniques that are appropriate in the circumstances, for which sufficient data is available, and which maximise the use of relevant observable inputs and minimise the use of unobservable inputs.

Insight – Minimising unobservable inputs

In some cases an entity may be required to adjust the available observable inputs significantly given the characteristics of the asset or liability being measured or market conditions at the measurement date. Unobservable inputs are a part of a fair value measurement if they are required inputs in order to arrive at a fair value measurement and if they relate to factors that market participants would consider.

For example, the fair value of an unquoted security held as an asset may be based primarily on observable market multiples such as EV/EBITA. However, to the extent that market participants would be expected to apply a discount because the shares valued are not publicly traded, a discount for lack of marketability should be considered, even though this is not directly observable.

6.6.1

Premiums, discounts and blockage factors

IFRS 13.69

The inputs used for the valuation technique 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. In some cases, market participants might take into account inputs that require the application of an adjustment, such as a control premium or a non-controlling interest discount.

IFRS 13.69

Whether or not to include a premium or discount in a fair value measurement is a complex matter. Factors to consider under IFRS 13 include: (1) the unit of account of the asset or liability; (2) whether Level 1 inputs (quoted prices in active markets for identical assets and liabilities) are available for the asset or liability; and (3) whether market participants would include a premium or discount in a transaction for the asset or liability given its unit of account.

Illustrative example – Level 1 prices not available

Company T enters into a forward contract to buy 51 percent of the shares in Company S, a listed company. A Level 1 price is available for the underlying shares, but not for the forward contract to buy 51 percent, which is the unit of account under IAS 39, IFRS 3 or IFRS 9. The fair value of the contract would therefore take into account adjustments to the share price if necessary to reflect the value of the forward contract.

IFRS 13.80, BC156

An entity may hold a large number of financial instruments traded in a market that does not have sufficient trading volume to absorb the quantity held, such that selling the holding in a single transaction would affect the quoted price. IFRS 13 clarifies that such a *blockage factor* is not a characteristic of the asset (the financial instrument), but a characteristic of the size of the entity's holding. Accordingly, a blockage factor is specific to the entity, not to the asset or liability itself, and therefore should not be included in the fair value measurement.

6.6.2

Inputs based on bid and ask prices

IFRS 13.70

Some assets or liabilities measured at fair value have a bid and ask price. In such cases, an entity uses the price within the bid-ask spread that is the most representative of fair value in the circumstances.

IFRS 13.70

Under IFRS 13 the use of bid prices for long positions and ask prices for short positions is permitted but not required.

IFRS 13.71

The use of mid-market prices or other pricing conventions is not prohibited if the same conventions are generally used by market participants as a practical expedient for fair value measurements within a bid-ask spread.

*IFRS 9.B5.4.4,
IAS 39.AG72*

The application guidance to IAS 39 established requirements for when bid and ask prices should be used in the context of financial instruments with a quoted market price in an active market. The fair value of a financial asset to be acquired or a financial liability held is usually determined using the current ask price; and for financial assets held or financial liabilities to be issued, the current market bid price is usually used.

IFRS 13 deletes this guidance and replaces it with the requirement to use the point in the bid-ask spread that is most representative of fair value. IFRS 13 applies the same principle to all levels of the fair value hierarchy (see 6.5).

*IFRS 9.B5.4.2,
IAS 39.AG70*

IAS 39 and IFRS 9 currently state that the bid-ask spread only includes transaction costs. IFRS 13 deletes this guidance although it does not specify what, if anything, besides transaction costs is included in the bid-ask spread. Therefore, an entity may need to make an assessment of what the bid-ask spread represents when determining the price that is most representative of fair value within the bid-ask spread.

6.7 Measuring fair value when volume/level of activity have significantly decreased

6.7.1 General principle

IFRS 13.B37, B42

The fair value of an item may be affected when there has been a significant decrease in the volume or level of activity for that item compared to its normal market activity. Judgement is required in determining whether, based on the evidence available, there has been a significant decrease in the volume and level of activity for the asset or liability. The entity should assess the significance and relevance of all facts and circumstances. Factors that might be taken into account when performing the assessment include:

- there are few recent transactions;
- price quotations are not based on current information;
- price quotations vary substantially over time or between market makers;
- indices that previously were highly correlated with the fair values of the asset or the 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 for transactions observed in the market or quoted prices compared with the entity's estimate of expected cash flows;
- there is a wide bid-ask spread or significant increase in the bid-ask spread;
- there is a significant decline in primary market activity for similar assets or liabilities; and
- little information is publicly available.

