

Understanding the measurement of land and buildings in accordance with IFRS 13 *Fair Value Measurement*

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Aim

» The aim of this session is to enhance knowledge and understanding, in the Ethiopian accountancy market, of the fair value of land use and buildings measured in accordance with IFRS 13 *Fair Value Measurement*.

» *[Note: the valuation session that follows after the coffee break is dedicated to enhancing skills in the Ethiopian accountancy market in the practical application of IFRS 13 to measuring the fair value of land and buildings in the Ethiopian context.]*

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Ethiopian context

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When is immovable property measured at fair value?

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When are land and buildings measured at fair value *Summary of class discussion*

IFRS Accounting Standard	Initial recognition	Subsequent measurement
IAS 2 <i>Inventories</i>	When acquired in: (i) exchange of non-monetary items; (ii) government grant (alternative); or (iii) business combination.	
IAS 16 <i>Property, Plant and Equipment</i>		Revaluation model / Cost model when impaired to fair value less costs to sell
IAS 40 <i>Investment Property</i>		Fair value model / Cost model when impaired to fair value less costs to sell
IFRS 5 <i>Non-current Asset Held for Sale</i>	Measured at fair value before classified NCAHFS. / Otherwise, if impaired to fair value less costs to sell.	Measured at fair value before classified NCAHFS / Otherwise, when impaired to fair value less costs to sell.
IFRS 16 <i>Leases</i> (Lessees RoU asset)	[Component in the calculation of the interest rate implicit in the lease.]	Revaluation model (PPE) / Fair value model (IP) / Cost model when impaired to fair value less costs to sell / [Also relevant to some measurement of sale and leaseback that qualifies as sale].

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Acquisition-date measurement of land and buildings

Quiz: Summary of class discussion

- » **Which measurement applies to immovable property acquired in a business combination on its acquisition date?** Choose one of: 1) historical cost; 2) fair value; 3) fair value less costs to sell; 4) value in use; 5) it depends...
- » **Which measurement applies to immovable property acquired by way of government grant on its acquisition date?** Choose one of: 1) historical cost; 2) fair value; 3) fair value less costs to sell; 4) value in use; 5) it depends on the filer's choice, either: (i) fair value; or (ii) nominal amount.
- » **Which measurement applies to immovable property acquired by way of exchange of non-monetary items on its acquisition date?** Choose one of: 1) historical cost; 2) fair value; 3) fair value less costs to sell; 4) value in use; 5) it depends...

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Subsequent measurement of land and buildings

Quiz: Summary of class discussion

- » **Which measurement applies to immovable property when it is classified as non-current asset held for sale?** Choose one of: 1) historical cost; 2) fair value; 3) fair value less costs to sell; 4) value in use; 5) it depends. If the fair value model applied before such classification then fair value. If the cost model applied before such classification then the lower of reclassification carrying amount and fair value less costs to sell.
- » **Which measurement applies to immovable property when it is revalued?** Choose one of: 1) historical cost; 2) fair value; 3) fair value less costs to sell; 4) value in use; 5) it depends...
- » **Which measurement applies to immovable property when it is impaired?** Choose one of: 1) historical cost; 2) fair value; 3) fair value less costs to sell; 4) value in use; 5) it depends, the higher of: (i) value in use; and (ii) fair value less costs to sell.

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Fair value of a building

Mini-case study: a regulators ruling: JSE (South Africa)

» In its proactive monitoring of 2016 financial statements, the JSE observed an issuer incorrectly determined the fair value of the **investment property** as '**fair value less costs to sell**' per **IFRS 5** when IFRS 13, is applicable to determining the fair value of investment property, even if it is subsequently transferred to non-current assets held for sale (ie in the scope of IFRS 5).

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What is fair value?

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Fair value: an asset *the concept*

- » The fair value of an asset is:
 - » the price that would be received to sell an asset (exit price)
 - » in an orderly transaction (not a forced sale)
 - » between market participants (market-based view)
 - » at the measurement date (current price) (IFRS 13 *Fair Value Measurement*)

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Fair value *measurement objective*

- » **Objective** of fair value measurement: **estimate the price** at which an orderly transaction to sell an asset would take place between market participants at the measurement date under current market conditions (paragraph B2 of IFRS 13)
- » The objective **provides focus** to fair value measurement
 - » **Market participant perspective**: consequently, the entity's intention to hold an asset is not relevant when measuring fair value.

