



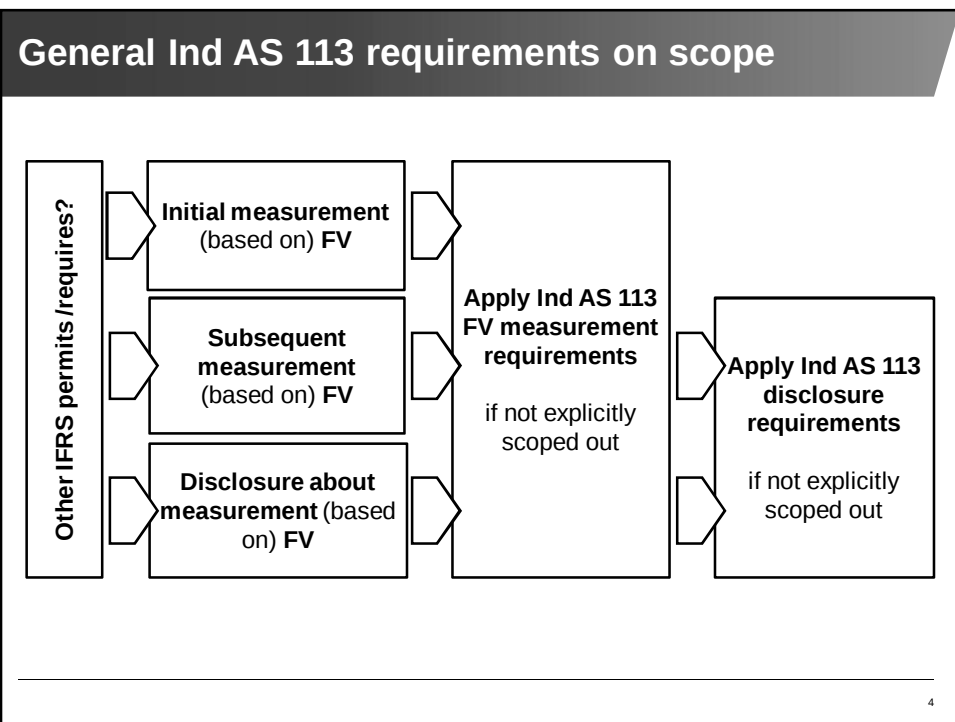
Why are we discussing this topic?

- Ind AS 113 is pervasive and impacts most Ind ASs that require or permit FV measurement or disclosure.
- Ind AS 113 introduces new and changed guidance for measuring FV and related disclosure requirements. New or changed guidance that is addressed in this module includes:
 - Changed FV definition, including:
 - Exit price and transfer notion.
 - New guidance on:
 - Unit of valuation.
 - Valuation adjustments.
 - Valuation premise for non-financial assets.
 - Significant decrease in volume or level of activity.



Which of these is in the scope of Ind AS 113?		
Item	In scope of FV measurement requirements	In scope of FV disclosure requirements
Interest rate swap		
Loan measured at amortised cost		
Property plant and equipment		
Revenue		
Investment property (cost model)		

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Background

- ▶ Defines 'fair value'
- ▶ Single source of guidance and improved consistency for measuring fair value
- ▶ Enhanced fair value disclosures



Overview of Ind AS 113

Fair value: The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price).

- ▶ Does not change **when** to measure at fair value
- ▶ Provides guidance on **how** to measure fair value, when required or permitted by specific Ind AS standards
- ▶ Does not include **transaction costs**

Scope of Ind AS 113

- ▶ Applies when another Ind AS standard requires or permits:
 - ▶ Fair value measurement (asset or liability, both financial and non-financial) or disclosures about fair value measurements
- ▶ Ind AS 113 scope excludes:
 - ▶ Ind AS 2 *Share-based Payment*
 - ▶ Ind AS 17 *Leases*
 - ▶ Similar terms (such as 'net realisable value' in Ind AS 2 *Inventory* or 'value in use' in Ind AS 36 *Impairment of Assets*)

Scope of Ind AS 113 (cont.)