IFRS 13.B38

If an entity concludes that the volume or level of activity 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. However, if an entity determines that a transaction or quoted price does not represent fair value, then an adjustment to these prices is necessary if they are used as a basis for determining fair value.

IFRS 13.B40

It might be appropriate for an entity to change the valuation technique used or to use multiple valuation techniques to determine the fair value of an asset or a liability, if the volume or level of activity has significantly decreased.

6.7.2 Transactions that are not orderly

IFRS 13.B43

It is generally reasonable to assume that an asset or liability is exchanged in an orderly transaction between market participants (see 4.2.2). However, there are circumstances in which an entity needs to assess whether a transaction is orderly. For example, a decline in the price of an asset may lead to a sale of all or part of an entity's holdings of the asset to meet margin requirements. Such a sale may be orderly depending on the time available compared with the usual and customary marketing period, the transaction price compared with other recent transactions, market liquidity etc. This determination is more difficult if there has been a significant decrease in the volume or level of activity in a market for the asset or liability.

IFRS 13.B43

It is not appropriate to conclude that all transactions in a market in which there has been a decrease in the volume or level of activity are not orderly. Therefore, an entity performs an analysis to determine whether, based on the evidence available, a transaction is orderly or not. If the evidence indicates that a transaction was not orderly, then the entity places little if any weight on the transaction price when measuring fair value. However, if evidence indicates that the transaction was orderly, then the entity considers the transaction price in estimating the fair value of the asset or liability. The weight placed on such a transaction price depends on the circumstances, such as the volume and timing of the transaction and the comparability of the transaction to the asset or liability being measured. If an entity does not have sufficient information to conclude whether a transaction was orderly, then it should take the transaction price into account but place less weight on it compared to transactions that are known to be orderly.

IFRS 13.B44

Although an entity need not undertake exhaustive efforts to determine whether a transaction was orderly, it should not ignore information that is reasonably available. When an entity is party to a transaction, it is presumed to have sufficient information to conclude whether the transaction was orderly.

6.7.3 Quoted prices provided by third parties

IFRS 13.B45

IFRS 13 does not preclude the use of quoted prices provided by third parties, such as brokers or pricing services, provided that the quoted prices are determined in accordance with the guidance in IFRS 13.

IFRS 13.B46, B47

If there has been a significant decrease in the volume or level of activity for an asset or a liability, then an entity needs to evaluate whether third-party prices are developed using current market information that reflects orderly transactions and market participant assumptions. If an entity obtains prices from a third-party pricing service or broker as inputs to a fair value measurement, then it places less weight on quotes that do not reflect the result of transactions. Furthermore, the nature of the quote should be taken into account with quotes representing binding offers given a higher weight than those representing indicative bids. Whether third-party prices represent observable or unobservable inputs depends on their nature and source.

Insights – Pricing services and broker quotes

The use of a pricing service does not change the analysis of the categorisation 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. Rather, an entity using a pricing service should obtain an understanding of the source of the inputs used by the pricing service to properly classify any fair value measurements based on those inputs. For example, if a pricing service provides an unadjusted quoted price from an active market for an identical instrument, then a fair value measurement based only on that price would be a Level 1 measurement. Alternatively, if the pricing service provides prices based on models generated by the pricing service, then any resulting fair value measurement would be a Level 2 or Level 3 measurement depending on the observability and significance of the inputs used.

Consensus pricing services obtain information from multiple subscribers who each submit prices to the pricing service. The pricing service returns consensus prices to each subscriber based on the data received. 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, then 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, then the use of those prices may result in Level 2 measurement.

Similar considerations apply to prices obtained from brokers. A broker quote generally is not a binding offer. Even if it is, it may not represent the price at which an orderly transaction would take place between market participants. When a broker quote reflects actual current market transactions in an identical instrument, it may represent a Level 1 or Level 2 input. However, when a broker quote is an indicative price based on the broker's valuation models, then it may represent a Level 2 or Level 3 input.

7. Disclosures

7.1 General requirements

IFRS 13.91, BC185

IFRS 13 contains a comprehensive disclosure framework that combines the fair value measurement disclosures currently required by IFRSs and requires additional disclosures that users of financial statements have suggested would be useful. The objective of the disclosures for assets and liabilities measured at fair value is to provide information that enables users of financial statements to assess the methods and inputs used to develop those measurements and, for recurring fair value measurements using significant unobservable inputs (Level 3), the effect of the measurements on profit or loss or other comprehensive income.

IFRS 13.93(a)

Disclosure requirements are different depending on whether the fair value measurement is recurring or non-recurring. Recurring fair value measurements arise from assets and liabilities measured on a fair value basis at each reporting date. This does not necessarily mean that a valuation is performed every reporting period. For example, an entity may carry land and buildings using the revaluation model under IAS 16 *Property, Plant and Equipment*. IAS 16 requires revaluations to be performed when the fair value of a revalued asset differs materially from its carrying amount.