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Fair value *market participants*

- » Characteristics of market participants (ie buyers and sellers in principal market (or most advantageous market)):
 - » 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

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Measuring the fair value of immovable property

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Fair value: market participant perspective

application guidance: how to measure fair value

- » To measure the fair value of an immovable property asset:
 - » determine all characteristics of the asset being measured (exclude things that are not characteristics of the asset or liability);
 - » apply the valuation premise;
 - » determine the highest and best use;
 - » determine the principal (or most advantageous) market;
 - » determine the appropriate valuation technique/s and inputs that **market participants would use** when pricing the asset
 - » determine the level of the fair value hierarchy within which the inputs are categorised.

Source: paragraph B2 of IFRS 13

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Fair value of a non-financial asset

application guidance: highest and best use

- » Fair value measurement logically assumes that a market participant would put a non-financial asset to its **highest and best use** because that maximises the value of the asset.
- » The highest and best use must be:
 - » physically possible;
 - » legally permissible; and
 - » financially feasible.

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Fair value of land and buildings

Example 1

- » Your factory is built on Plot 900 in a recently developed industrial development zone on the outskirts of Addis Ababa where the land that is divided into one hundred two acre plots that before their further development were essentially homogenous. Factories, like yours, are the highest and best use for the land rights.
- » On 31/12/2022 two of the plots adjoining your plot were sold (ie sale of the land rights and the buildings, if any, constructed thereon):
 - » Plot 901 sold for **ETB30 million**: land rights with a similar factory of the same age, same condition and same floor area as yours.
 - » Plot 899 sold for **ETB10 million** because it is undeveloped (yet to be built on).

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Fair value of land and buildings

Example 1: highest and best use


Summary of class discussion

On 31/12/2022 what is the fair value of your land rights (ie excluding the factory building)? Choose one of: 1) ETB0; **2) ETB10 million;** 3) ETB20 million; 4) ETB30 million; 5) ETB70 million; 6) ETB80 million; 7) ETB100; million; or 8) another amount.

On 31/12/2022 what is the fair value of your factory building (ie excluding the land rights)? Choose one of: 1) ETB0; 2) ETB10 million; **3) ETB20 million;** 4) ETB30 million; 5) ETB70 million; 6) ETB80 million; 7) ETB100; million; or 8) another amount.

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Fair value of land and buildings
Example 2: highest and best use
What do you think?

Facts are the same as Example 1. A decade later on 31/12/2032:


» **high-rise commercial development** is now the highest and best use for your land rights because the rapidly expanding financial district of Addis Ababa has grown to the boundary of plots 899, 900 and 901.

» Plots 899 and 901 each sell for ETB100 million.

On 31/12/2032 what is the fair value of your land rights (ie excluding the factory building)? Choose one of: 1) ETB0; 2) ETB10 million; 3) ETB20 million; 4) ETB30 million; 5) ETB70 million; 6) ETB80 million; 7) ETB100; million; or 8) another amount

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Fair value of land and buildings
Example 2: highest and best use
What do you think?

On 31/12/2032 what is the fair value of your factory building (ie excluding the land rights)? Choose one of: 1) ETB0; 2) ETB10 million; 3) ETB20 million; 4) ETB30 million; 5) ETB70 million; 6) ETB80 million; 7) ETB100; million; or 8) another amount

Does your estimate of the fair value of your factory building (ie excluding the land rights) depend on which model you use for your land rights (cost model or revaluation model)?

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Fair value of land and buildings
Example 2: highest and best use
Summary of class discussion


On 31/12/2032 what is the fair value of your land rights (ie excluding the factory building)? Choose one of: 1) ETB0; 2) ETB10 million; 3) ETB20 million; 4) ETB30 million; 5) ETB70 million; 6) ETB80 million; **7) ETB100; million;** or 8) another amount.

On 31/12/2032 what is the fair value of your factory building (ie excluding the land rights)? Choose one of: **1) ETB0;** 2) ETB10 million; **3) ETB20 million;** 4) ETB30 million; **5) ETB70 million;** 6) ETB80 million; **7) ETB100; million;** or **8) another amount**

Does your estimate of the fair value of your factory building (ie excluding the land rights) depend on which model you use for your land rights (cost model or revaluation model)? **Answer: No**

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Fair value of land and buildings
Example 3: highest and best use
What do you think?

» Facts are the **same as in Example 1, except in Example 3** there have been **no recent sales of similar assets** (ie Plots 899 and 901 are unsold).

