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IFRS Newsletter

Special Edition

IFRS 13, *Fair Value Measurement*

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"Fair value is pervasive in International Financial Reporting Standards (IFRS) – it's permitted or required in more than twenty of the International Accounting Standards Board's (IASB) standards. But most reported assets and liabilities do not have quoted market prices, so fair value needs to be estimated. Despite its widespread use, the guidance in IFRS on fair value estimation has been patchy and inconsistent. IFRS 13 aims to address this by providing a single, more comprehensive source of guidance that will apply to almost all fair value estimates (including disclosed fair values).

Valuation techniques and assumptions used in making these estimates will need to be reviewed. For non-financial assets in particular, entities may find that they need to refine their valuation methods.

But will IFRS 13 actually change fair values significantly? The answer will often be "no", as much of the new guidance is intended to be consistent with common valuation practices. However, its impact ultimately depends on the items being fair valued and the techniques currently used. For example, if a company includes "blockage" adjustments when valuing a large shareholding, then IFRS 13 will certainly make a difference.

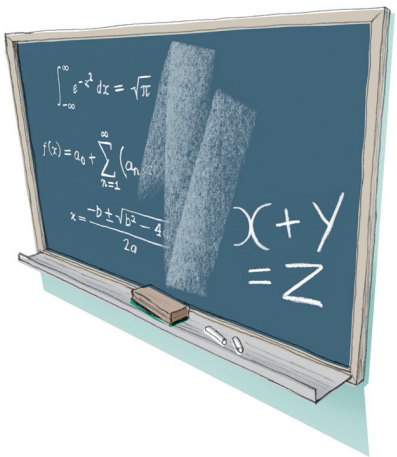
Even entities largely unaffected by the valuation guidance are likely to be affected by IFRS 13's extensive disclosures."

Andrew Watchman
Executive Director of International Financial Reporting

The IASB has published IFRS 13, *Fair Value Measurement*. The standard:

- explains how to measure fair value by providing a clear definition and introducing a single set of guidance for (almost) all fair value measurements;
- clarifies how to measure fair value when a market becomes less active;
- improves transparency through additional disclosures.

IFRS 13 applies to both financial and non-financial items but does not address or change the requirements on when fair value should be used.



Summary of IFRS 13

IFRS 13 provides a new definition of fair value and a single source of guidance for (almost) all fair value measurements used in IFRS financial statements. Prior to its publication, the guidance on fair value was distributed across many IFRSs, with some containing quite limited guidance while others contained extensive guidance that was not always consistent.

The table to the right summarizes the main requirements of the new standard.

Summary of IFRS 13's requirements

Requirement	Significance
Scope	• Addresses all fair value and "fair value-based" measurements (except those in IFRS 2, *Share-based Payment,* and IAS 17, *Leases*); • Covers both financial and non-financial items; • Fair values that are required to be disclosed in the notes are also captured.
Definition of fair value	• An exit value-based approach; • Emphasis on market participants; • Exclusion of entity-specific factors; • A transaction or entry price may not necessarily represent fair value eg where related parties are involved or a transaction takes place under duress.
Fair value measurement approach	• Transactions are assumed to take place in the principal (or most advantageous) market; • For non-financial assets, the highest and best use of the asset is considered; • Guidance is provided for measuring the fair value of a liability in the absence of an active market for the liability; • Adjustments for premiums and discounts must be consistent with the unit of account; blockage factors should not be reflected.
Valuation techniques	• Entities are required to maximize the use of relevant observable inputs and minimize the use of unobservable inputs; • A three-level fair value hierarchy gives the highest priority to quoted prices in active markets and lowest priority to unobservable inputs (Level 3 inputs).
Disclosures	• Fair value hierarchy disclosures are required for financial and non-financial items and also items not measured at fair value but for which fair value is disclosed; • Disclosure requirements are proportionally greater for so-called Level 3 fair value measurements.
Effective date	• Annual periods beginning on or after January 1, 2013; • Earlier application is permitted; • Prospective application.

Scope of the standard

IFRS 13 applies when another IFRS requires or permits fair value measurements – either in the primary statements themselves or in the notes (including "fair value-based" measurements). In other words, it explains how to measure fair value rather than when to.

At first glance it may look like the standard will not affect many entities. The reality however is that fair value measurements are much more prevalent in IFRS than may at first be appreciated. The table to the right illustrates some of the many standards that either require or permit fair value measurements.