Non-recurring fair value measurements are fair value measurements that are triggered by particular circumstances, e.g. an asset being classified as held for sale.

IFRS 13.93(h)(iii)


The requirement to provide a quantitative sensitivity analysis to a reasonably possible alternative significant unobservable input is limited to financial assets and financial liabilities that are both measured at fair value on a recurring basis and within Level 3 of the fair value hierarchy.

IFRS 13.93, 94

In order to meet the disclosure objective, an entity makes the required disclosures for each class of assets and liabilities. Class is determined based on the nature, characteristics, and risks of the asset or liability, and the level into which it is categorised within the fair value hierarchy.

The disclosure requirements are more extensive for Level 3 measurements that are recurring, as is shown in the following table:

	Requirement	Recurring			Non-recurring			FV disclosed		
		L1	L2	L3	L1	L2	L3	L1	L2	L3
<i>IFRS 13.93(a)</i>	Fair value at end of reporting period									
<i>IFRS 13.93(a)</i>	Reasons for the measurement									
<i>IFRS 13.93(b)</i>	Level within hierarchy									
<i>IFRS 13.93(c)</i>	Transfers within hierarchy									
<i>IFRS 13.93(d)</i>	Description of valuation technique									
<i>IFRS 13.93(d)</i>	Any changes to valuation technique and reasons									
<i>IFRS 13.93(d)</i>	Quantify unobservable inputs									
<i>IFRS 13.93(e)</i>	Reconciliation of opening and closing balance									
<i>IFRS 13.93(f)</i>	Unrealised gains/losses from remeasurement									
<i>IFRS 13.93(g)</i>	Description of valuation processes and policies									
<i>IFRS 13.93(h)(i)</i>	Narrative sensitivity to changes in unobservable inputs									
<i>IFRS 13.93(h)(ii)</i>	Quantitative sensitivity to changes in unobservable inputs (for financial assets and financial liabilities only)									
<i>IFRS 13.93(i)</i>	If highest and best use differs from actual, then reasons why									

 Disclosure required

Insight – Non-recurring fair value measurement disclosures

The requirements for non-recurring fair value measurements require the disclosure of amounts as at the reporting date. However, a non-recurring fair value measurement, such as an impairment write-down, may have occurred prior to the reporting date, e.g. the impairment test of an asset measured in accordance with IFRS 5 was performed at 30 September and the entity has a 31 December reporting date. While not explicit, it appears that the fair value measurement disclosures should be based on the fair value at which the item is measured at the reporting date, even if that fair value was determined as of an earlier date. For example, Company X has assets that are classified as held for sale at its reporting date of 31 December 2011. These assets were written down to fair value less costs to sell at 30 September 2011. In its financial statements, X uses the valuation at 30 September 2011 to form the basis of its fair value disclosures as this valuation formed the basis of its carrying amount at 31 December 2011.

Illustrative disclosure – Narrative description of the sensitivity to changes in unobservable inputs

The significant unobservable inputs used in the fair value measurement of Company B's livestock assets are growth rates and mortality rates. The inputs used for growth and mortality are 12 percent and 5 percent 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 the 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. The effects of these changes partially offset each other. We have estimated that a 1 percent increase in the growth rate would increase the mortality rate by 0.4 percent.

Illustrative disclosure – Asset used differently from highest and best use

Company X operates a brewery on a 1,000 square metre piece of land in an area that has recently been re-zoned 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.

X is using the land and buildings in a manner that differs from its highest and best use in order to continue its current manufacturing operations. This is consistent with the long-term strategy and core operations of X. X is not in a position to carry out such a conversion as the brewery is integral to X's operations.

IFRS 13.95, 96

IFRS 13 requires disclosure of accounting policy choice elections in relation to:

- the timing of transfers between levels in the hierarchy, e.g. the beginning of the reporting period; and
- the decision whether or not to apply the exception in relation to measuring a group of financial assets and financial liabilities with offsetting risk positions in paragraph 48 of IFRS 13.

IFRS 13.98

An entity discloses the existence of an inseparable third-party credit enhancement issued with a liability and whether that credit enhancement is reflected in the fair value measurement of the liability.

7.2 Financial instruments

IFRS 7.27B(e),
13.93(h)(iii), BC209

For financial assets and financial liabilities measured at fair value on a recurring basis categorised within Level 3, a quantitative sensitivity analysis is disclosed. The sensitivity analysis requires the quantification of the effect, if significant, of changing one or more of the unobservable inputs to reflect reasonably possible alternative assumptions as currently required by IFRS 7, including how the effect was calculated.