» **How could the fair value of the factory building on Plot 900 be measured at 31/12/2022?**

» **What judgements would be made in measuring such a Level 3 fair value?**

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Fair value of land and buildings
Example 3: highest and best use
Summary of class discussion

- » Use a **different model** to estimate the fair value of the land and buildings. For example, a **DCF model** using **market participant inputs**, ie market participant cash flows.
- » What judgements would be made in measuring such a Level 3 fair value?
 - » **Identifying the relevant market participants** (for example, factory owners if current use is highest and best use);
 - » **Identifying the model market participants would use** to estimate fair value (for example, DCF model for the land and the building in its highest and best use (likely current use));
 - » **Estimating the model inputs from the market participant perspective** (including, if a DCF model for the land, the a notional cash flows for the current market rentals for the land use and the market participant discount rate/s).

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Fair value of land and buildings
Example 4: highest and best use
What do you think?

- » Facts are the **same as in Example 2**, except in **Example 4** there have been **no recent sales of similar assets** (ie Plots 899 and 901 are unsold).
 - » **How could the fair value of the factory building on Plot 900 be measured at 31/12/ 2032?**
 - » **What judgements would be made in measuring such a Level 3 fair value?**

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Fair value of land and buildings

Example 4: highest and best use

Summary of class discussion

- » Use a **different model** to estimate the fair value of the land. For example, a **DCF model using market participant inputs**, ie market-participant cash flows (including notional cash flows = current market rentals for the land use).
- » Fair value of the **building is likely nil** because logically it would be replaced with a high-rise building).
- » What judgements would be made in measuring such a Level 3 fair value?
 - » **Identifying the relevant market participants** (for example, property developers)
 - » **Identifying the model market participants would use** to estimate fair value (for example, DCF model for the land.
 - » **Identifying/estimating the model inputs from the market participant perspective** (including, if a DCF model for the land, the cash flows to remove the factory building and to build a high-rise building, then over the economic life of the high-rise building: rental income and high-rise building maintenance expenses etc and the market participant discount rate/s.

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Fair value: market participants' viewpoint

application guidance: characteristic of an asset or liability

- » Fair value measurement is for a **particular** asset
 - » it captures all characteristics of the asset or liability being measured that **market participants would take into account** when pricing the item
 - » location
 - » condition
 - » restrictions on use or sale that are a characteristic of the item
 - » it excludes things that are not characteristics of the asset or liability
 - » transactions costs
 - » restrictions on use or sale that are not a characteristic of the item

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Fair value of land and buildings: characteristic of the asset?

Example 1: transaction costs

Summary of class discussion

» 31/12/2022:

- » Market price = ETB100 billion;
- » Transaction costs = ETB10 billion

» What is the fair value of the asset? Choose one of:

- » ETB110 billion;
- » **ETB100 billion;** or
- » ETB90 billion.

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Fair value of land and buildings: characteristic of the asset?

Example 2: restriction on use

- » You own land use rights to Plot A that is **zoned 'green belt'**—which prohibits the construction of buildings on that land.
- » Similar neighbouring plots' with the same land use rights and subject to the same restrictions sold recently:
 - » for ETB950,000 on 30 October 2022 (Plot B); and
 - » for ETB30,000,000 on 31 December 2022 (Plot C).
- » The difference in the selling price of Plots B and C is attributable primarily to the press leaked confidential government dossier setting out the government's plans for **proposing an amendment to the law to allow for the construction of high-rise buildings** on some (but unspecified which) green belt land.

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Fair value of land and buildings: characteristic of the asset?

Example 2: restriction on use

Summary of class discussion

You employ a reputable property valuation expert to value the land use rights to Plot A at 31/12/2022 under each of the following hypothetical scenarios:

- » **Scenario 1:** the land is rezoned allowing for the construction of a high-rise building: ETB100,000,000
- » **Scenario 2:** market participants believe there is no prospect of the zoning laws changing: ETB1,000,000

What is the fair value of the land use rights to Plot A at 31/12/2022? Choose one of: 1) ETB950,000; 2) ETB1,000,000; **3) ETB30,000,000;** 4) ETB100,000,000; or 5) another amount.

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Fair value of land and buildings: characteristic of the asset?

Example 3: restriction on use (subject to operating lease)

Summary of class discussion

» 01/01/2023 in a business combination you acquire land that is subject to an operating lease (acquiree is the lessor) that is ETB2 billion (fair value) favourable to the lessor when compared with market terms.