In addition to items measured at fair value in the primary statements, IFRS 13 also applies to items that are fair valued for disclosure purposes only. Examples include the fair value disclosure requirements in IFRS 7, *Financial Instruments: Disclosures*, and those in IAS 40, *Investment Property*, when the cost model is applied.

IFRS 13 does not however apply to:

- transactions within the scope of IFRS 2 or IAS 17;
- measurements that have some similarity to fair value but are not fair value (eg net realizable value in IAS 2, *Inventories*, and value in use in IAS 36, *Impairment of Assets*).

Examples of fair value measurement within the scope of IFRS 13

IFRS	Required	Permitted	Details
IFRS 3	✓		• Acquisition-date fair value of consideration transferred and of most assets and liabilities acquired
IFRS 5	✓		• Use of fair value less costs to sell* for non-current assets held for sale and disposal groups
IAS 16		✓	• Option to revalue plant, property and equipment at fair value
IAS 19	✓		• Defined benefit plan assets are measured at fair value
IAS 27, 28 and 31		✓	• Option to measure investments in subsidiaries, associates or jointly controlled entities at fair value
IAS 36	✓		• Use of fair value less costs to sell* when necessary to establish recoverable amount
IAS 38		✓	• Option to revalue intangible assets at fair value (in limited circumstances)
IAS 39	✓	✓	• Use of fair value depends on the type of financial instrument
IAS 40		✓	• Option to value investment property at fair value
IAS 41	✓		• Biological assets and agricultural produce are measured at fair value

Convergence

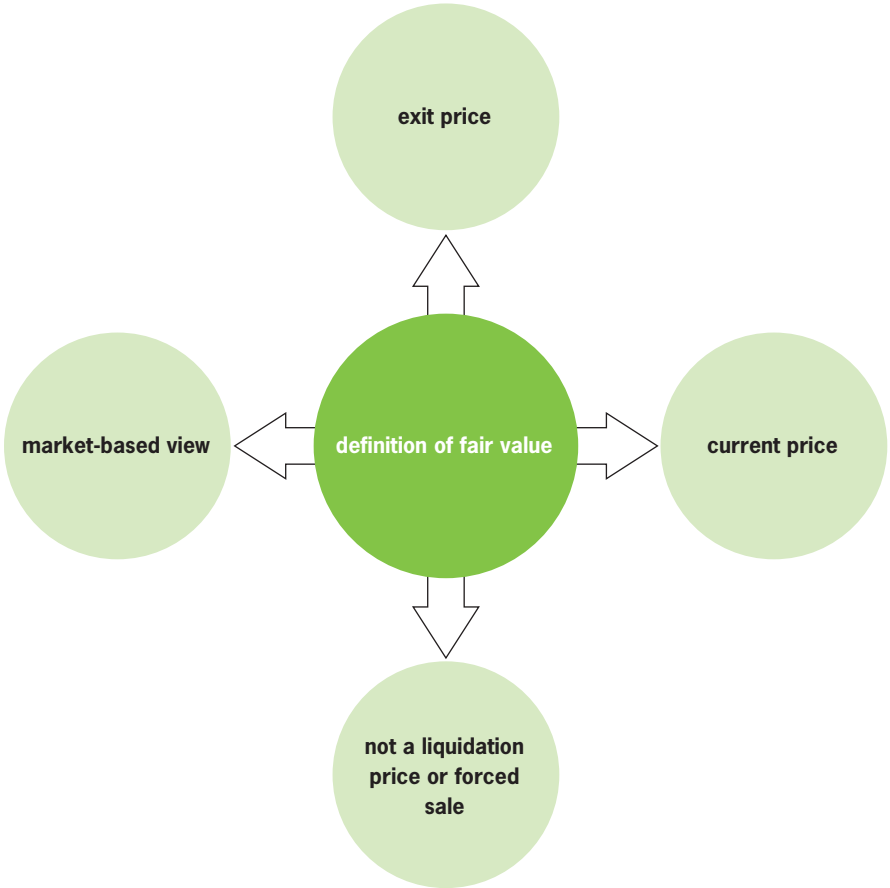
IFRS 13 represents the culmination of a convergence project undertaken with the U.S. Financial Accounting Standards Board. Following publication of the standard, the two Boards have largely achieved their aim of establishing a single global accounting standard for measuring fair value.