Insight – Reasonably possible alternative assumptions

In our view, reasonably possible alternative assumptions are assumptions that could reasonably have been included in the valuation model at the reporting date based on the circumstances at that date. A quantitative sensitivity analysis for financial instruments provides information about the sensitivity of the fair value measurement at the measurement date to changes in reasonably possible alternative unobservable inputs. Therefore, we do not believe that this disclosure is intended to be a forward looking sensitivity analysis about an entity's exposure to future changes in market variables.

IFRS 13.BC206

The IASB proposed a measurement uncertainty analysis, which took into account the impact of correlation of inputs, in its June 2010 exposure draft. In re-deliberations the IASB took into account concerns raised that the costs associated with preparing such a disclosure would outweigh the benefits to users once the information had been aggregated by class of asset or liability. As a result, narrative disclosure of the existence and directional effect of interrelationships between unobservable inputs is required but IFRS 13 does not require the effect of that interaction to be reflected in a quantitative disclosure. Also, the Boards decided not to extend at present the quantitative sensitivity analysis beyond financial instruments to non-financial items. However, the IASB will consider whether such a requirement should be introduced in the future.

IFRS 13.D78

For financial instruments measured at fair value, the fair value disclosures required in annual financial statements also apply for interim financial reports in accordance with IAS 34.

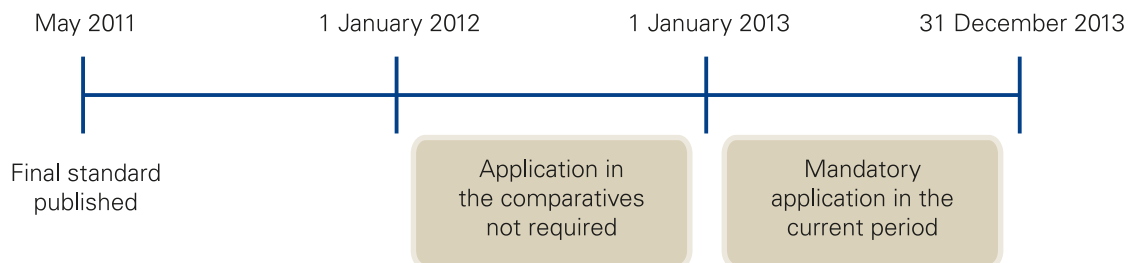
IFRS 13.BC224

The preparation of these disclosures on a more frequent basis will result in increased costs and disclosures for entities preparing interim financial reports. However, the IASB considered that the benefit of these disclosures for financial instruments outweighed the costs given the increased interest in those instruments during the global financial crisis.

8. Effective date and transitional requirements

IFRS 13.C1, C2

IFRS 13 specifies prospective application for annual periods beginning on or after 1 January 2013. Prospective application will mean that any changes from adjustments to valuation techniques will be recognised in profit or loss in the period of adoption. Entities may be required to disclose the impact, if significant. The consequential amendments to IAS 34 will be applicable when an entity applies IFRS 13. Comparative disclosures and measurements are not required for the first period of application. The following diagram demonstrates the transitional requirements of IFRS 13:



IFRS 13.C1

IFRS 13 may be applied earlier, in which case this fact should be disclosed.

9. Impact of consequential amendments to other standards

IFRS 13 contains consequential amendments to other IFRSs. Prior to the issuance of IFRS 13, other IFRSs contained definitions of fair value as well as guidance on how to perform fair value measurements. By issuing IFRS 13, a single source of guidance for fair value measurements has been established, with the consequential amendments reflecting that fair value measurement guidance is generally no longer included in other IFRSs. In addition, there have been some instances in which subtle changes to the requirements of some standards have been made in order to align fair value measurement principles across IFRSs.

Some editorial changes have been made across many standards to improve the consistency of IFRSs. These amendments include changing:

- 'determining fair value' to 'measuring fair value'
- 'estimating fair value' to 'measuring fair value'
- 'market price' to 'quoted price', which is not defined in IFRS 13
- 'market value' to 'fair value'
- 'unquoted instrument' to 'instrument that does not have a quoted price in an active market for an identical instrument, i.e. a Level 1 input'
- 'willing buyer and seller' to 'market participant buyers and sellers'
- 'estimated cash flow model' to 'a present value technique'
- 'reliably determinable' to 'reliably measurable'.

The following discussion summarises the key impacts of the consequential amendments to other standards.