- » Without the lease market participants would pay ETB98 billion (fair value) for the land.

» **At 01/01/2023 what is the fair value of the land classified as IAS 40 Investment Property?** Choose one of: 1) ETB96 billion; 1) ETB98 billion; **3) ETB100 billion;** or 4) another amount

Note: an **IFRS rule** (see paragraph B42 of FRS 3 *Business Combinations*) specifies that one must take into account the terms of the lease in measuring the acquisition-date fair value of the land and consequently, not recognise a separate asset for the favourable (or unfavourable) terms of the operating lease (from the lessor's perspective) when compared with market terms.

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Fair value of land and buildings: characteristic of the asset?

Example 5: restriction on use (easements)

Summary of class discussion

- » You own a plot of land that is subject to easements—specified utility companies have the right to run water pipes, gas pipes, electricity lines and broadband cables across the land.
- » The easements are specific to the land and, if the land were to be sold the easements would necessarily transfer to the buyer.
- » You employ a reputable land valuation expert to value your land at 31/12/2022 under each of the following scenarios:
 - » **Scenario 1 (hypothetical):** the land without being subject to any easements: ETB100 billion.
 - » **Scenario 2:** the land subject to the specified easements: ETB90 billion.
- » **What is the fair value of the land at 31/12/2022?** Choose one of: 1) ETB90 million; 2) ETB100 million; or 3) another amount.

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Fair value of land and buildings: characteristic of the asset?

Example 4: donor-imposed restriction on use

- » **01/01/2000**, you receive **farmland** by way of donation. This farmland is subject to a **donor imposed restriction that prohibits you from using the land for any purpose other than grazing animals on it.**
- » In **2010** agricultural practices in the region evolved in response to climate change and management determine that **it would now be significantly more profitable to grow intensive annual crops** on the land.
- » By **2022** the land bordering your farmland had been developed into **upmarket domestic housing** in response to the tourism industry unexpectedly booming in the region.

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Fair value of land and buildings: characteristic of the asset?

Example 4: donor-imposed restriction on use

Summary of class discussion

» Periodically you employ a reputable property valuation expert to measure the current value of your farmland if restricted to the following uses:

Measurement-date	Grazing	Cropping	Housing
01/01/2000	ETB1 billion	ETB0.5 billion	ETB0.1 billion
31/12/2010	ETB1.5 billion	ETB2.5 billion	ETB0.2 billion
31/12/2022	ETB2 billion	ETB5 billion	ETB10 billion

» **What is the fair value of the land at 01/01/2000?** Choose one of: 1) ETB0.1 billion; 2) ETB0.5 billion; 3) ETB1 billion; or 4) it depends (specify...)

» **What is the fair value of the land at 31/12/2010?** Choose one of: 1) ETB0.2 billion; 2) ETB1.5 billion; 3) ETB2.5 billion; or 4) it depends (specify...)

» **What is the fair value of the land at 31/12/2022?** Choose one of: 1) ETB2 billion; 2) ETB5 billion; 3) ETB10 billion; or 4) it depends (specify...)

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Fair value of immovable property

application guidance: appropriate valuation technique/s and inputs

» Fair value is measured using the valuation technique/s and inputs that **market participants would use** when pricing the asset.

» The **level of the fair value hierarchy** within which the inputs are categorised must be determined because:

» Unadjusted Price x Quantity rule applies to Level 1 fair value measurement.

» To achieve a reliable measurement (faithful representation) different disclosures are specified for each level of the fair value measurement hierarchy.

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Examples—fair value measurement applying the fair value measurement principle

- » Fair value measurement **principle**: estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions (ie an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability). (paragraph 2 of IFRS 13)
- » **Judgements** include, has the registrant: (i) used an appropriate model? (ii) used appropriate model inputs? (iii) taken account of all factors market participants would consider in measuring fair value? (iv) applied the model properly (without material error)?

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Regulatory mini-case study: JSE (South Africa) (1 of 6 slides)

Fair value of investment properties

In this matter, **investment properties** were the most significant assets for the issuer. In their 2020 interims (issued in the midst of the **covid-19 pandemic**) the **issuer stated** that:

**“Investment properties were last revalued at (the previous financial year end).
Caution needs to be exercised by the user of this announcement, bearing in mind that the valuations were performed without the covid-19 impact”.**

The issuer **initially asserted** that **there was no reliable information available** with which to prepare valuations at the interim reporting date. IAS 34.41 notes that the preparation of interim results will generally require a greater use of estimation than for AFS.”

