

# Session 3

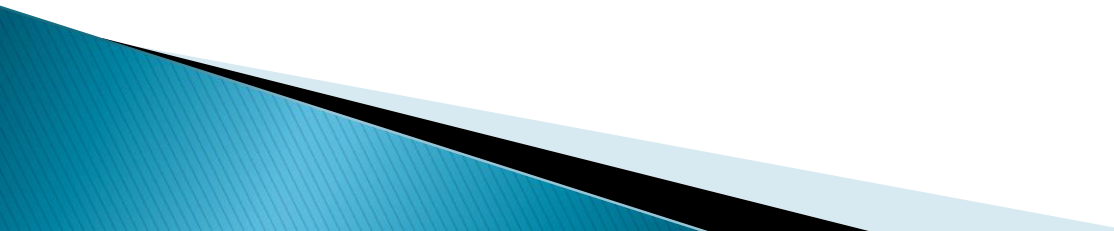
## IFRS 13 (Fair Value Measurement)

# International Financial Reporting Standards (IFRS)

- ▶ International Financial Reporting Standards (IFRSs) is a principle based financial report presentation standards.
- ▶ IFRSs was adopted in Ethiopia in 2014.
- ▶ Currently the IFRSs are the most widely adopted *Financial Reporting Standards globally.*

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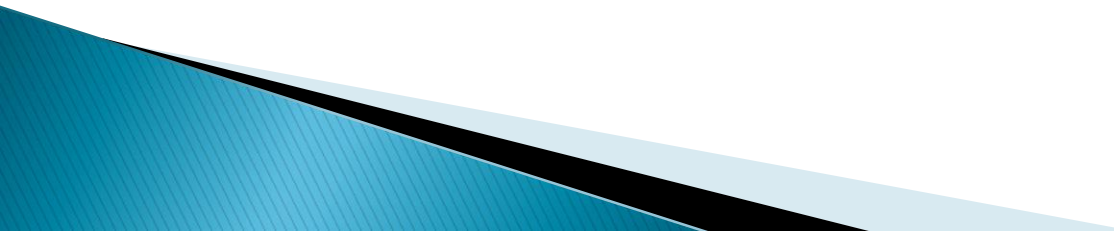
Examples of valuation for different accounting purposes include:

- measurement of the value of an asset or liability for inclusion on the statement of financial position,
  - allocation of the purchase price of an acquired business,
  - impairment testing,
  - depreciation charges in the profit and loss account.
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# Cont'd

- ▶ Valuations undertaken for inclusion in a financial statement shall be provided to meet the requirements of the International Financial Reporting Standards (i.e., IFRS 13).
- ▶ Example: the treatment of *real property owned by an entity may differ* depending on whether it is:
  - occupied for the purpose of the entity's business,
  - held as an investment,
  - surplus to requirements or, etc

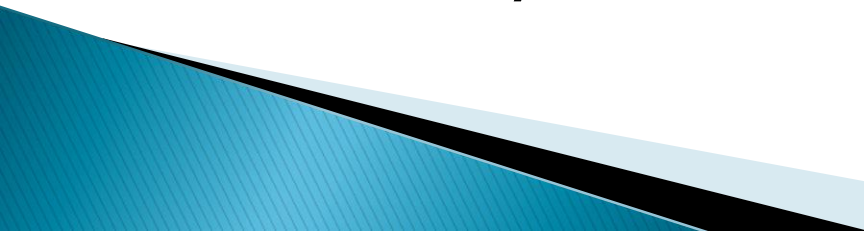
# Fair Value

- ▶ The basis of value for IFRS is **Fair Value**
  - ▶ IFRS definition: 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.
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# Cont'd

- ▶ in particular, the references
  - to market participants,
  - an orderly transaction,
  - the transaction taking place in the principal or the most advantageous market and
  - to the highest and best use of an asset,make it clear that fair value under IFRSs is generally consistent with the concept of *market value as defined and discussed in the IVS Framework.*

# Characteristics of fair value

- ▶ market based measurement (not entity-specific measurement).
  - ▶ an exit value
  - ▶ reflects all changes that market participants' factor into pricing at the measurement date
  - ▶ requires judgement to measure (especially Level 3 measurements)
  - ▶ estimated based on the appropriate valuation technique/s and inputs that market participants would use when pricing the asset or liability.
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# Basic concepts in the estimation of Fair Value

## ▶ *The asset or liability*

- A fair value measurement is performed for a particular asset or liability.
- **The characteristics of the asset or liability should be taken into account**
- Such characteristics include:
  - the condition and/or location of the asset or liability and
  - any restrictions on sale or use of the asset.