9.1 First-time adoption of IFRS

IFRS 1.D6, 13.D2-D4

IFRS 1 *First-time Adoption of International Financial Reporting Standards* contains exemptions that allow assets and liabilities to be measured at fair value. Of particular note is that fair value can be used as deemed cost at the date of transition for some assets, e.g. property, plant and equipment. IFRS 1 requires an entity to apply the definition of fair value in IFRS 1 and 'any more specific guidance in other IFRSs on the determination of fair values for the asset or liability in question'. This has now been amended to 'apply the definition of fair value in IFRS 13 along with the requirements in that IFRS for measuring the fair value of the asset or liability in question'.

As a result of this amendment, there is no longer a need for entities to determine which standard they should refer to for guidance on fair value measurement.

9.2 Business combinations

IFRS 3.B44, B45, 13.D8

IFRS 3 contains limited fair value measurement guidance in relation to particular identifiable assets and non-controlling interests (NCI) in an acquiree. IFRS 3 generally allows entities to elect to measure NCI at fair value at the acquisition date. This guidance remains after the consequential amendments, though it has been modified. NCI is required to be valued at the quoted price multiplied by the number of units when there is an active market for those units.

IFRS 3.B43, 13.D8

Guidance on measuring the fair value of assets that the acquirer intends not to use or to use in a way that is different from the way in which other market participants would use them is consistent with the

guidance on the highest and best use premise for non-financial assets in IFRS 13 (see 5.1). As such, there is only a modification in IFRS 3 to clarify that the fair value measurement reflects highest and best use both initially and when subsequently measuring the fair value less costs to sell of the assets for impairment testing purposes.

IFRS 3.B45, 13.D8

IFRS 3 notes that the per-share valuation of the acquirer's interest and the NCI might differ. The main difference is likely to be the inclusion of a control premium in the per-share fair value of the acquirer's interest, or conversely, a non-controlling interest discount in the per-share fair value of the NCI. IFRS 13 clarifies that this would be the case if market participants would take into account such a premium or discount when pricing the non-controlling interest (when no Level 1 price is available for such a non-controlling interest).

IFRS 3.B46, 13.81, D8

Guidance for an entity to follow in relation to measuring the acquisition-date fair value of its pre-existing interest in the acquiree has been changed. Existing guidance required an entity to use one or more valuation techniques that are appropriate in the circumstances and for which sufficient data are available. An entity is now required to maximise the use of relevant observable inputs and minimise the use of unobservable inputs in performing the fair value measurement.

9.3 Financial instruments

9.3.1

IFRS 7 Financial Instruments: Disclosures

IFRS 13.120

The fair value measurement disclosure requirements in relation to the fair value hierarchy will be moved from IFRS 7 to IFRS 13. The following table maps the disclosure requirement moves:

Old requirement	New requirement
IFRS 7.27	IFRS 13.93(d)
IFRS 7.27A	IFRS 13.72
IFRS 7.27B(a)	IFRS 13.93(b)
IFRS 7.27B(b)	IFRS 13.93(c)
IFRS 7.27B(c)	IFRS 13.93(e)
IFRS 7.27B(d)	IFRS 13.93(f)
IFRS 7.27B(e)	IFRS 13.93(h)(ii)

IFRS 13.B211, B212

These disclosure requirements have not significantly changed following their move to IFRS 13, with the exception of paragraph 27B(b) of IFRS 7, which requires "any significant transfers between Level 1 and Level 2 of the fair value hierarchy and the reasons for those transfers" to be disclosed. The requirement by paragraph 93(c) of IFRS 13 is for "the amounts of any transfers between Level 1 and Level 2 of the fair value hierarchy, the reasons for those transfers and the entity's policy for determining when transfers between levels are deemed to have occurred". The IASB decided against using the word 'significant' because of the over-arching materiality principle in IFRSs.

IFRS 7.28, 28A, 13.D14

Additional disclosures are required when an entity uses a fair value measurement at initial recognition that is different from the transaction price and which is not based wholly on data from observable markets such that the difference is not immediately recognised in profit or loss (see 5.3.1 and 9.3.2). Currently, in similar circumstances, IFRS 7 requires, by class of financial asset or financial liability, disclosure of the entity's accounting policy for recognising that difference in profit or loss, the amount of the difference yet to be recognised in profit or loss and a reconciliation of changes in this balance during the period. The amendments require additional disclosure of the reason why the entity concluded that the transaction price was not the best evidence of fair value and a description of the evidence that supports that fair value.

9.3.2

IAS 39 *Financial Instruments: Recognition and Measurement*

Most of the guidance currently contained in IAS 39 and IFRS 9 on how to measure fair value is deleted and replaced by cross-references to IFRS 13.