New definition of fair value

IFRS 13 defines fair value as:

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

A number of concepts are embodied in the new definition. Firstly, it clarifies that fair value is an "exit" price – for example it refers to the transfer of a liability rather than settlement. Secondly, it assumes an orderly sale or transfer (ie not a forced transaction or a distressed sale). Thirdly, there is an explicit reference to "market participants", emphasizing that fair value is a market-based concept. Finally, IFRS 13 clarifies that fair value is a current price at the measurement date (eg the acquisition date in a business combination, or the period end for a recurring fair value measurement).



Practical insights – transaction prices and "day 1" fair values

IFRS 13 indicates that a transaction price (eg the price paid to acquire an asset) often equals the initial or "day 1" fair value. However, this should not be presumed to always be the case. This guidance is particularly relevant to financial assets and liabilities as IAS 39, *Financial Instruments: Recognition and Measurement*, included such a presumption (which was rebuttable only in strictly limited circumstances).

Examples of situations where a transaction price may not equal "day 1" fair value include transactions:

- between related parties;
- entered into under duress or forced circumstances (eg where the seller is experiencing severe financial difficulty);
- in a large block of identical items (eg shares) but where the unit of account is each individual item;
- in a market that is not the principal (or the most advantageous) market.

In such situations, entities may need to use valuation techniques to determine "day 1" fair value, resulting in a difference between this and the transaction price. This difference will affect profit or loss unless another IFRS requires a different treatment (eg deferral or capitalization). For financial assets and liabilities, IAS 39 and IFRS 9, *Financial Instruments*, require these differences to be deferred in many cases.

Even when "day 1" fair value equals the transaction price, IFRS 13 requires a calibration of the valuation technique if it uses unobservable inputs and the item will be fair valued going forward.

IFRS 13's guidance in this area should be considered in conjunction with its requirements on bid-ask spreads (see subsequent discussion).

Practical insights – working with valuation specialists

Entities that use external valuation specialists to assist in estimating fair values will need to ensure that the bases and methods used comply with IFRS 13.

To put this into context, the term "fair value" is used in professional valuation standards but its definition may differ from IFRS 13's. For example, International Valuation Standards (IVS) define fair value as an amount that is fair in the circumstances, which may take into account factors such as synergistic value. IFRS 13's definition is generally more consistent with the IVS concept of "market value". Despite differences in terminology, applying a market participant perspective is very familiar to professional valuers, as are many of the other concepts and techniques in IFRS 13 (such as the "highest and best use" concept).

That said, IFRS 13 does include some principles and requirements that may be less familiar, or not intuitive, to a professional valuer. These include requirements that are primarily accounting concepts rather than valuation matters. Management therefore needs to ensure that the valuation expert is instructed in sufficient detail to ensure clarity and a common understanding of what is required for financial reporting purposes.

Examples of such areas to consider in this respect could, depending on the circumstances, include:

- specifying the items for which a fair value measurement is required – for example, in a business combination the assets and liabilities that meet IFRS 3's, *Business Combinations*, recognition requirements;
- unit of account issues – put simply, whether the valuation is of a single asset or liability, or a group of items such as a cash-generating unit;
- the characteristics of the asset or liability to be taken into account in the valuation – such as when restrictions on use or sale are relevant;
- the reference market – for example identifying the market(s) that are accessible or inaccessible to the entity as well as the market normally used;
- the need for valuations to be supported by more observable, quantitative evidence than may have been the case in the past;
- when a valuation should incorporate a consideration of potential alternative uses for assets;
- including the effects of non-performance risk when valuing liabilities.

In summary, the key to working effectively with valuation experts is timely, clear communication. Management is of course ultimately responsible for the amounts in the financial statements.

Having established the basic context in which fair value is to be determined, IFRS 13 then goes into further depth, considering:

- the characteristics of the asset or liability;
- the market in which the transaction is assumed to take place (reference market);
- application to non-financial assets;
- application to liabilities and own equity.

We consider these in turn on the following pages.

The characteristics of the asset or liability

A valuation will differ depending on which characteristics of an asset or liability are taken into consideration – for example condition, location and restrictions on use or sale. The concept in IFRS 13 is that these types of factor are taken into account in fair value estimates if (i) they are a characteristic of the asset or liability in question (rather than a characteristic of the entity that holds the item); and (ii) they would influence market participants' pricing decisions.

In the case of restrictions on sale of an asset, a critical factor to consider is whether market participants would be faced with the same restriction if they acquired the asset. This in turn depends on whether the restriction is part of the asset's contractual terms or arises from a separate, entity-specific agreement.

By contrast, when fair valuing a liability, IFRS 13 prohibits any adjustments for restrictions that prevent transfer. This is noteworthy as such restrictions are a feature of many liabilities.