# Cont'd

## ▶ **Market participant assumptions**

- fair value is a market-based measurement, not an entity-specific measurement.
  - management's intended use of an asset, or
  - planned method of settling a liability
- It should be determined based on a hypothetical transaction at the measurement date, from the perspective of a market participant.
  - a market participant were to assign value to an asset acquired in a business combination,
  - Capital value appreciation purpose

# Cont'd

## ▶ *determining the market*

- A key principle in the fair value standards is the concept of valuation based on the principal market or, in the absence of a principal market, the most advantageous market.
- The principal market is the market with the **greatest volume and level of activity** for the asset or liability being measured at fair value.
- **The market where the reporting entity, or a business unit within the overall reporting entity, would normally enter into a transaction to sell the asset or transfer the liability is presumed to be the principal market, unless there is evidence to the contrary.**
- **The principal market must be available to and accessible by the reporting entity.**

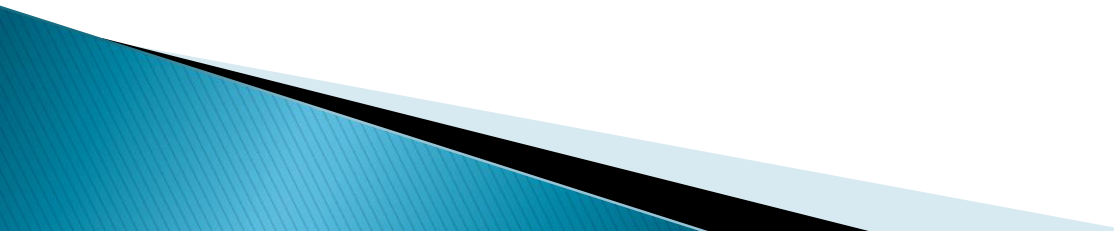
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## ▶ **Characteristics of market participants**

- independent
- knowledgeable
- diligent
- use all available information
- willing to transact for the asset or liability
- able to transact for the asset or liability

Assumption: market participants act in their economic best interest

# Cont'd

- ▶ ***Valuation premises and Highest and Best Use***
  - ▶ This concept refers to both
    - the different ways of utilizing the individual asset (e.g., as a factory or residential site), the highest and best
    - the valuation premise, whether the maximum value is on a standalone basis or in combination with other assets.
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# Cont'd

- ▶ To apply the highest and best use must be:
  - physically possible
  - legally permissible
  - Financially feasible

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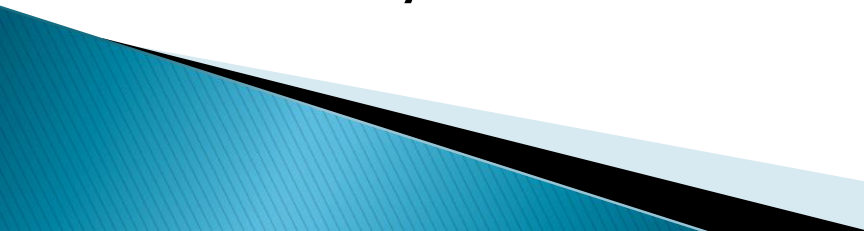
- *Use of appropriate valuation techniques*
  - market approach,
  - the income approach, and
  - the cost approach

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## ▶ *The fair value hierarchy*

- To increase consistency, transparency and comparability in reporting fair value measurements, the fair value standards establish the fair value hierarchy to prioritize the inputs used in valuation techniques.
- There are three levels to the fair value hierarchy
  - Level 1 is the highest priority and
  - Level 3 is the lowest priority

# Cont'd

- ▶ Level 1: Observable inputs in the **principal market** that reflect quoted prices (unadjusted) for **identical assets** or liabilities in **active markets**.
  - ▶ Level 2: Inputs other than quoted prices included in Level 1 that are observable for the asset or liability either directly or indirectly.
  - ▶ Level 3: Unobservable inputs (e.g., a reporting entity's or other entity's own data). Level 3 inputs may include information derived through extrapolation or interpolation that cannot be directly corroborated by observable market data.
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# Cont'd

- ▶ For valuation techniques to estimate FV:
  - maximise the use of relevant observable inputs and
  - minimise the use of unobservable inputs.

# Disclosure