IFRS 13.D96-D112

However, guidance on recognising gains or losses at initial recognition, although modified by IFRS 13, is retained in IAS 39. Under IAS 39, a financial asset or liability is initially recognised at fair value (plus transaction costs, if appropriate). The best evidence of fair value at initial recognition is assumed to be the transaction price unless a different fair value measurement is evidenced by comparison with other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable markets. If the application of this observability condition results in no gain or loss being recognised at initial recognition, i.e. an apparent day one gain or loss is not recognised because an alternative fair value measurement is not supported by observable market data, then a gain or loss is recognised after initial recognition only to the extent that it arises from a change in a factor (including time) that market participants would consider.

The consequential amendments introduced by IFRS 13 align the guidance on measurement with the definitions in IFRS 13 but without substantively changing the threshold for the recognition of day one gains or losses. Under the amended IAS 39 guidance, the initial measurement of the financial instrument is based on fair value as defined in IFRS 13, but the carrying amount of the financial instrument is adjusted to defer any difference between the fair value measurement and the transaction price. However, an exception arises when the fair value measurement is evidenced by a quoted price in an active market for an identical asset or liability, i.e. a Level 1 input, or based on a valuation technique that uses only observable market data. If this observability condition is met at initial recognition, then any difference is recognised in profit or loss immediately. If the observability condition is not met, then the deferred difference is subsequently recognised 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 below illustrates the application of the day one gain and loss guidance at initial recognition in cases when there is a difference between the transaction price (100) and management's alternative estimate of fair value (99) and the estimate does not satisfy the observability condition.

	Pre IFRS 13	Post IFRS 13
Fair value	Transaction price, e.g. 100	Management's estimate of exit price, e.g. 99
Initial measurement (ignoring transaction costs)	Fair value = 100	Fair value 99 <i>plus</i> difference between fair value and transaction price 1 (100 - 99) = 100

9.3.3

IFRS 9 *Financial Instruments*

IFRS 13.D18-D46

IFRS 9 is updated in a similar manner to IAS 39, with the key change being the addition of paragraphs B5.1.2A and B5.2.2A that discuss day one gains or losses. Under IFRS 13 the guidance in IFRS 9 on when cost may be the most appropriate measure of fair value is retained (see 5.3.3).

9.4

Tangible and intangible assets

*IFRS 13.D55,
IAS 16.26, 38.47, 40.29*

IFRS 13 provides guidance in relation to assessing when fair value can be measured reliably for items of property, plant and equipment, intangible assets and investment property. These standards all contain the same guidance allowing comparable market transactions to be used as a fair value

measurement without further consideration. The amendment to these paragraphs results in entities having to make further assessments to ensure that (1) the variability in the range of reasonable fair value measurements is not significant for that asset and (2) the probabilities of the various estimates within the range can be reasonably assessed when measuring fair value.

9.4.1 **IAS 16 Property, Plant and Equipment**

IFRS 13.D56, IAS 16.72 Guidance on how to measure fair value under IAS 16 has been deleted. The guidance in IFRS 13 is largely consistent with the guidance that has been deleted from IAS 16.

IFRS 13.D57, IAS 16.77 The disclosure requirements in IAS 16 have been deleted when they are duplicated in IFRS 13. In addition to the disclosure requirements of IFRS 13, entities are still required to disclose the effective date of any revaluation, whether an independent valuer was involved and, for each class of property, plant and equipment, the carrying amount that would have been recognised under the cost model and the revaluation surplus.

9.4.2 **IAS 40 Investment Property**

IFRS 13.11, D119, D120 A significant amount of guidance has been deleted from IAS 40 as it relates to measurement guidance that is addressed in IFRS 13. IFRS 13 contains guidance for all assets and liabilities rather than the investment property specific guidance in IAS 40. The deletion of paragraph 51 of IAS 40 may result in changes to practice as this paragraph restricted future capital expenditure from being included in a fair value measurement.

9.4.3 **IAS 41 Biological Assets**

IFRS 13.11, D126 Fair value measurement guidance existed in IAS 41 that is deleted by IFRS 13. Much of this guidance is consistent with IFRS 13 as shown in the table below:

IAS 41 guidance	IFRS 13 guidance
9. The fair value of an asset is based on its present location and condition. As a result, for example, the fair value of cattle at a farm is the price for the cattle in the relevant market less the transport and other costs of getting the cattle to that market.	11. When measuring fair value an entity shall take into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset at the measurement date. Such characteristics include the condition and location of the asset.
17. If an entity has access to different active markets, the entity uses the most relevant one.	17. In the absence of evidence to the contrary, the market in which the entity would normally enter into a transaction to sell the asset or to transfer the liability is presumed to be the principal market.
18. If an active market does not exist, an entity may use one or more of (a) the most recent transaction price, (b) market prices for similar assets with adjustments to reflect differences or (c) sector benchmarks.	63. If multiple valuation techniques are used to measure fair value, the results shall be evaluated and weighted, as appropriate, considering the reasonableness of the range of values indicated by those results. A fair value measurement is the point within that range that is the most representative of fair value in the circumstances.