Source: REPORTING BACK ON PROACTIVE MONITORING OF FINANCIAL STATEMENTS IN 2021

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Regulatory mini-case study: JSE (South Africa) (3 of 6 slides)
Summary of class discussion

1. Is it appropriate to temporarily suspend fair value measurement in a pandemic because there is widespread disruptions to markets? Choose one of: 1) Yes; or 2) No. The property-by-property cost model **impracticability exception can only be triggered at initial recognition** (paragraphs 53 and 55 of IAS 40).

Note: the JSE observed that “Heightened uncertainty about the future does not justify the non-application of IFRS to determine the fair value at the interim date. This was confirmed by the IASB in their document ‘Applying IFRS standards in 2020-impact of covid-19’ which highlights that **an increase in uncertainty is not a reason to “freeze” estimates.**”

Source: REPORTING BACK ON PROACTIVE MONITORING OF FINANCIAL STATEMENTS IN 2021

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Regulatory mini-case study: JSE (South Africa) (4 of 6 slides)
Summary of class discussion

2. Can an SOE rectify inappropriate accounting policies either by disclosure of the accounting policy used or by notes or explanatory material? Choose one of: 1) Yes; or 2) No.

“An entity cannot rectify inappropriate accounting policies either by disclosure of the accounting policy used or by notes or explanatory material.” (paragraph 18 of IAS 1)

Source: REPORTING BACK ON PROACTIVE MONITORING OF FINANCIAL STATEMENTS IN 2021

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Regulatory mini-case study: JSE (South Africa) (5 of 6 slides)
Summary of class discussion

3. In instances of widespread disruptions to markets (such as the covid-19 pandemic) how could the fair value of investment property be measured?

The JSE observed that “In instances of widespread disruptions to markets (such as the covid-19 pandemic) reliance is placed on unobservable inputs applied in a valuation technique. Unobservable inputs can be developed using the best information available about the assumptions that market participants would use when pricing the asset.”

Source: REPORTING BACK ON PROACTIVE MONITORING OF FINANCIAL STATEMENTS IN 2021

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Regulatory mini-case study: JSE (South Africa) (6 of 6 slides)
Summary of class discussion

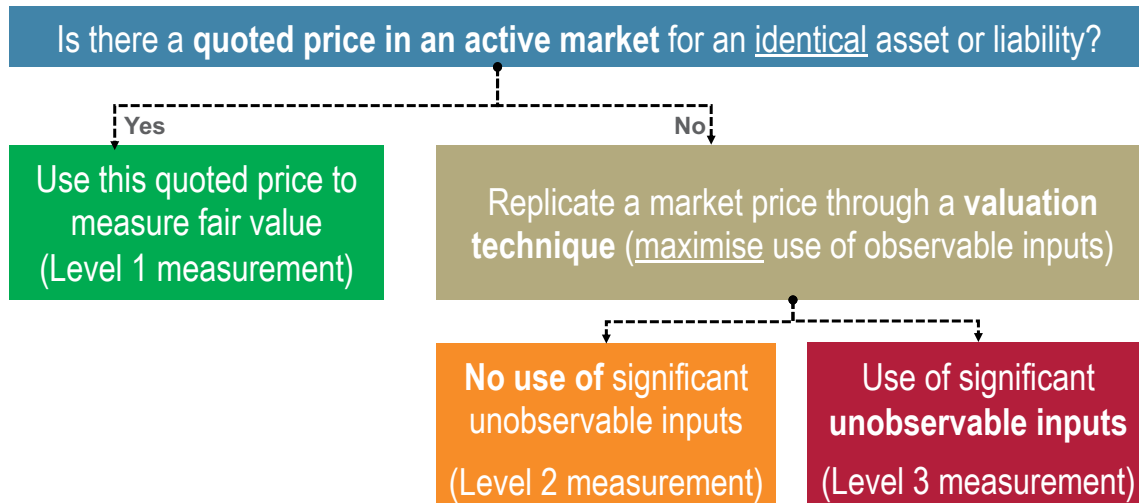
“IFRS 13.B23 describes the expected **present value technique** as a possible valuation approach. In so doing it describes as a starting point the use of a set of cash flows that represents the probability-weighted average of all possible future cash flows. It later caveats this (IFRS 13.B28) by noting that it might be possible to develop a limited number of discrete scenarios and probabilities that capture the array of possible cash flows. IFRS 9.B5.5.41 and B5.5.42 (applied by analogy) also explain that estimates are neither a worst-case scenario nor an estimate of a best-case scenario but rather an estimation that reflects a range of possible outcomes. A similar requirement for estimates of future cash flows is drawn in IFRS 17.B37, noting that the objective of estimating future cash flows is to consider the full range of possible outcomes. A caveat is again provided in B39 of IFRS 17 in that, in practice, explicit scenarios may be unnecessary if the resulting estimate is consistent with the measurement objective of considering all reasonable and supportable information available.”