The following table illustrates how this guidance applies in practice:

Applying guidance in practice – restrictions

Situation	Impacts fair value
• Entity holds equity shares (financial asset) and has agreed with another entity not to sell for at least 12 months	**No**
• Charity holds land donated for use only as a playground but which could be sold to raise funds and the restriction would not transfer to the buyer	**No**
• Entity holds a piece of land that is subject to an enduring legal right enabling a utility company to run power cables across the land	**Yes**

In each of the three scenarios, the restriction impacts fair value only where market participants would be affected by it.

Practical insights – transport and transaction costs

IFRS 13 takes the view that transaction costs (the commission that would be charged by a selling agent) are not a characteristic of an asset or liability and do not therefore affect fair value.

By contrast, transport costs are relevant to fair value if location is a characteristic of an asset. This may be the case for physical assets, for example, if the principal or most advantageous market (see next page) is an export market, and for commodities that are valued using benchmark prices that are location-specific.

The reference market

IFRS 13's emphasis on a market-based view raises questions as to which market should be referenced if more than one exists in the asset or liability in question (the "reference market" concept). IFRS 13 assumes that the transaction to sell the asset or transfer the liability takes place:

- in the principal market;
- or, in the absence of a principal market, in the most advantageous market.

The principal market is the market with the greatest volume and level of activity for the asset or liability. The most advantageous market is the market that maximizes the amount that would be received to sell the asset or minimizes the amount that would be paid to transfer the liability, after considering transaction and transport costs. It should be noted that the most advantageous market does not always result in the highest fair value because fair value excludes transaction costs.

The IASB's belief is that in most cases the principal market will also be the most advantageous market, and will also be the market that the entity would actually use. Entities do not therefore need to undertake an exhaustive search of all possible markets but are required to take into account all information that is reasonably available.

Practical insights – reference market

In applying IFRS 13's guidance on the reference market, entities should consider:

The market it actually uses

In the absence of evidence to the contrary, the market in which an entity would normally enter into a transaction (to sell the asset or to transfer the liability) is presumed to be the principal market or, in the absence of a principal market, the most advantageous market.

Access to particular markets

A market that is not accessible to the entity is not used as the reference market, so the principal or most advantageous market is identified among those markets that are accessible. For instance, in valuing a derivative, a bank that trades in such instruments might look to the dealer (inter-bank) market, whereas a commercial entity is unlikely to have access to that market.

The existence of an observable market

Many assets and liabilities that are fair valued are rarely (sometimes never) bought and sold, or are bought and sold only as part of a larger transaction such as a business combination. Indeed, many liabilities include restrictions that prevent their transfer. In such cases, the entity is still required to take a "market participant perspective" but the reference market is a hypothetical one. For example, in valuing customer-related intangibles in a business combination, the acquirer should consider the types of potential market participants (eg competitors) and aim to make assumptions that are consistent with their perspective.

Guidance on inactive markets

IFRS 13 includes a definition of "active market" and guidance on how to assess whether market activity has significantly decreased. This is mainly relevant for financial assets that are traded and for which quoted prices are available. If the market is "active", as defined, the quoted price is classified as a Level 1 input (see guidance on fair value hierarchy) and must be used as the fair value. If the volume or level of activity on a market has declined significantly, a quoted price may need to be adjusted or even supplanted by a valuation technique. This issue became a hot topic in the global financial crisis and has continued to be controversial more recently in the context of valuing Greek debt and other sovereign debt.

IFRS 13 sets out a number of factors to consider in determining whether there has been such a decrease, while noting that a decrease in the volume or level of activity on its own may not indicate that a transaction price or quoted price does not represent fair value or that a transaction in that market is not orderly.

Guidance is then provided to help identify transactions that are not orderly. Circumstances that may indicate that a transaction is not orderly include the following:

- There was not adequate exposure to the market to allow for the usual level of marketing activities;
- There was a usual and customary marketing period, but the asset or liability was marketed to a single market participant;
- A distressed sale (ie the seller is in or near bankruptcy or receivership);
- A forced sale (eg the seller was required to sell to meet regulatory or legal requirements);
- The transaction price is an outlier when compared with other recent transactions.

Where a transaction is not orderly, an adjustment to observed transaction prices or another valuation technique may be necessary to measure fair value.