- ▶ Ind AS 113 disclosures exclude:
 - ▶ Employee benefit plan assets under Ind AS 19 *Employee Benefits*
 - ▶ Recoverable amount (based on fair value less costs of disposal) under Ind AS 36 *Impairment of Assets*

Applying fair value in practice



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Unit of account

- ▶ Defines what is being measured and recognised for financial reporting purposes (level of aggregation or disaggregation)
- ▶ Is generally determined in accordance with the Ind AS that requires or permits the fair value measurement in the first place



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Unit of account: question

An entity holds a large position in a company that is traded in an active market. If the entity sells its entire holding in a single transaction, the market's normal daily trading volume would not be sufficient to absorb the quantity held. That single transaction would affect the quoted price and result in the entity receiving a lower selling price.

Should the entity adjust the fair value of that asset to reflect this?

- ▶ Since there is an active market, the fair value of the asset or liability should continue to be measured as the product of the quoted price and the quantity held ($P \times Q$).
- ▶ The same applies to a liability or a position comprising a large number of identical assets or liabilities, such as a holding of financial instruments, that are traded in an active market.

Characteristics of the asset or liability

- ▶ Characteristics of asset or liability are considered if market participants would consider those characteristics when pricing the asset or liability at the measurement date.
- ▶ Examples:
 - ▶ Condition and location of the asset
 - ▶ Restrictions on the sale or use of the asset
- ▶ Asset or liability measured at fair value might be:
 - ▶ A stand-alone asset or liability
 - ▶ A group of assets, a group of liabilities or a group of assets and liabilities

Example: restriction on the sale of an equity instrument

An entity holds an equity instrument (i.e., financial asset) for which sale is contractually restricted for a specified period by limiting its transfer or sale to qualifying investors.

1. Is this restriction a characteristic of the instrument?
 2. How should fair value be measured?
-
1. The restriction is a characteristic of the instrument and would therefore be transferred to market participants.
 2. Fair value should be measured based on the quoted price for an otherwise identical unrestricted equity instrument of the same issuer that trades in a public market, adjusted to reflect the effect of the restriction. The adjustment would reflect the amount market participants would demand, due to risk relating to the inability to access public market for the specified period.

Highest and best use for non-financial assets

- ▶ Fair value considers a market participant's ability to generate economic benefits by using the asset in its highest and best use.
- ▶ Highest and best use considers a use that is:
 - ▶ Physically possible
 - ▶ Legally permissible
 - ▶ Financially feasible
- ▶ Current use is presumed to be highest and best use.
- ▶ Highest and best use is always considered when measuring fair value, even if the entity intends a different use.

Highest and best use for non-financial assets (cont.)

Can be either:

- ▶ On a stand-alone basis
- ▶ In combination with other assets and/or liabilities
 - ▶ Assumed the complementary assets/liabilities are available to market participants
 - ▶ Complementary liabilities include liabilities that fund working capital, but exclude liabilities to fund assets outside the relevant group
 - ▶ Assumptions must be consistent for all assets and/or liabilities of the relevant group

Example: highest and best use

Land acquired in a business combination is currently developed for industrial use as a site for a manufacturing facility. Nearby sites were recently developed for residential high-rise. It was determined that the land could be used to develop residential high-rise.

How is highest and best used determined?

- ▶ In this case, the highest and best use is determined from the higher of:
 - a) The value of the land used in the manufacturing operation
 - b) The value of the land as a vacant site for residential use
- ▶ Note that transformation costs (e.g., costs to demolish the manufacturing facility) would be considered in the value of land as a vacant site.

Principal market and most advantageous market

Assumes that transaction takes place in either:

► **Principal market**

- Market with greatest volume and level of activity for the asset or liability
- Entity must have access to the market at measurement date
- Rebuttable presumption that principal market is market in which entity normally transacts

► **Most advantageous market (absent a principal market)**

- Market that maximises amount that would be received, **after transaction and transport costs**

Example

Particulars	Market A	Market B	Market C
Annual volume	30,000	12,000	6,000
Transactions per month	30	12	10
Price	50	48	53
Transport cost	(3)	(3)	(4)
Quoted value	47	45	49
Transaction costs	(1)	(2)	(1)
Net proceeds	46	43	48

Entity trades in market C.

