Understanding the measurement of financial assets in accordance with IFRS 13 *Fair Value Measurement*

Date: 30 May 2023
Addis Ababa

WORLD BANK GROUP

AABE
Accounting and Audit Board of Ethiopia
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1

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2

2

Aim

» The aim of this session is to enhance knowledge and understanding, in the Ethiopian accountancy market, of the fair value of financial assets 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 financial assets in the Ethiopian context.]*

3

3

Identifying financial assets

4

Definition of a financial instrument paragraph 11 of IAS 32 *Financial Instruments: Presentation*

Classification	Nature	Purpose to which put, ie held for…
Financial instrument	A **financial instrument** is "any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity"	
Financial asset	• cash; • equity of another entity; • a contractual right to receive cash or another financial asset • a contractual right to exchange financial assets or financial liabilities under conditions that are potentially favourable; or • a contract that will or may be settled in the entity's own equity instruments and is not settled 'fixed-for-fixed'.	• collect contractual cash flows • speculation, trading, etc • collect and sell (ie business model aspect of subclassification)

5

5

Definition of a financial instrument paragraph 11 of IAS 32 *Financial Instruments: Presentation*

Classification	Nature
Equity instrument	An **equity instrument** is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.
Financial liability	• a contractual obligation to deliver cash or another financial asset; • a contractual obligation to exchange financial assets or financial liabilities under conditions that are potentially unfavourable; or • a contract that will or may be settled in the entity's own equity instruments and is not settled 'fixed-for-fixed'.

6

6

Offsetting
FRC (UK) regulatory observation

» A financial asset and a financial liability should be offset when, and only when, the entity has a legal right to offset and the entity intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously. (paragraph 42(b) of IAS 32)

» In March 2016, in relation to a specifically described **cash-pooling arrangement**, the IFRS Interpretations Committee concluded that the settlement of the entire period-end balance on a net basis is necessary to meet the requirement.

» In several cases, **bank overdrafts** or similar liabilities had been **offset against cash and cash equivalents** in the statement of financial position but it was not clear how the IAS 32 criteria for offset were met. (p18)

Source: FRC (UK), Annual Review of Corporate Reporting 2020/21

Ethiopian context

Ethiopian context
Which financial assets do Ethiopian companies have?
Summary of class discussion

- Cash and cash equivalents
  - Cash on hand, short-term-deposits, etc
- Equity instruments of other entities
- Bonds
  - ETB denominated
  - Foreign currency denominated
- Loans: financial institutions, employees
- Related party loans
- Operating, e.g. trade receivables

10

10

Ethiopian context:
Example 1 Commercial Bank of Ethiopia

COMMERCIAL BANK OF ETHIOPIA
CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 30 JUNE 2021
(IN ETHIOPIAN BIRR)

	Note	30 June 2021	30 June 2020
Assets			
Cash and cash equivalents	9	117,165,815,748	97,524,063,189
Debt and equity securities	10	552,453,627,251	445,140,387,326
Loans and advances to customers, net	11	279,001,679,067	232,510,755,443
Loans to micro-finance institutions, net	12	207,442,852	576,608,467
Receivables	13	7,799,402,955	8,904,265,586
Investments in associates	14	277,125,422	211,041,876
Non-current assets held for sale	15	935,486,774	1,030,518,314
Investment property	16	186,977	186,977
Property, plant and equipment, net	17	13,182,461,314	13,497,757,373
Intangible assets	18	136,458,634	219,179,194
Other assets	19	12,197,667,537	11,679,397,631
Right of use asset	20	3,895,212,080	3,929,727,524
Deferred tax assets	25	4,066,481,458	4,054,933,886
Total assets		**991,319,048,071**	**819,278,822,786**

11

11

Ethiopian context:
Example 2 Ethiopian Airlines Group

ETHIOPIAN AIRLINES GROUP
STATEMENT OF FINANCIAL POSITION
AS of 30 JUNE 2021

	Notes	Birr	2020 Birr
ASSETS			
NON-CURRENT ASSETS			
Property, plant and equipment	2(f),(g),9	255,882,476,143	208,039,709,357
Intangible Assets	2(h),(g),10	250,195,036	208,274,212
Right of use assets	2(c)(d),29A	123,234,070,922	101,660,545,066
Investment in associates	2(q),11	282,667,596	679,621,685
Standing deposits	13	16,086,242,811	14,440,967,183
Other loan receivables	2(j),14	524,158,491	485,326,884
		396,259,810,999	325,514,444,387
CURRENT ASSETS			
Stock	2(p),15	7,769,012,608	6,514,499,341
Trade and other receiveables	2(k),16	30,954,905,930	19,128,121,173
Short term investments	17	1,144,878	1,679,810,839
Cash and cash equivalents	2(r),18	35,101,311,627	17,129,005,132
		73,826,375,043	44,451,436,485
TOTAL ASSETS		470,086,186,042	369,965,880,872

12

12

When to measure the fair value of a financial asset?