Practical insights – highest and best use

The inputs to a valuation technique may differ depending on how a non-financial asset is assumed to be used. Because IFRS 13 measures fair value from the perspective of market participants, an asset's current use by its owner may not be relevant if other market participants would use the asset differently. An intangible asset may for example provide defensive value (protecting its competitive position) because the acquirer holds the asset to keep it from being used by competitors. The defensive value of the intangible asset would not be relevant to the calculation of the asset's fair value, however, unless other market participants would use the asset in the same way.

IFRS 13 does not however require an entity to perform an exhaustive search for other potential uses of a non-financial asset if there is no evidence to suggest that the current use of an asset is not its highest and best use.

The highest and best use principle should be applied in conjunction with the guidance on the most advantageous market, and also the valuation premise. The interactions between assets also need to be evaluated. For example, in valuing a land with an industrial building, an alternative use for the "bare" land may yield a higher value. This would however imply a zero value for the building. When the land and the building are considered together, the combined value may be higher based on current use. In that case, the current use is the highest and best use.

Application to non-financial assets

IFRS 13 states that a fair value measurement of a non-financial asset takes into account the highest and best use of the asset. The highest and best use of a non-financial asset must be:

- physically possible;
- legally permissible; and
- financially feasible.

The concept of highest and best use is not relevant to financial assets because such assets have specific contractual terms and therefore do not have alternative uses (a different use would only be possible if the characteristics of the financial asset were to be changed). It is also not relevant to liabilities.

Valuation premise for non-financial assets

The highest and best use of a non-financial asset establishes how its fair value should be measured (the "valuation premise") in terms of whether it should be valued on a stand-alone basis or as a group in combination with other assets (or other assets and liabilities).

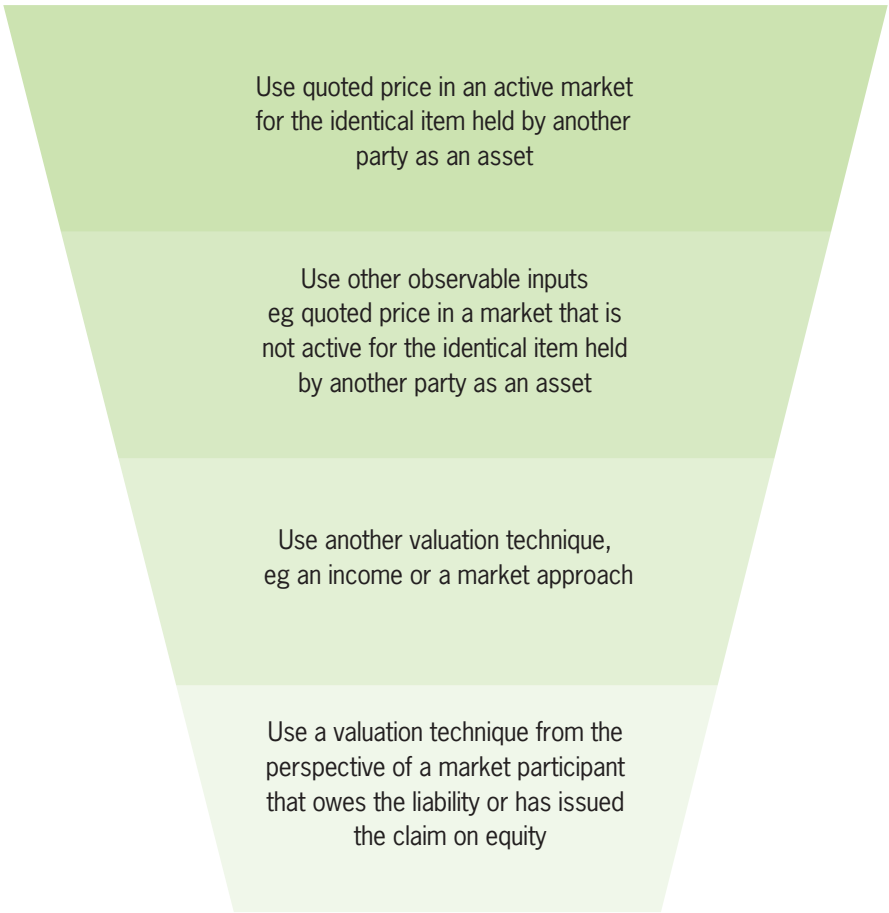
Where the resulting fair value measurement assumes that the highest and best use of the asset is to use it in combination with other assets or with other assets and liabilities, it is assumed that the market participant already holds those complementary assets and associated liabilities. This assumption is necessary as, without it, IFRS 13's exit value approach might lead to valuing some highly specialized assets and items such as work-in-progress on a scrap basis.