Principal market

Fair value

Most advantageous market (if no principal market)

Fair value

Market A

47

Market C

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Liquidity

- ▶ Ind AS 113 requires liquidity considerations to be incorporated into the valuation.
 - ▶ This may be demanding and require input and engagement from valuation experts.
- ▶ Liquidity is a new Ind AS concept for non-financial assets.
 - ▶ Further discussion may be necessary at the IASB level on how to build liquidity into valuation of non-financial instruments.

Example: liquidity

Investor X holds a 10% investment in private company Y, classified as an FVOCI investment under Ind AS 109. It values Y using a market multiple of recent earnings of comparable listed entity Z.

Should this valuation be adjusted for:

1. Illiquidity of Y's shares, as compared to Z?
 2. The lower price X is likely to get if X sold the entire 10% investment in a single transaction, rather than if it sold its shares in Y in smaller batches?
1. X should adjust for Y's illiquidity because this is a characteristic of Y's shares. Y's shares are not listed; Z's are listed.
 2. However, X should not adjust the valuation for the likely outcome that if it sold all of the 10% investment in a single transaction, it might receive a lower price. This is because the unit of account in Ind AS 109 is deemed to be a single instrument. Therefore, fair value must reflect the fair value of each share in Y.

Orderly and disorderly transaction

- ▶ Exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary
- ▶ Ind AS 113 assumes:
 - ▶ An orderly transaction at measurement date
 - ▶ That the transaction involves market participants that are willing and motivated to transact, but not forced or compelled
- ▶ Unlike an orderly transaction, in a distressed transaction:
 - ▶ Market participants are compelled to transact
 - ▶ There is little or no exposure to the market
- ▶ Circumstances that may indicate a transaction is not orderly:
 - ▶ Inadequate exposure to the market
 - ▶ Marketed to a single market participant
 - ▶ Seller in or near bankruptcy or forced regulatory or legal requirements
 - ▶ Transaction price is an outlier

Orderly and disorderly transaction (cont.)

- ▶ A significant decrease in volume and activity within a market **does not** mean that all transactions are not orderly.
 - ▶ Further analysis needed to assess their relevance
- ▶ Less weight should be placed on transactions without sufficient information to conclude whether the transaction is orderly, compared with other transactions that are known to be orderly.

Example: orderly and disorderly transactions

A private investor pays 25 million to purchase a rare painting at a public auction. The seller had advertised the sale of the rare painting for six months prior to the event. A total of 15 individuals placed bids on the rare painting during the public art auction. All bidders were provided with the same information and ability to view the rare painting prior to the public art auction.

- ▶ Is this an orderly transaction, despite the supply and demand imbalance for the rare painting?
- ▶ What if the rare painting was marketed solely to one buyer (e.g., a particular museum)?

Active and inactive market

- ▶ The determination of whether a market is active or inactive affects the extent of judgement that management can apply.
 - ▶ Example:-
 - ▶ Few recent transactions
 - ▶ Price quotations are not developed using current information
- ▶ The same factors used to determine if a market is inactive can be used to assess whether there has been a significant decrease in activity. This is based on:
 - ▶ The weight of the available evidence
 - ▶ The relevance of observed transactions or quoted prices

Valuation techniques

- ▶ Objective – Estimate the Price
- ▶ Use valuation techniques that:
 - ▶ Are appropriate in the circumstances
 - ▶ Have sufficient available data
 - ▶ Maximise use of relevant observable inputs
 - ▶ Minimise use of unobservable inputs
- ▶ Ind AS 113 describes three valuation techniques
 - ▶ Income approach (discounted future cash flows)
 - ▶ Cost approach (current replacement cost)
 - ▶ Market approach (price and other relevant information)
- ▶ One or several valuation techniques might be used
 - ▶ If a range of values are indicated, select the point within that range most representative of fair value

Valuation techniques (cont.)