13

When are financial assets measured at fair value?
Summary of class discussion

At initial recognition	Subsequent measurement	Disclosure only
Nearly all financial assets in the scope of IFRS 9 and IFRS 3 *Business Combinations*. However, except when subsequently measured FVPL, include transactions costs in initial measurement.	'Fail' IFRS 9's SPPI test = FVPL. Qualifying instruments can deem FVOCI. 'Pass' SPPI test BUT business model is not 'hold to collect'. FVOCI if hold to collect and sell. Otherwise = FVPL. Qualifying instruments can deem FVPL.	IFRS 9 when carrying amount is not a reasonable approximation of fair value.
Investment entities' investments in subsidiaries, joint ventures, associates, etc	**Investment entities**' investments in subsidiaries, joint ventures, associates, etc	
	When **IAS 36's fair value less costs to dispose** applies to **impaired equity method investments** in associates and joint ventures (paragraph 20 of IAS 28).	

Financial instruments measurement at **initial recognition** (IFRS 9)
Summary of class discussion

- **Principle:** initially measure a financial asset at its fair value (FV).
- However, IFRS 9 specifies exceptions from principle. For example:
  - **Rule:** when in accordance with IFRS 15 *Revenue from Contracts with Customers* trade receivables are measured initially at their transactions price which differs from FV, (for example, when the practical expedient in paragraph 63 of IFRS 15 applies).
  - **Rule:** when FV on initial recognition does not equal transaction price and FV is not Level 1 or 'upper' Level 2 (ie only observable inputs), then defer recognition of 'day-1 gain or loss'.
- **Principle:** when subsequent measurement = FVPL, transactions costs are an expense.
  - **Rule:** if not subsequently measured at FV through profit or loss add/(deduct) transactions costs to/(from) a financial asset's/(financial liability's) initial FV.

Sources: paragraph 5.1.1 of IFRS 9 and paragraph 43 of IAS 39

IFRS 9: classification and subsequent measurement

	Business model = hold to collect	Business model = hold to collect and sell	Other business models (eg held for trading)	**FVPL option** available to avoid an **accounting mismatch**	**FVOCI option** available for **equity** not held for trading
Cash flows: solely payments of principal and interest (SPPI)	Amortised cost (AC)	FV through other comprehensive income (OCI) (but with AC in PL)	FVPL	FVPL	
Other types of cash flows	Fair value (FV) through profit or loss (PL)	FVPL	FVPL		FVOCI

17

17

IFRS 9: classification approach
Summary of class discussion

- Classify **whole instrument** (ie no bifurcation of financial assets) on the basis of:
  - cash flow characteristics; and
  - observable business model within which the financial assets are being managed (not based on intent for individual asset).

18

18

Financial statement compliance review areas of ongoing focus FRC (UK)

We will continue to challenge companies during our routine reviews when we do not see:

- Entity specific classification policies with linkage to the business model for more complex portfolios. For non-banking entities, discussion of a hold-to-collect model, where relevant.
- Explanation of policy choices where assets and liabilities are designated at FVOCI or FVPL, in particular, how the criteria for designation has been met.
- Clear explanation of the judgements applied, particularly to determine if there has been a significant increase in credit risk.
- Analysis of the gross carrying amount of financial assets by credit risk ratings grade, days past due or in a provision matrix.
- Application of the ECL requirements to material contract balances or lease receivables.
- Discussion of the basis on which forward looking information has been factored into the calculation of ECLs.
- Sensitivity analysis where ECLs are identified as a source of estimation uncertainty.

Source: FRC (UK) IFRS 9 Thematic Review: Review of Disclosures in the First Year of Application, p24

19

19

When are financial assets measured at fair value?