Application to liabilities and own equity

Measuring fair value can be problematic for liabilities and an entity's own equity instruments due to quoted prices for the transfers of such items not being available.

Where a quoted price is not available, IFRS 13 states that fair value shall be measured from the perspective of a market participant that holds the identical item as an asset. The logic is that, in an efficient market, the price of a liability held by another party as an asset must equal the price for the corresponding asset. Where a quoted price is not available and the identical item is not held by another party as an asset, IFRS 13 requires an entity to use a valuation technique from the perspective of a market participant that owes the liability or has issued the claim on equity.

IFRS 13's hierarchical approach can be shown diagrammatically as follows:



Valuation techniques

IFRS 13 provides guidance on the use of valuation techniques when measuring fair value. The standard notes that there are three widely used "families" of valuation techniques (see box on the right) and states that entities should use valuation techniques consistent with one or more of them to measure fair value.

In some cases, using one of these valuation techniques will be appropriate. In other cases, multiple valuation techniques will be appropriate (eg when measuring a cash-generating unit). In using valuation techniques, IFRS 13 emphasizes that an entity should maximize the use of relevant observable inputs and minimize the use of unobservable inputs. Specific guidance is then given on certain problematic areas including:

- the application of premiums and discounts;
- bid and ask prices.

Three widely used "families" of valuation techniques:

Name	Technique
The market approach	• Uses prices and other relevant information generated by market transactions involving identical or comparable (ie similar) assets, liabilities or a group of assets and liabilities, such as a business
The cost approach	• Reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost)
The income approach	• Converts future amounts (eg cash flows or income and expenses) into a single current (ie discounted) amount. The fair value measurement reflects current market expectations about those future amounts • For example: present value techniques, option pricing models, the multi-period excess earnings method

Practical insights – bid and ask prices

A bid price is the highest price a potential buyer is willing to pay (for an asset), and an ask price, the lowest price a potential seller will accept. The difference is the bid-ask spread. In some markets (eg dealer markets), both bid and ask prices are quoted. If these prices are used as inputs to measure fair value, which point in the spread is the right fair value? On the face of it, it would seem that bid prices should always be used for assets, and ask prices, for liabilities. However, IFRS 13 provides more flexible guidance as follows:

- The reporting entity should use the price within the bid-ask spread that is most representative of fair value;
- The use of bid prices for asset positions and ask prices for liability positions is permitted, but is not required;
- The use of mid-market pricing or other pricing conventions that are used by market participants is not precluded as a practical expedient for fair value measurements within a bid-ask spread.

The existence of a "true" bid-ask spread seems difficult to reconcile with IFRS 13's indication that initial fair value often equals the transaction price. This is because, all else being equal, an entity would purchase an asset at the (higher) ask price and would be able to sell it at the (lower) bid price. One way of explaining this is to characterize the difference as a transaction cost (eg a dealer's margin).

The application of premiums and discounts

IFRS 13 requires an entity to select inputs in a fair value measurement that are consistent with the characteristics of the asset or liability that market participants would take account of. The standard notes that in some cases this will result in the application of an adjustment such as a premium or discount where this is necessary to reflect the characteristics of the asset or liability.

Where a quoted price in an active market exists for the asset or liability, then that price is used without adjustment. Most often, however, no such price exists and the fair value measurement should then incorporate premiums or discounts if market participants would take them into account in a transaction for the asset or liability. An example would be the incorporation of a control premium when measuring the fair value of a controlling interest.

Where a premium or discount is reflective of the size of an entity's holding as opposed to a characteristic of the holding (such as the controlling interest characteristic above), then the premium or discount should not be included in the fair value measurement. An example would be a blockage factor, ie an adjustment that would alter the quoted price of an asset or a liability because the market's normal daily trading volume is not sufficient to absorb the quantity held by the entity.

Allowed

- Adjustments that are:
  - consistent with the unit of account;
  - reflective of the characteristics of the asset or liability.

Not permitted

- Blockage factors – premiums or discounts that relate to the size of an entity's holdings.

The unit of account

IFRS 13 states that a premium or discount should not be included in a fair value measurement if it is inconsistent with the unit of account. The unit of account itself is not specified by IFRS 13. Rather, the requirements for determining the unit of account result from the application of other IFRS.

For financial instruments governed by IAS 39 for example, the unit of account will usually be the individual financial instrument. In contrast, the unit of account may be a group of assets or assets and liabilities where another standard applies, for example where recoverable amount of a cash-generating unit is determined by reference to fair value less costs of disposal under IAS 36. Problems may however be encountered where a particular standard is not clear on the unit of account (see examples below).

