

SLFRS 13

Chartered Accountancy Strategic Level Advanced Business Reporting (ABR)

Imraz Iqbal
FCA, ACMA, MBA, ASA

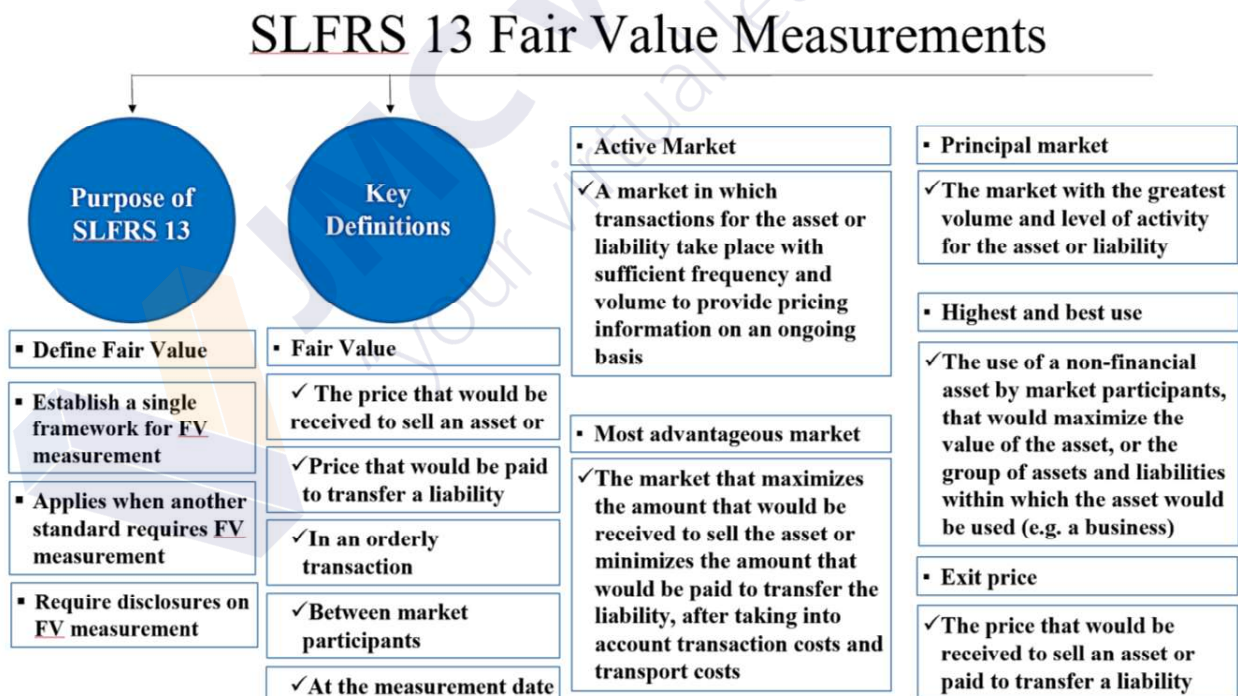
SLFRS 13 – Fair Value Measurements

1.) Objective of SLFRS 13

Objective of SLFRS 13 is to:

- define “fair value”
 - set out (in a single SLFRS) a framework for measuring fair value
 - require disclosures about fair value measurements
- SLFRS 13 applies when another SLFRS requires/permits fair value measurement or disclosures about fair value measurements (also e.g. fair value less costs to sell)
 - SLFRS 13 does not apply to:
 - SLFRS 2 transactions
 - LKAS 17 transactions
 - Measurements that have similarities to fair value, but that are not fair values (e.g. net realisable value (LKAS 2) or value in use (LKAS 36))

Key definitions



SLFRS 13 Fair Value Measurements

Principal and Most Advantageous market determination

	Market X	Market Y	Market Z
Volume traded	30,000	12,000	6,000
Market price	50	48	53
Transport cost	(3)	(3)	(4)
Fair value	47	45	49
Transaction cost	(1)	(2)	(2)
Net proceeds	46	43	47

ABC Ltd Buys and sells in Market Z

▪ Market X is the **PRINCIPAL** market as it has the highest volumes

▪ Market Z is the **Most ADVANTAGEOUS** market as it has the highest net proceeds