IAS 41 guidance	IFRS 13 guidance
19. In some cases these information sources may suggest different conclusions. An entity considers the reasons for these differences, in order to arrive at the most reliable estimate of fair value within a relatively narrow range of reasonable estimates.	B38. Adjustments may also be necessary in other circumstances (e.g. when a price for a similar asset requires significant adjustment to make it comparable to the asset being measured or when the price is stale).
20. If market prices are not available, an entity uses the present value of expected net cash flows from the asset discounted at a current market-determined rate.	61. Use valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs.
21. In determining the present value of expected net cash flows, an entity includes the net cash flows that market participants would expect the asset to generate in its most relevant market.	B10. When using the income approach, the fair value is the value indicated by current market expectation about those future amounts.

IAS 41.40

The fair value disclosures apply to IAS 41 assets in addition to the existing disclosures of IAS 41. Of the disclosure requirements from paragraphs 40 to 57 of IAS 41, only paragraphs 47 and 48 are deleted as these are duplications of IFRS 13. As a result, there are significant new disclosure requirements for IAS 41 assets, with no relief from existing disclosure requirements.

9.5 Impairment of assets

*IFRS 13.D85,
IAS 36.53A*

IFRS 13 inserts additional guidance into IAS 36 in order to clarify the differences between value in use and fair value. It does not give an exhaustive list of the differences, but rather points out the major differences to clarify that although it is similar to fair value, value in use is not fair value and should not be used as a proxy for fair value.

*IFRS 13.D86,
IAS 36.134(d)*

IFRS 13 amends the disclosure requirements when an entity uses fair value less costs to sell to measure recoverable amount. These disclosures are required regardless of whether the asset has been impaired and so would need to be made even if the carrying amount is not reflective of fair value less costs to sell. The additional disclosure requirements relate to the level within the hierarchy in which the fair value measurement is categorised (ignoring the impact of costs to sell) and the valuation technique used. If there has been a change in the valuation technique, then the change and the reason for making the change is disclosed. This requirement does not encompass a change from value in use to fair value less costs to sell, but rather a change in the valuation technique used to measure fair value less costs to sell from the previous valuation.

9.6 Employee benefits

IFRS 13.D62, IAS 19.102

IFRS 13 deletes guidance in IAS 19 on how to measure the fair value of plan assets when market prices are not available.

IAS 26.33

IFRS 13 deleted guidance that stated that in the case of marketable securities fair value is usually market value because this is considered the most useful measure of the securities at the reporting date and the investment performance for the period. However, the deleted guidance is consistent with guidance in IFRS 13 in relation to valuation techniques and using inputs to valuations.

10. US GAAP comparison

10.1 Background

In November 2006 the IASB published a discussion paper *Fair Value Measurements*, using FASB Statement No 157, *Fair Value Measurements* (Statement 157) (subsequently codified as Topic 820) as a basis for its preliminary views. The IASB used Statement 157 as a starting point for its deliberations given its consistency with much of the fair value measurement guidance in IFRSs and the desire for convergence with US GAAP.

In May 2009 the IASB published an exposure draft on fair value measurement. The IASB received 160 comment letters in response to the proposals. One of the most prevalent comments was that the Boards should work together to develop common fair value measurement and disclosure requirements, as some of the IASB proposals were inconsistent with Topic 820. The Boards began to deliberate jointly and in June 2010 the IASB exposed a proposal to require a quantitative sensitivity analysis related to unobservable inputs in a fair value measurement, while the FASB concurrently exposed amendments to Topic 820. After further joint redeliberations at the end of 2010, the project culminated in May 2011 in the release of IFRS 13 and a revised Topic 820 containing largely consistent fair value measurement requirements.

10.2 US GAAP/IFRS fair value measurement differences

10.2.1 Differences between IFRS 13 and Topic 820

IFRS 13 is largely consistent with Topic 820. However certain differences exist:

IFRS 13.BC238(a)

Measuring the fair value of investments in investment entities. US GAAP contains a practical expedient that permits use without adjustment of the reported net asset value of an investment in an investment entity as a measure of the fair value if certain criteria are met. IFRS 13 does not include a similar practical expedient.

Measuring the fair value of a financial liability with a demand feature. US GAAP describes the fair value measurement of a deposit liability as the amount payable on demand at the reporting date. Under IFRS 13 the fair value measurement of a financial liability with a demand feature cannot be less than the present value of the amount payable on demand.