The unit of account

Situation	Unit of account
• 100 shares in a large quoted company classified as available-for-sale in accordance with IAS 39	• Each share
• A non-controlling interest of 10%, comprising 100 shares, in an acquired entity to be measured at fair value under IFRS 3	• Generally considered to be the entire non-controlling interest (but no adjustment to Level 1 inputs permitted)
• A 100% holding in an unquoted subsidiary, comprising 100 shares, to be measured at fair value in accordance with IAS 39 in the parent's separate financial statements	• Generally considered to be the entire controlling interest

The fair value hierarchy

IFRS 13 establishes a fair value hierarchy under which the inputs to valuation techniques used to measure fair value are categorized into three levels. This requirement, which had previously applied only to financial instruments, is aimed at increasing consistency and comparability when measuring fair value and making related disclosures. The three levels of the hierarchy are as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date;
- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly;
- Level 3 inputs are unobservable inputs for the asset or liability.

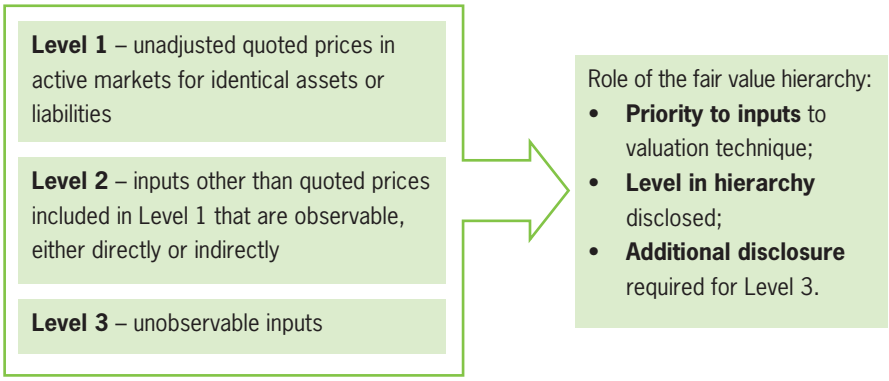
Illustration of the application of the fair value hierarchy

Example	Likely hierarchy level
Quoted shares in a company traded on a major stock exchange	Level 1
Unquoted shares in a private company, for which valuation uses earnings multiple from similar listed competitors along with various unobservable inputs	Level 3
Bonds traded on a market with quoted prices but infrequent recent transactions, where the last transaction was two weeks prior to reporting date. Valuation uses quoted price adjusted for observable market trends in past 2 weeks	Level 2
Investment property valued using observable prices per square meter for similar properties with adjustments for specific characteristics	Level 2 or Level 3 (depending on the adjustments)

Level 1 inputs are considered to be the most reliable measure of fair value, and are therefore given the highest priority within the hierarchy. Except for a few limited circumstances (where special criteria apply), Level 1 inputs must be used without adjustment whenever they are available. The least priority is given to Level 3 inputs.

IFRS 13 establishes a three-level fair value hierarchy for inputs to fair value measurements of both financial and non-financial items. This requirement had previously applied only to financial instruments

Where some of the inputs used in a fair value measurement fall within one level of the hierarchy and some within other levels, then the fair value measurement is categorized in its entirety in the same level of the fair value hierarchy as the lowest level input that is significant to the entire measurement.



Disclosures

IFRS 13 introduces a comprehensive disclosure framework for fair value measurements. This framework is intended to help users of financial statements assess the valuation techniques and inputs used to develop those measurements.

As can be seen from the table on the following page, the disclosures required are affected by the fair value hierarchy discussed above, with increased disclosure requirements applying to the lower levels of that hierarchy.

A distinction is also made between recurring fair value measurements (measurements made on a fair value basis at each reporting date) and non-recurring measurements (measurements triggered by particular circumstances). Disclosure of the effect of the fair value measurement on profit or loss or other comprehensive income for the period is required for recurring fair value measurements that involve significant unobservable (Level 3) inputs.

Disclosure requirements also apply to each class of assets and liabilities not measured at fair value in the statement of financial position but for which the fair value is disclosed.