▪ ABC Measures **FV** based on Market X at a value of 47 per unit

▪ If ABC cannot access market X then it measures **FV** based on Market Z at a value of 49 per unit

2.) Fair value hierarchy

SLFRS 13 seeks consistency and comparability by providing this hierarchy

- The hierarchy categorises the inputs used in valuation techniques into three levels

– Level 1

- Highest priority
- Unadjusted quoted prices in active markets for identical assets or liabilities

– Level 3

- Lowest priority
- Unobservable inputs

3.1) Level 1 inputs

– Quoted prices in active markets for identical assets or liabilities that the entity can access at the measurement date

– Most reliable evidence of fair value

– Used without adjustment, with limited exceptions

– Fair value = quoted price x quantity held

- Even if the market's normal daily trading volume is not sufficient to absorb the quantity held

- Even if placing orders to sell the position in a single transaction might affect the quoted price

3.2) Level 2 inputs

– Inputs other than quoted market prices included within level 1, that are still observable for the asset or liability, either directly or indirectly

– Include:

- Quoted prices for similar assets or liabilities in active markets (i.e. not identical)
- Quoted prices for identical or similar assets or liabilities in markets that are not active
- Inputs other than quoted prices that are observable for the asset or liability (e.g. interest rates & yield curves available at commonly quoted intervals, implied volatilities, credit spreads)
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means ('market-corroborated inputs')

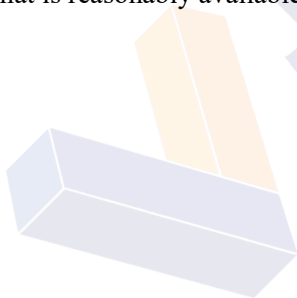
3.3) Level 3 inputs

– Unobservable inputs for the asset or liability

– These are used to measure fair value to the extent that relevant observable inputs are not available (e.g. when there is little, if any, market activity for the asset or liability at measurement date)

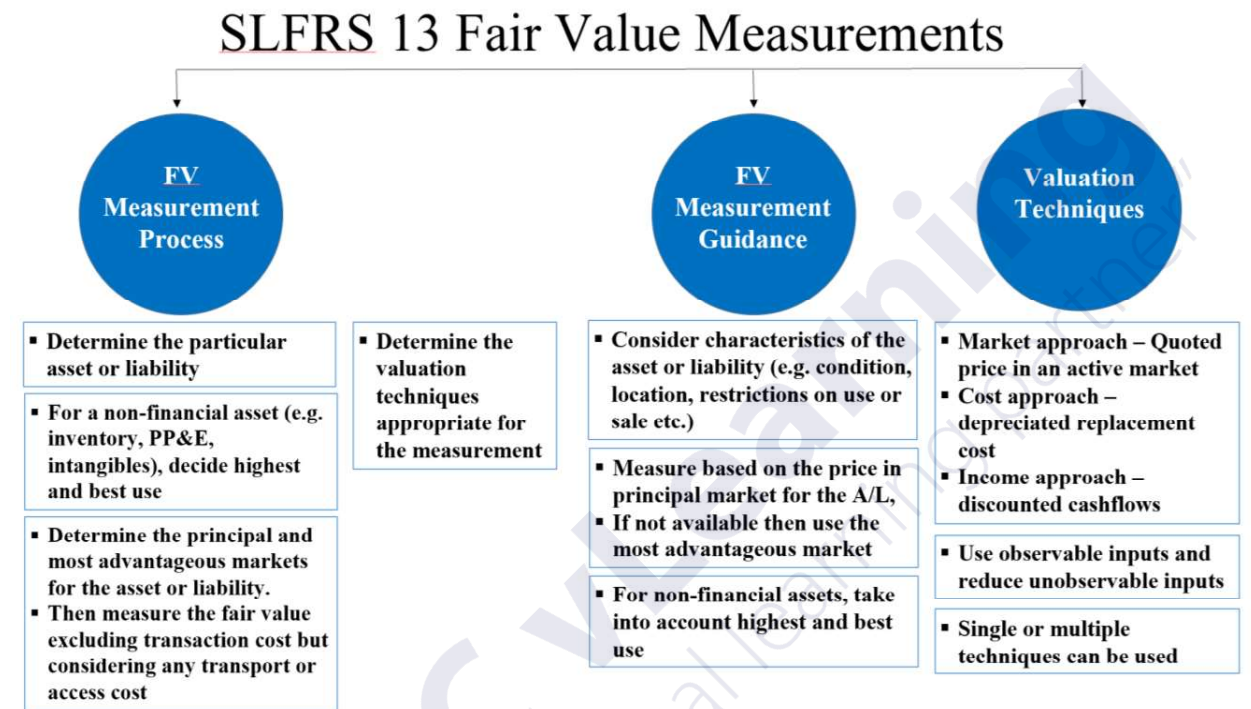
– The best available information is used in the circumstances (e.g. entity's own data)