Separate financial statements (IAS 27)

Summary of class discussion

At initial recognition	Subsequent measurement	Disclosure only
When elected **IFRS 9 alternative** for investments in subsidiaries, joint ventures, associates, etc	When elected **IFRS 9 alternative** for **investments in subsidiaries, joint ventures, associates,** etc	
	When **IAS 36's fair value less costs to dispose** applies to impaired **equity method investments** in associates and joint ventures (IAS 28).	
	When **IFRS 5's fair value less costs to sell** measure applies under the **equity method alternative** for investments in subsidiaries, joint ventures, associates, etc (paragraph 20 of IAS 28)	

20

20

Fair value: low-interest loan asset
Summary of class discussion

» Entity C advances an 'interest-free' loan of ETB121,000 million to a related party on 1 January 2023.

» The loan is repayable on 31 December 2024 at ETB121,000 million.

» The annual market interest rate that would otherwise have applied to the related party borrowing would have been 10%. However, this estimate is not based solely on observable market data.

At 1 January 2023 the fair value of the loan is? Choose one of:

1) ETB0; 2) ETB21,000 million; 3) ETB100,000 million (ie the present value of ETB121,000 million); or 4) ETB121,000 million (the cash flow)

23

23

Financial assets: measurement at initial recognition example: transaction price does not = fair value
Summary of class discussion

» To enhance its standing in the community Entity advances a ETB1.331 billion interest-free three-year loan to Wildlife Protection Agency. At market interest rates the loan would have borne interest at 10% per year.

» What amount should Entity measure its loan asset on initial recognition? Choose one of:

a) 1 billion;
b) 1.331 billion; or
c) another amount.

25

25

Fair value of interest-free loans
mini-case study: a regulators ruling: JSE (South Africa)

Matter 11 (2015): The application of IFRS to interest free loans continues to be misapplied. The contract value of such a loan is not its fair value.

Matter 13 (2014): The application of IFRS to interest free loans continues to be misunderstood. These loans must be measured at fair value plus transaction costs on initial recognition. The contract value of the loan is not the fair value. In one instance, the misapplication of this principle extended to a loan with a fixed interest rate.

This principle was also misapplied to trade receivables. In one instance the receivable balance was large, and repayment did not occur in the short term. The impact of discounting therefore became material.

Source: Combined findings of the JSE proactive monitoring of financial statements, 28 October 2022, p59 26

26

Fair value of interest-free loans
mini-case study: a regulators ruling: JSE (South Africa)

Matter 18 (2012)

We once again identified a problem with the accounting for interest free loans receivable. Whilst the issuers' accounting policy correctly stated that this financial instrument was measured at fair value, this policy was in fact not applied. This was evident from the fact that despite market interest rate changes over the period, there were no resultant fair value changes reflected in the issuer's accounts.

Matter 21 (2011)

In determining the fair value for initial recognition purposes of a financial asset or liability issuers cannot simply assume that the transaction price is the fair value. This is particularly relevant for an interest free financial instrument. In one instance the issuer ignored these measurement criteria for their long-term interest free loan receivable and recorded it at the initial transaction value.

Source: Combined findings of the JSE proactive monitoring of financial statements, 28 October 2022, p60-61 27

27

Financial asset measurements

Measurement	Requirement type
Fair value	✓ **principle:** the amount that would be received to sell an asset in an orderly transaction between market participants at the measurement date. A few **rules.** For example: • unit of account in IFRS 9 is the individual financial instrument • 'Level 1' FV = price x quantity (no adjustments)
Amortised cost	✓ **artificial construct:** • effective interest rate • credit-adjusted effective interest rate • **MUST DISCLOSE FAIR VALUE!** (**principle**)

