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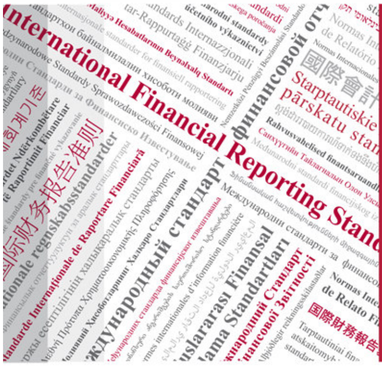
International Financial Reporting Standards



IFRS 13
Fair Value Measurement

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The views expressed in this presentation are those of the presenter, not necessarily those of the IASB or IFRS Foundation.

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Use of fair value in IFRS

ASSET TYPE	MEASUREMENT AT INITIAL RECOGNITION	SUBSEQUENT MEASUREMENT
IFRS 9 *Financial Instruments*	**Fair value**	**Amortised cost** or **fair value**, depending on the business model.
IAS 16 *Property, Plant and Equipment*	**Cost**, which includes purchase costs + construction costs + costs to bring to the location and condition necessary to be capable of operating in the manner intended by management.	Accounting policy choice: **cost model** or **revaluation model**.
IAS 38 *Intangible Assets*	**Cost**, which includes purchase costs + development costs + costs to bring to the location and condition necessary to be capable of operating as intended by management.	Accounting policy choice: **cost model** or **revaluation model**.
IAS 40 *Investment Property*	**Cost** including transaction costs	Accounting policy choice: **cost model** or **fair value model**.
IAS 41 *Agriculture*	**Fair value** less costs to sell	**Fair value** less costs to sell

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Criticisms of fair value

Criticisms	Our response
Subjectivity of fair values measurements	• Other estimates require a similar process and involve similar uncertainties (for example, measurement of provisions). • Use valuation technique when there are no observable market prices available or when observable market prices do not represent fair value. • Measurements with a higher degree of subjectivity are subject to more disclosure requirements.
Volatility introduced in reported income	• Fair value reflects the underlying economic volatility of the assets and liabilities themselves. • For earnings to be informative to investors, they need to reflect this volatility.
Procyclicality	• Procyclicality is a natural consequence of an economic downturn. Amplified by fair value? From 2004–2006 banks held c. 50% assets not subject to fair value and prudential filters neutralised the effect to Tier 1 capital of some fair value gains and losses.

Criticisms of fair value - *continued*

Criticisms	Our response
Information constraints (for example, few deep and liquid markets)	• The lack of market data or other key information is a global constraint, rather than a regional one. • Even when limited information is available, fair value measurements can still be performed.
Limited valuation expertise	• Commitment to provide educational material to assist in the implementation of fair value principles.
Guidance provided is not detailed enough	• Educational material must benefit all entities (in developed and emerging economies).

"Proposals for alternative accounting methods, such as historical cost or simplistic mechanisms to smooth valuation effects on bank balance sheets, reduce the transparency of a financial institution's health by blurring the underlying capital position."[(4)]

(4): *Global Financial Stability Report,* International Monetary Fund, October 2008.

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The previous definition of fair value

Fair value definition	Its weaknesses
The amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arms length transaction. ?	It did not specify whether an entity is buying or selling the asset. It was unclear about what settling meant because it did not refer to the creditor. It was unclear about whether it was market-based. It did not state explicitly when the exchange or settlement takes place.

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IFRS 13's 'new' definition of fair value

New fair value definition	Its improvements
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.	It specifies that the entity is selling the asset. It refers to the transfer of a liability. It is not a forced or distressed sale. It is clear it is market-based. It states explicitly when the sale or transfer takes place.

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How do we arrive to a market-based measurement?

Is there a quoted price in an active market for an identical asset or liability?

Yes

Use this quoted price to measure fair value (Level 1)

Must use without adjustment

No

Replicate a market price through a valuation technique* (using observable+ and unobservable inputs: Levels 2 and 3)

No use of significant unobservable (Level 3) inputs‡ = Level 2 measurement

Use of significant unobservable (Level 3) inputs‡ = Level 3 measurement

* Valuation techniques include the market approach, income approach and cost approach.

+ Maximise the use of *relevant* observable inputs and minimise the use of unobservable inputs. Observable inputs include market data (prices and other information that is publicly available).

‡ Unobservable inputs include the entity's own data (budgets, forecasts) which must be adjusted if market participants would use different assumptions.

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Disclosures

- Fair value at end of reporting period
- Level in hierarchy
- Transfers between levels
- Valuation techniques and inputs used
- If highest and best use is different from current use

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Disclosures *continued*

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- Disclosures also required for disclosed (but not recognised) fair values, even if on SFP at different amount
  - eg financial asset at amortised cost, but IFRS 7 requires disclosure of asset's fair value
- Quantitative disclosures in a table unless another format is better

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More information about Level 3

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- Quantitative disclosure of unobservable inputs and assumptions used
- Reconciliation of opening to closing balances
- Description of valuation process in place

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More information about Level 3 *continued*

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- Sensitivity analysis:
  - narrative discussion about sensitivity to changes in unobservable inputs, including inter-relationships between inputs that magnify or mitigate the effect on the measurement
  - quantitative sensitivity analysis for financial instruments
- More granularity in determining classes

Thank you

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