Summary of IFRS 13's disclosure requirements

	Recurring	Non-recurring
General disclosure requirements		
• Fair value at the end of the period;	✓	✓
• Reasons for the measurement.		✓
General disclosures relating to the fair value hierarchy		
• The level of the fair value hierarchy within which each fair value measurement is categorized;*	✓	✓
• The policy for determining when transfers between levels of the hierarchy are deemed to have occurred;	✓	✓
• Reasons for transfers between different levels of the hierarchy;	✓	
• A description of the valuation techniques and inputs used in fair value measurements categorized within Levels 2 and 3 of the hierarchy.*	✓	✓
Fair value hierarchy disclosures specific to Level 3 valuations		
• Quantitative information about significant unobservable inputs used in fair value measurements;*	✓	✓
• A reconciliation of changes in fair value movements, disclosing separately changes attributable to:	✓	
– total gains or losses recognized in profit or loss and the line item in which they are recognized;		
– total gains or losses recognized in other comprehensive income and the line item in which they are recognized;		
– purchases, sales, issues and settlements;		
– transfers into or out of Level 3.		
• Total gains or losses included in profit or loss attributable to the change in unrealized gains or losses for measurements within Level 3;	✓	
• A description of the valuation processes used for Level 3 measurements;	✓	✓
• A narrative description of sensitivity analysis for Level 3 measurements;	✓	
• The effect of altering an unobservable input where to do so would change the fair value significantly.	✓	
Other disclosure requirements		
• For non-financial assets where highest and best use differs from current use, an explanation of why this is the case;	✓	✓
• For liabilities measured at fair value and issued with an inseparable third-party credit enhancement, the existence of that credit enhancement and whether it is reflected in the fair value measurement of the liability;	✓	✓
• Where the exception of measuring a group of financial assets and financial liabilities on the basis of the net position is taken, disclosure of that fact.	✓	✓

* Disclosure also required for assets and liabilities not measured at fair value but for which fair value is disclosed in the financial statements.

Practical insights – disclosures

A number of factors affect the amount and type of disclosures required, in particular:

Fair values on initial recognition

Fair values that are required or permitted only on initial recognition are exempted from IFRS 13's disclosures altogether. Examples of fair value on initial recognition include:

- using fair value as deemed cost on initial application of IFRS in accordance with IFRS 1, *First-time Adoption of International Financial Reporting Standards*;
- measuring most assets acquired and liabilities assumed in a business combination at fair value in accordance with IFRS 3;
- initial recognition of financial assets and liabilities that will subsequently be measured at amortized cost in accordance with IAS 39 (or IFRS 9).

Level in the fair value hierarchy

As can be seen from the table on page 14, significant differences in disclosure requirements apply to the different levels within the fair value hierarchy. In particular, extensive disclosures are required for Level 3 measurements, in order to provide users with some insight into the reliability of such measurements.

These disclosures could be a challenge for some entities. For example, real estate valuations may end up being classified in Level 3 of the hierarchy where the valuation takes place in an inactive or less transparent real estate market, triggering the extensive disclosures referred to previously.

Recurring versus non-recurring fair values

Some disclosures are required for recurring but not for non-recurring fair value measurements, and vice versa. An example of a recurring measurement is the fair value of derivatives and other held-for-trading financial instruments in IAS 39. Examples of non-recurring fair value measurements include those required on classification of a non-current asset as held for sale in accordance with IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*, and when making a non-cash distribution to owners under IFRIC 17, *Distributions of Non-cash Assets to Owners*.

Practical insights – transition

In transitioning from the existing fair value guidance to IFRS 13 an entity:

- applies the new measurement guidance at the beginning of the annual period in which it adopts IFRS 13, not the beginning of the comparative period (ie as at January 1, 2013, for a company with a December 31 year-end, assuming it adopts it at the effective date and not earlier);
- treats any differences arising in the same way as a change in accounting estimate (eg a change will affect profit or loss for investment property measured under IAS 40's fair value model, or other comprehensive income for an available-for-sale financial asset).

Effective date

IFRS 13 is effective for annual periods beginning on or after January 1, 2013. Earlier application is permitted.

The requirements of the standard are to be applied prospectively (see above). The disclosure requirements do not need to be applied in comparative information provided for periods before the initial application of the standard.

Concluding remarks

IFRS 13 is likely to change current practice in various ways. We leave you below with some of the major points to consider:

- Fair value is defined in terms of an "exit price";
- Transaction price may not necessarily represent fair value;
- Priority is given to observable inputs when measuring fair value;
- More consideration of possible alternative uses is required for non-financial assets;
- Explicit guidance is given on the valuation of liabilities and own equity instruments;
- Additional and improved disclosure requirements apply;
- Non-financial items are included in the hierarchical fair value disclosures.

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