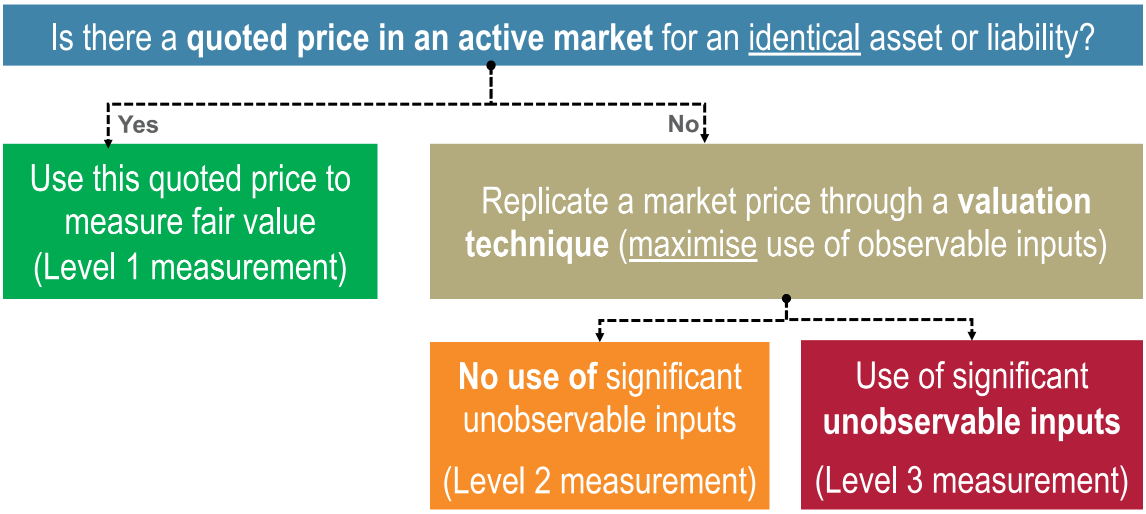
28

28

Fair value hierarchy

29

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



30

Fair value hierarchy classification of trade receivables
Summary of class discussion

At which level of the FVM hierarchy Ethiopian trade receivable assets likely categorised? Choose one of: 1) Level 1; 2) Level 2; or 3) Level 3.

32

32

Fair value of financial assets
mini-case study 2: a regulators ruling: JSE (South Africa)

» In its proactive monitoring of 2016 financial statements the JSE observed an issuer incorrectly classified their **operational financial instruments** such as trade receivables and loans receivable as being level 2 fair values as opposed to level 3 fair values.
  » As a result of this incorrect classification the level 3 disclosures were also omitted.

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

33

33

Fair value hierarchy classification of exchange listed corporate debt
Summary of class discussion

Reporting Entity's investment in corporate debt instruments that are listed in the Johannesburg Stock Exchange.

At which level of the FVM hierarchy is the exchange listed asset likely categorised? Choose one of: 1) Level 1; 2) Level 2; 3) Level 3; or 4) it depends….

35

35

Examples—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? (IFRS 13.A)

Example: **regulatory finding**—JSE proactive monitoring found that in nearly all instances, debt Issuers, in applying IFRS 13, inappropriately classified their own debt instruments as being within the Level 1 hierarchy because the market in which the quoted price is observed is **not an 'active market'** given the **inactivity of trade in listed notes** on the South African interest rate market.

- Even when trade does occur, it is **not usually of sufficient frequency and volume** to meet a Level 1 classification. At best, corporate debt in South Africa is likely to be a Level 2 classification, and perhaps even a Level 3.

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

36

36

Examples—fair value measurement hierarchy judging the boundaries of the artificial constructs

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)."

37

37

Unit of account for measuring the fair value of financial assets

38

Unit of account requirements of IFRS 13

- Use 'unit of account' specified in underlying Standard (see paragraph 14)
- However, if Level 1 input available, it must be used for measuring fair value (see paragraphs 22, 69, 77 and 80 of IFRS 13)
  - **the principle:** measure fair value using the **assumptions that market participants would use** when pricing the item when acting in their economic best interest.
  - **a rule:** when a Level 1 measurement is available for an identical financial instrument (including a position comprising of a number of identical assets or liabilities), **fair value = quoted price x quantity held** even if the market's normal daily trading volume is not sufficient to absorb the quantity held by the entity. (paragraph 80)

39

39

Fair value: a large holding
Summary of class discussion

Reporting Entity holds 10% of the (1 million shares) share capital in Entity Z

» Entity Z's shares trade actively in a deep and liquid market

  » at 31/12/2023 trading in Entity Z shares closes at **ETB1 million per share**

» Reporting Entity believes that it would be able to sell its 10% stake in Entity Z in a single transaction for ETB0.95 billion at 31/12/2023

At 31/12/2023 is the fair value of Reporting Entity's 10% holding in Entity Z (Choose one of):

1) ETB0.95 billion;
2) ETB1 billion (PxQ, ie without reflecting an adjustment because IFRS 13 paragraph 80 specifies a rule price x quantity for LEVEL 1 fair value measurement.; or
3) it depends on an assessment of all facts and circumstances?