Source: REPORTING BACK ON PROACTIVE MONITORING OF FINANCIAL STATEMENTS IN 2021

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Fair value hierarchy application guidance: Levels 1, 2 and 3



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Fair value measurement hierarchy judging the boundaries of the artificial constructs

- » Boundary between **levels 1 & 2**—do transactions in the market in which the **identical item** trades (and that the entity can access at the measurement date) take place with **sufficient frequency and volume** to provide pricing information on an ongoing basis? (Appendix A to IFRS 13)
- » Boundary between **level 2 and level 3**—significant unobservable inputs?

Example **entity-specific policy**—HSBC (2020) financial statements, p292:

- » “significant unobservable inputs if, in the opinion of management, a significant proportion of the instrument’s inception profit or greater than 5% of the instrument’s valuation is driven by unobservable inputs
- » ‘Unobservable’ in this context means that there is little or no current market data available from which to determine the price at which an arm’s length transaction would be likely to occur. It generally does not mean that there is no data available at all upon which to base a determination of fair value (consensus pricing data may, for example, be used)”

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Fair value of land and buildings

Quiz: summary of class discussion

- » Which level of the fair value measurement hierarchy do you believe appropriate for an issuer owned unlet partly constructed multi-storey building in Addis Ababa that is classified as investment property? Choose one of: 1) Level 1; 2) Level 2; or **3) Level 3.**
- » Which level of the fair value measurement hierarchy do you believe appropriate for an issuer owned fully let high-end multi-storey building in Addis Ababa that is classified as investment property? Choose one of: 1) Level 1; 2) Level 2; or **3) Level 3.**
- » Which level of the fair value measurement hierarchy do you believe appropriate for a 50-year land use right in Oromia that is classified as the PPE by a coffee farmer (the issuer)? Choose one of: 1) Level 1; 2) Level 2; or **3) Level 3.**

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Regulatory mini-case study: JSE (South Africa)

Fair value of investment property

- » In its proactive monitoring of financial statements the JSE observed issuer-owned **investment property** incorrectly classified at **level 2** fair value.
 - » it is highly unlikely that property in the South African market will meet the criteria for a level 2 fair value classification (ie no significant unobservable inputs).

Source: REPORTING BACK ON PROACTIVE MONITORING OF FINANCIAL STATEMENTS IN 2016

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Regulatory mini-case study: ESMA Summary of class discussion

If **not** the correction of a prior period error, is the following: 1) a change of accounting policy; or 2) a change in accounting estimate?

Issue	IAS 8 and
A change in the valuation technique to measure fair value, eg from a market approach to an income approach (Level 3).	IFRS 13

Fair value measurement **principle**: estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions (ie an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability). (paragraph 2 of IFRS 13)

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Regulatory mini-case study: JSE (South Africa) fair value of investment property (1 of 2 slides)

“Determining fair value has always been a subjective matter. It requires issuers to make assumptions about the future and can lead to the incorporation of significant levels of estimation uncertainty into valuation models. **IAS 1.125** requires disclosure of these uncertainties. Our observations of these disclosures are that issuers often include generic (or ‘**boiler plate**’) statements without providing **entity specific** (or useful) information relevant to their particular situation. The consequences of uncertainties following the **covid-19 pandemic** are expected to elevate both the level of subjectivity and the importance of these (and other) disclosures.”

Source: derived from JSE, Investment property: Common findings report (November 2020)

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Regulatory mini-case study: JSE (South Africa)
fair value of investment property (2 of 2 slides)
What do you think?