- ▶ If transaction price equals fair value at initial recognition, calibrate valuation technique to this price at initial recognition
- ▶ Apply valuation techniques consistently
- ▶ Change in valuation technique needed if:
 - ▶ New markets develop
 - ▶ New information becomes available
 - ▶ Information previously used is no longer available
 - ▶ Valuation techniques improve
 - ▶ Market conditions change
- ▶ Change in valuation technique = change in estimate
- ▶ Evaluate whether changes to valuation techniques are appropriately disclosed (IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* has limited application)

Fair value hierarchy

	Level 1	Level 2	Level 3
Definition	Quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date	Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly	Unobservable inputs to valuation techniques
Examples	Quoted prices for an equity security that trades on the London Stock Exchange	Interest rates and yield curves observable at commonly quoted intervals, implied volatilities and credit spreads	Growth rate applied to historical cash flows used to value a business or non-controlling interest in an entity that is not publicly listed

Fair value hierarchy (cont.)

- ▶ Valuation must be based on the quoted price of an identical asset or liability traded in an active market (if available).
- ▶ Valuation techniques must maximise use of relevant observable inputs and minimise unobservable inputs.
- ▶ Multiple inputs might be categorised in different levels of the hierarchy.
 - ▶ The overall fair value measurement is categorised in the hierarchy at the lowest level input that is significant to entire measurement.
 - ▶ This requires judgement.
 - ▶ Adjustments to arrive at measurements based on fair value are not considered when determining the level in the hierarchy (e.g., fair value less cost to sell).

Disclosures



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Disclosure principles

- ▶ Disclose information that helps users assess the following:
 - ▶ For assets and liabilities measured at fair value on a recurring or non-recurring basis after initial recognition, valuation techniques and inputs used to develop those measurements
 - ▶ For recurring fair value measurements using significant unobservable inputs (Level 3), the effect of measurements on profit or loss or other comprehensive income for the period
- ▶ Fair value disclosures are required separately for each class of assets and liabilities.
- ▶ Quantitative disclosures are presented in a tabular format unless another format is more appropriate.

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Fair value hierarchy and disclosures

	Recurring fair value measurement	Non-recurring fair value measurement (after initial recognition)	Fair value disclosure (for items not measured at fair value)
Fair value at end of reporting period	a	a	a
Reasons for measurement at fair value		a	
Level in fair value hierarchy	a	a	a
Amounts of transfers between Level 1 and Level 2, reasons for transfers and policy for determining when transfers occurred	a		
If highest and best use differs from current use, that fact, and why being used that way	a	a	a

Fair value hierarchy and disclosures (cont.)

	Recurring fair value measurement	Non-recurring fair value measurement (after initial recognition)	Fair value disclosure (for items not measured at fair value)
For Level 2 and 3, a description of valuation technique(s) and inputs used	a	a	a
For Level 2 and 3, any changes in valuation technique(s), and reasons for change	a	a	a
For Level 3, quantitative information about significant unobservable inputs	a	a	
For Level 3, description of valuation processes	a	a	

Recurring Level 3 measurement disclosures

- ▶ For recurring Level 3 fair value measurements, reconcile opening balances to closing balances showing separately:
 - ▶ Total gains or losses recognised in P&L, and which line item(s)
 - ▶ Unrealised gains or losses relating to assets and liabilities held at balance date and which line item(s)
 - ▶ Total gains or losses recognised in other comprehensive income and which line item(s)
 - ▶ Purchases, sales, issues and settlements (each separately)
 - ▶ Amounts of any transfers in/out of Level 3 (each separately)
 - ▶ Reasons for transfers in/out of Level 3
 - ▶ Accounting policy for determining when transfers occurred

Recurring Level 3 measurement disclosures (cont.)

- ▶ A narrative description of sensitivity to changes in unobservable inputs, if a change in those inputs to a different amount might result in a significantly higher or lower fair value
- ▶ If there are interrelationships between those inputs and other unobservable inputs used, describe those interrelationships and how they might magnify or mitigate effect of changes in unobservable inputs
 - ▶ At a minimum, qualify the unobservable inputs
- ▶ For financial assets and financial liabilities, disclose if changing one or more of the unobservable inputs would change fair value significantly
 - ▶ Same disclosure previously required in Ind AS 7.27B(e) *Financial Instruments: Disclosures*

Thank you