41

41

Measuring the fair value of financial assets

45

Fair value
measurement objective

» Objective of fair value measurement: estimate the price at which an orderly transaction to sell and 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

46

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

47

Judgement mindset
Summary of class discussion

Which judgement mindset applies when measuring fair value?
Choose one of:

1) objective-focussed critical-thinking mindset aiming to reflect faithfully relevant information about the underlying economic phenomenon.
2) unclear (look to the IASB's Basis for Conclusions for the context for developing the mindset for making judgements).
3) blind rigidity.

However, in particular circumstances, IFRS 13 specifies rules that override the FVM principle. In those limited circumstances, the rule must be applied with blind rigidity. For example, the P x Q rule at Level 1 of the FVM hierarchy.

51

51

Fair value: market participant perspective
application guidance: how to measure fair value

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

(see paragraph B2 of IFRS 13)

52

52

Fair value: market participants' viewpoint
application guidance: characteristic of an asset

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

53

53

Fair value: restriction on sale of a financial asset
example 1:
Summary of class discussion

Entity A pledges 100,000 BP shares that it owns as collateral in a borrowing arrangement.

- Consequently, Entity A cannot sell its BP shares until it settles the borrowing.
- BP plc shares are issued without such a restriction and trade on both the London Stock Exchange and the New York Stock Exchange.

Is the restriction relevant to measuring the fair value of the BP shares held by Entity A? Choose one of: 1) Yes; 2) No; or 3) It depends (specify)

55

55

Fair value: restriction on sale of a financial asset *example 2*

- Entity B acquires 100,000 MTN Zakhele shares the sale of which is by design restricted as follows:
  - the share cannot be traded for the next three years
  - for a further three-year period the shares can be sold only to those that qualify as being previously disadvantaged in accordance with MTN Zakhele's South African broad-based black economic empowerment (BEE) scheme.
  - thereafter trading in the share is unrestricted.
- Assume MTN Zakhele has no liabilities and its **only assets are its MTN shares** (which are unrestricted and trade actively on the Johannesburg Stock Exchange).

56

56

Fair value: restriction on sale of a financial asset *example 2: Summary of class discussion*

Are the restrictions relevant to measuring the fair value of the MTN Zakhele shares held by Entity B? Choose one of:

1) Yes, only the initial three-year prohibition of trading
2) Yes, only the subsequent three-year restriction of trading to qualifying BEE participants
3) Yes, both 1) and 2) above
4) It depends (specify)

58

58

Fair value: restriction on sale of a financial asset
example 2 extended:
Summary of class discussion

MTN Zakhele uses the dividends it receives from the MTN shares it holds to meet its operating costs and interest on its loans. Any surplus cash is applied to reducing its loan liabilities.

When measuring the fair value of a MTN Zakhele shares what adjustments from the price of an MTN share would Entity B's management make? Decreases for (choose one of):

1) liabilities funded by each MTN Zakhele share
2) liquidity restriction 1: initial three-year prohibition of trading
3) liquidity restriction 2: subsequent three-year restriction of trading to qualifying BEE participants
4) operating costs of MTN Zakhele to be met from dividends on its MTN shares
5) liquidity expectation: dividends received by MTN Zakhele from its MTN shares will be used to reduce liabilities
6) all of the above

60

60

Fair value: market participants' viewpoint
application guidance: which market?

Most advantageous market only when cannot identify principal market.

» **Principal market** has the greatest volume and level of activity for the asset or liability

» **Most advantageous** market
  » maximises the amount that would be received to sell an asset
  » minimises the amount that would be paid to transfer the liability
  » after taking into account transactions costs and transport costs.

» Other considerations:
  » absent evidence to the contrary use the market the reporting entity usually accesses
  » reporting entity must have access to the market at the measurement date

61

61

Fair value: which market (transaction costs)?
Summary of class discussion

You have access to two active markets to sell an asset:

» Market (M)1: price = ETB100; **transaction** costs = ETB10

» M2: price = ETB95; **transaction** costs = ETB3.

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

1) ETB100 if M1 is the principal market, otherwise ETB95;
2) ETB90 if M1 is the principal market, otherwise ETB92;
3) ETB95 because the most advantageous market (M2) must be the principal market;
4) ETB92 because the most advantageous market (M2) must be the principal market.

63

63

Fair value: significantly decreased trading volume
What do you think?

» Reporting Entity holds 1% of the share capital in Entity V.

» Entity V:

» **At 31/12/2022** the quoted price on the stock exchange is ETB200 per share.