Overarching disclosure objective: sufficient information to help users assess the valuation techniques and inputs used to develop fair value measurements (paragraph 91(a) of IFRS 13)

1. Which valuation technique/s for measuring the fair value of investment property in Africa?
2. For discounted cash flow or income capitalisation method what are the quantitative inputs you would expect disclosure of?
3. What is the objective of the quantitative disclosures to fair value (required by paragraph 93(d))?
4. How many model inputs should be disclosed?
5. How much aggregation or disaggregation to meet the overarching objective?

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Regulatory mini-case study: JSE (South Africa)
fair value of investment property (2a of 2 slides)
Summary of class discussion (1)

1. Which valuation technique/s are typically used for measuring the fair value of investment property in Africa?

- » Typically discounted cash flow or income capitalisation method.
- » Less frequently adjusted recent selling prices for similar location etc.

2. For investment property valued in terms of a discounted cash flow or income capitalisation method what are the quantitative inputs you would expect disclosure of?

- » Inputs such as discount rates, capitalisation rates, rental incomes, rentals per square meter, vacancy rates, yields etc.

Source: derived from JSE, Investment property: Common findings report (November 2020)

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Regulatory mini-case study: JSE (South Africa)
fair value of investment property (2b of 2 slides)
Summary of class discussion (2)

3. What is the objective of the quantitative disclosures to fair value (required by paragraph 93(d))?

- » the objective is to **provide enough information for users to assess whether the entity's views about individual inputs differ from their own**. It is not to enable users to replicate the entity's pricing models (IFRS 13.BC192).

4. How many model inputs should be disclosed?

- » The identification of only one (or even two) inputs when providing IFRS 13 disclosures for investment properties is **insufficient**. The valuation methodology is **typically more complex (and sensitive) than one or two inputs imply**.

Source: derived from JSE, Investment property: Common findings report (November 2020)

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Regulatory mini-case study: JSE (South Africa)
fair value of investment property (2c of 2 slides)
Summary of class discussion (3)

5. How much aggregation or disaggregation to meet the overarching objective?

- » Paragraph 30A of IAS 1 emphasises that, in aggregating information an entity must not reduce the understandability thereof. Too much aggregation reduces the quality and usefulness of the information.
- » Too much aggregation reduces the quality and usefulness of the information. This occurs when:
 - » too many inputs are combined without explaining how they are used; or
 - » when a wide range is disclosed that does not yield 'usable' information.
- » Consequently, the **level of aggregation is entity/circumstance specific!**

Source: derived from JSE, Investment property: Common findings report (November 2020)

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Regulatory mini-case study: JSE (South Africa) fair value of investment property *What do you think?*

- » Entity with portfolio of >100 properties across multiple geographic and asset classes provides quantitative disclosures aggregated as follows:
 - » Discount rates applied for valuations on the discounted cash flow method ranged between 12.1% and 17.3%; and
 - » Capitalisation rates applied to valuations on the income-capitalisation method ranged between 8.3% and 13%.
- » Entity also disclosed that factors such as geographic position, grading of building and tenant grading had an impact on the determination of the discount rate.
- » **Does the level of aggregation/disaggregation meet the overarching objective (ie provide enough information for users to assess whether the entity's views about individual inputs differ from their own)?**

Source: derived from JSE, Investment property: Common findings report (November 2020)

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Regulatory mini-case study: JSE (South Africa) fair value of investment property *Summary of class discussion*

No:

- » Although Entity disclosed that factors such as geographic position, grading of building and tenant grading had an impact on the determination of the discount rate, it provided no further information to be able to link these inputs to the wide range disclosed.
- » Without additional information being provided in the audited financial statements we do not believe that the above disclosures are useful. How can this information be used to assess which properties (or even how many properties) were valued using a discount rate of 8.3% versus 13% or how these inputs impacted the fair value determination (IFRS 13.91(a)?
- » We understand that the valuation result is often extremely sensitive to even a small change (as little as 0.25%) in the capitalisation or discount rate. If a user wanted to assess the extent of the portfolio to which a discount rate of 12% was applied they would be unable to make this assessment given the disclosures provided above.

Source: derived from JSE, Investment property: Common findings report (November 2020)

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Regulatory mini-case study: JSE (South Africa) fair value of investment property *What do you think?*

Does the level of aggregation/disaggregation meet the overarching objective (ie provide enough information for users to assess whether the entity's views about individual inputs differ from their own)?