IFRS 13.BC233(b)

Disclosures. There are some differences in disclosure requirements. For example, IFRS 13 requires a quantitative sensitivity analysis for financial instruments that are measured at fair value and categorised in Level 3 of the fair value hierarchy; this is not required by Topic 820. Also, Topic 820 has different disclosures for non-public entities.

Effective date. The amendments to Topic 820 are effective for periods beginning on or after 15 December 2011, meaning that this standard will be effective one year before IFRS 13 will be mandatorily effective.

IFRS 13.BC237

In addition, there are minor wording and style differences that do not impact the application of the standards.

10.2.2 Differences in when and what fair value measurements are required between IFRS and US GAAP

IFRS 13 and Topic 820 provide guidance on how to measure fair value. There are other differences that arise due to differences in other accounting literature in IFRSs and US GAAP. These include:

Scope. Different assets, liabilities and equity instruments are measured at fair value in IFRSs and US GAAP.

Recognition of gains or losses at initial recognition. IFRS 13 and Topic 820 contain identical guidance as to the fair value measurement at initial recognition of a financial instrument. However, IAS 39 and IFRS 9 continue to restrict recognition of the difference between the transaction price and the fair value at initial recognition as a gain or loss unless the fair value measurement uses only data from observable markets. Conversely, although Topic 820 does not contain such a restriction, US GAAP requires many financial assets and financial liabilities to be measured initially at cost.

Unit of account considerations. As IFRS 13 and Topic 820 generally do not prescribe the unit of account, there continue to be differences between IFRSs and US GAAP in relation to the unit of account.

Presentation. Presentation differences may also arise because IAS 32 generally does not allow the net presentation (offsetting) of derivatives. The IASB and the FASB currently have an active project in relation to offsetting of financial instruments, which may impact this area.

About this publication

This publication has been produced by the KPMG International Standards Group (part of KPMG IFRG Limited).

Content

Our First Impressions publications are prepared upon the release of a new standard, interpretation or other significant actual or proposed amendment to the requirements of IFRSs. They include a discussion of the key elements of the new requirements and highlight areas that may result in a change of practice. Examples are provided to assist in assessing the impact of implementation.

This edition of First Impressions considers the requirements of IFRS 13 *Fair Value Measurement*.

The text of this publication is referenced to IFRS 13 and to other current IFRSs in issue at 1 June 2011. References in the left-hand margin identify the relevant paragraphs of the IFRSs.

In many cases further interpretation will be needed in order for an entity to apply IFRSs to its own facts, circumstances and individual transactions. Further, some of the information contained in this publication is based on initial observations developed by the KPMG International Standards Group, and these observations may change as practice develops.

We will update and supplement the interpretative guidance and examples in this publication by adding additional interpretative guidance to *Insights into IFRS*, our practical guide to IFRSs.

Abbreviations

Throughout this publication we use the following abbreviations:

FASB	US Financial Accounting Standards Board
IASB	International Accounting Standards Board
IFRSs	International financial reporting standards
US GAAP	US generally accepted accounting principles

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A more detailed discussion of the accounting issues that arise from the application of IFRSs can be found in our publication *Insights into IFRS*.

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Acknowledgements

We would like to acknowledge the principal authors of this publication. They are Jim Calvert, Silvie Koppes, Heath Preston, Andrea Schriber and Chris Spall of the KPMG International Standards Group.

We would also like to thank the contributions made by other reviewers, who include other members of the global Valuations and Impairment Topic Team:

Cyrus Balsara	KPMG in the UAE
Marc Castedello	KPMG in Germany
Robert de Virion	KPMG in Poland
Egbert Eeftink	KPMG in the Netherlands
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Sylvie Leger	KPMG in Canada
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BJ Orzechowski	KPMG in the US
Julie Santoro	KPMG in the UK
Elizabeth Sherratt	KPMG in South Africa
Kuldip Singh	KPMG in Panama
Sharon Todd	KPMG in the US
Orazio Vagnozzi	KPMG in Italy
Beth Zhang	KPMG in China

as well as other members of the global Financial Instruments Topic Team:

Marco Andre Almeida	KPMG in Brazil
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Ana Cortez	KPMG in Hong Kong
Jean-François Dandé	KPMG in France
Terry Harding	KPMG in Germany
Gale Kelly	KPMG in Canada
Agnes Lutukai	KPMG in South Africa
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Venkataramanan Vishwanath	KPMG in India
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Publication name: *First Impressions: Fair value measurement*

Publication number: 314672

Publication date: June 2011

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