» Trading volume **on 31/12/2022** is similar to the average daily trading volume since July 2022.

» From **1 June to 31 July 2022** trading was suspended and the government took several steps to support the market.

» Due to financial and political instability, the share price and trading activity have declined sharply **since July 2022**, with historical lows in **November 2022**.

» **At 31/12/2022 is the market in Entity V shares active (ie is the quoted price a Level 1 input)?** Choose one of: 1) Yes; 2) No; or 3) it depends (specify on what it depends).

69

69

Fair value: significantly decreased trading volume
Summary of class discussion

At 31 December 2022 is the market in Entity V shares active (ie is the quoted price a Level 1 input)?

Choose one of: 1) Yes; 2) No; or 3) it depends (specify on what it depends).

1) Yes. Because in an active market, transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis (Appendix A to IFRS 13 definition of an active market). **A significant decrease in volume or level of activity ≠ inactive market:**

there may be a significant decrease in volume or level of activity for the shares in V (paragraph B37 of IFRS 13) but on its own that does not indicate that quoted prices are not fair value, for example, not orderly (paragraph B38) **even if market is inactive, quoted price** may **still represent best evidence of fair value** as the transactions can still be orderly (paragraph B43)

70

70

Fair value: infrequent trading

» Reporting Entity holds 1% of the share capital in Entity T.

» Although Entity T's shares are quoted on the stock exchange they trade very infrequently.

» The most recent trade occurred on **31/10/2022** at ETB2,000,000 per share.

» On **31/03/2023**, before Entity T approved its 2022 financial statements for issue, a small number of Entity T shares traded at ETB2,200,000 per share.

» Reporting Entity's management believe that at 31/12/2022 the fair value of its Entity T shares is about ETB3,000,000 per share.

71

71

Fair value: infrequent trading
Summary of class discussion

Is the price of the trade on 31/10/2022 in the market (ETB2,000,000) indicative of the fair value of an Entity T share at 31/12/2022? Choose one of:

1) Yes (ETB2,000,000 is fair value at 31/12/2022);
2) No (ignore the trade in determining fair value at 31 December); or
3) the weight placed on the trade on 31 October depends on whether the transaction on 31 October was orderly and on the extent of changes in Entity T's circumstances since that trade. Because:
   - even if market is inactive, quoted price may still represent best evidence of fair value as the transactions **can still be orderly** (paragraph B43 of IFRS 13)
   - however, consider whether there are circumstances that indicate the transactions in Entity T shares **are not orderly** as that determines the weight to place on that transaction price when measuring fair value (paragraph B44)

73

73

Fair value: derivative assets

74

Measuring the fair value of derivative assets

» For **exchange-traded** derivatives in active markets: measure fair value using unadjusted quoted market prices.

» For **non-exchange-traded** derivatives: following the income or market approach measure fair value using a valuation technique incorporating market participant assumptions. For example, the fair value of a basic swap could be measured by:

  » market approach: by obtaining accommodation quotes from dealers (with appropriate testing performed by the reporting entity)

  » income approach: by a discounted cash-flow analysis based on available forward yield curves for plain-vanilla swaps of the same type

75

75

Fair value measurement approaches / techniques: financial assets

76

Measuring fair values of financial instruments measurement approaches

- Generally measure fair value using:
  - **market approach** (for example, quoted market prices and market multiples for comparable assets); and/or
  - **income approach** (for example, present value techniques and option-pricing models)
- Generally do <u>not use</u> the cost approach
- Considerations that affect the fair value of financial instruments include:
  - the time value of money
  - non-performance / credit risk
  - liquidity risk
- Effect of risk: (i) variable expectations of future cash flows, (ii) price for bearing this uncertainty (see paragraphs B15 to B17 of IFRS 13)

77

77

Measuring the fair value of **unquoted equity instruments** approaches to measuring fair value

- Adjusted net asset method
  - **when investee's value is mainly derived from the holding of assets** rather than from deploying those assets as part of a broader business.
- **Market approach**
  - **when recent arm's length transaction prices for identical/similar equity instruments** are available.
  - **when sufficiently comparable company peers** can use **comparable company valuation multiples** technique
- **Income approach**
  - **DCF method** when cash flows of an investee present unique characteristics such as periods of unequal rates of growth (eg a period of high growth that stabilises later to more steady levels of growth).
  - **dividend discount models** (DDM) when investee has clear dividend policy and there is limited financial information about comparable listed company peers.

78

78