At the reporting date, the key assumptions and unobservable inputs used by the Group in determining fair value were in the following ranges for the Group's portfolio of properties:

Investment property

Description	Valuation technique	Significant unobservable inputs and range of estimates used			
		Discount rate (%)	Exit capitalisation rate (%)	Capitalisation rate (%)	Rental growth rate (%)
Retail sector		11.0 – 15.5	7.5 – 13.5	7.0 – 13.0	2.5 – 6.0
Office sector		11.0 – 15.25	8.0 – 11.0	8.0 – 10.5	2.4 – 5.5
Industrial sector	Discounted cash flow model	10.5 – 16.5	8.5 – 13.0	8.0 – 13.75	2.85 – 5.5
Healthcare sector		13.5 – 14.5	8.5 – 9.5	8.5 – 9.5	5.0 – 5.0

NOTE: The information was further cross referenced to (audited) property portfolio information in which individual valuations and risk information per property was also disclosed.

Source: derived from JSE, Investment property: Common findings report (November 2020)

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Regulatory mini-case study: JSE (South Africa) fair value of investment property *Summary of class discussion*

Yes, the Group appears to have disaggregated appropriately in its disclosures of unobservable inputs applied to the fair value determination. Whilst some of the ranges disclosed in the table may be wide, the information was further cross referenced to (audited) property portfolio information in which individual valuations and risk information per property was also disclosed.

Source: derived from JSE, Investment property: Common findings report (November 2020)

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Fair value of investment property sensitivity disclosures required for level 3

“for all such measurements, a **narrative description of the sensitivity** of the fair value measurement 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 measurement.

If there are interrelationships between those inputs and other unobservable inputs used in the fair value measurement, an entity shall also provide a **description of those interrelationships** and of **how they might magnify or mitigate** the effect of changes in the unobservable inputs on the fair value measurement.

To comply with that disclosure requirement, the narrative description of the sensitivity to changes in unobservable inputs shall **include, at a minimum, the unobservable inputs disclosed when complying with (d).**”

Source: paragraph 93(h)(i) of IFRS 13

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Regulatory mini-case study: JSE (South Africa) fair value of investment property *What do you think?*

Does the sensitivity analysis satisfy the disclosure requirement in paragraph 93(h)(i) of IFRS 13?

Inter-relationship between key unobservable inputs and fair value measurements

The estimated fair value would increase/(decrease) if:

- expected market rental growth was higher/(lower);
- expected expense growth was lower/(higher);
- vacant periods were shorter/(longer);
- occupancy rate was higher/(lower);
- rent-free periods were shorter/(longer);
- discount rate was lower/(higher);
- exit capitalisation rate was lower/(higher);
- capitalisation rate was lower/(higher);
- bulk rate was higher/(lower); or
- core yield was lower/(higher).

Source: derived from JSE, Investment property: Common findings report (November 2020)

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Regulatory mini-case study: JSE (South Africa)
fair value of investment property
Summary of class discussion

Does the sensitivity analysis satisfy the disclosure requirement in paragraph 93(h)(i) of IFRS 13?

No, the disclosure provided is not meaningful as it merely 'states the obvious'.

It does not provide any indication as to which inputs the fair value measurement is most sensitive to. Would a change in the rent free period have a greater or lesser impact to the fair value measurement than market rental growth rates?

Source: derived from JSE, Investment property: Common findings report (November 2020)

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Regulatory mini-case study: JSE (South Africa)
fair value of investment property
What do you think?

Does the sensitivity analysis satisfy the disclosure requirement in paragraph 93(h)(i) of IFRS 13?

The valuations of the investment properties are sensitive to changes in the unobservable inputs used in such valuations. Changes to one of the unobservable inputs, while holding the other inputs constant, would have the following effects on the fair value of investment property and fair value adjustment in profit or loss:

Input	Change %	Group	
		2020 R'000	2019 R'000
Increase in discount rate	0.25	(251.9)	(287.7)
Decrease in discount rate	0.25	264.6	303.1
Increase in capitalisation rate	0.25	(252.9)	(656.4)
Decrease in capitalisation rate	0.25	265.7	528.2

Source: derived from JSE, Investment property: Common findings report (November 2020)

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Regulatory mini-case study: JSE (South Africa)
fair value of investment property
Summary of class discussion

Does the sensitivity analysis satisfy the disclosure requirement in paragraph 93(h)(i) of IFRS 13?

Yes, the sensitivity disclosure is beneficial to the user. It quantifies the sensitivity (despite quantification not being explicitly required) and highlights the specific inputs to which the fair value measurement is most sensitive.

Source: derived from JSE, Investment property: Common findings report (November 2020)

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