– The best available information takes account of all information about market participant assumptions that is reasonably available to the entity



3.) Fair value measurement

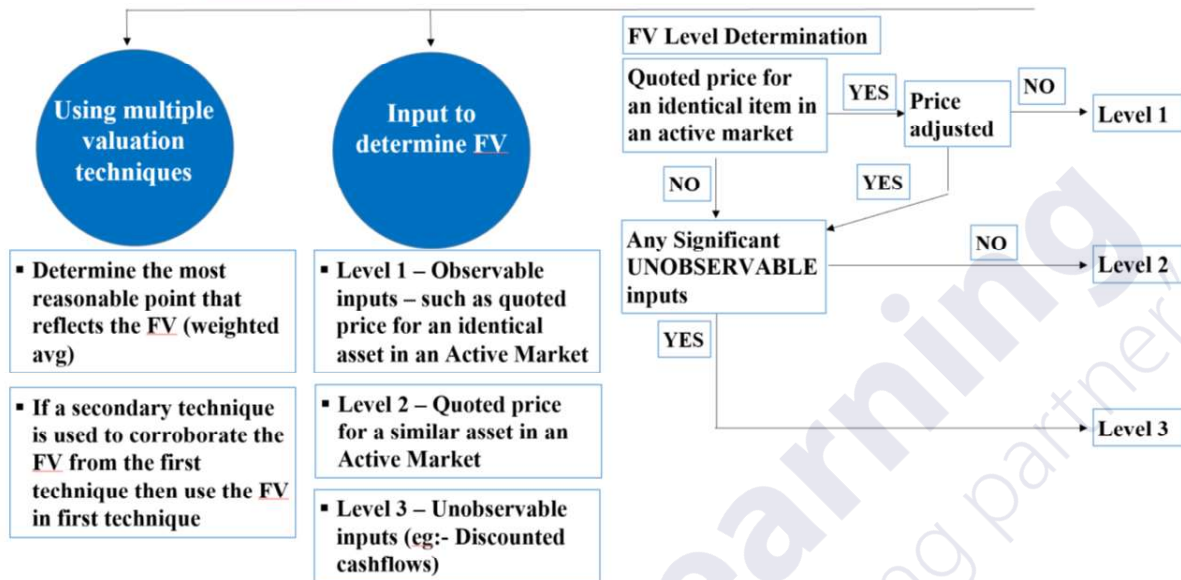
– Estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions



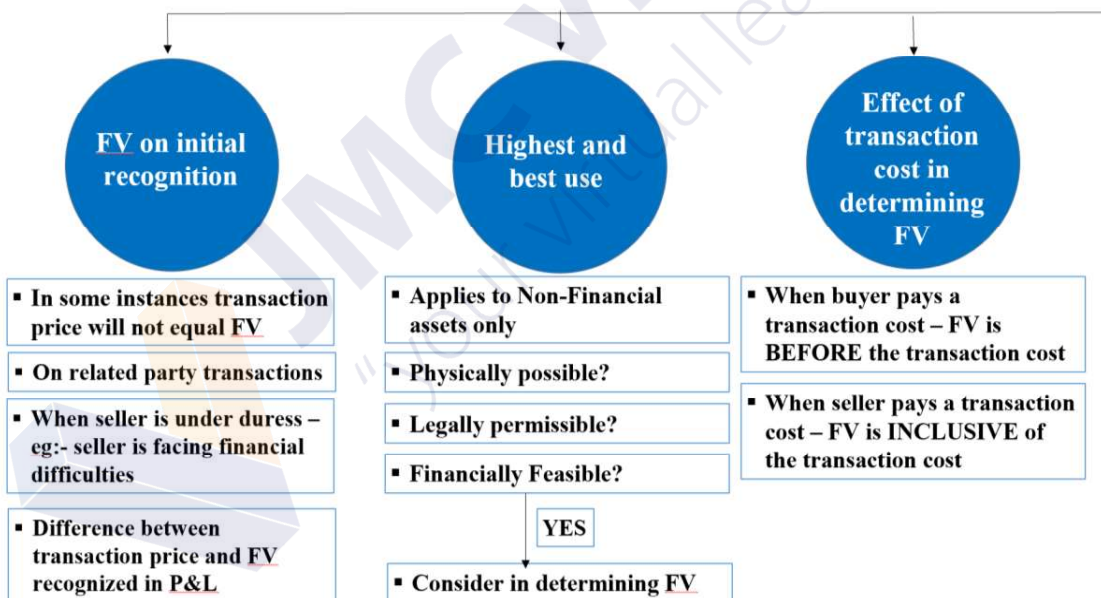
4.3) Valuation techniques

- Must be appropriate in the circumstances
- Sufficient data must be available
 - Maximum observable and minimum unobservable inputs
- Three common valuation techniques are used:
 - **Market approach** (prices and info generated by market transactions for identical or similar A/L)
 - **Cost approach** (the amount that would currently be required to replace the service capacity of an asset)
 - **Income approach** (future cash flows are converted to a single current discounted amount, reflecting market expectations)
- Single or multiple valuation techniques may be appropriate

SLFRS 13 Fair Value Measurements



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Highest and best use examples

Example

Company X acquired a brewery that is located in an area that has recently been re-zoned to allow both residential and industrial use. X determines that market participants would take into account the potential to develop the brewery site for residential use in pricing the land on which the brewery is currently located.

Therefore, X measures the fair value of the land based on the higher of:

the value of the land as currently developed as a brewery; and

the value of the land as a vacant site for residential use, taking into account the costs of demolishing the brewery and other costs necessary to convert the land to a vacant site.

Example

Company B acquires a brand in a business combination. B decides not to use the brand on the assumption that its removal from the market will generate greater incremental value as a result of increased revenues from its existing brands.

However, a market participant would choose to continue to use the brand, because it would not hold the other brands that B does.

In this example, the fair value of the brand would be based on its continued use, because a market participant would choose to continue actively using the brand. This is despite the fact that B's decision not to use the brand results in higher benefits to B.



Practice Questions

Question 1

Jayach, a public limited company, is reviewing the fair valuation of certain assets and liabilities in light of the introduction of IFRS 13.

It carries an asset that is traded in different markets and is uncertain as to which valuation to use. The asset has to be valued at fair value under International Financial Reporting Standards. Jayach currently only buys and sells the asset in the Australasian market. The data relating to the asset are set out below:

Year to 30 November 2012	Asian Market	European Market	Australasian Market
Volume of market – units	4 million	2 million	1 million
Price	\$19	\$16	\$22
Costs of entering the market	\$2	\$2	\$3
Transaction costs	\$1	\$2	\$2

Additionally, Jayach had acquired an entity on 30 November 2012 and is required to fair value a decommissioning liability. The entity has to decommission a mine at the end of its useful life, which is in three years' time. Jayach has determined that it will use a valuation technique to measure the fair value of the liability. If Jayach were allowed to transfer the liability to another market participant, then the following data would be used.

Input	Amount
Labour and material cost	\$2 million
Overhead	30% of labour and material cost
Third party mark-up – industry average	20%
Annual inflation rate	5%
Risk adjustment – uncertainty relating to cash flows	6%
Risk-free rate of government bonds	4%
Entity's non-performance risk	2%

Jayach needs advice on how to fair value the liability.

Required:

Discuss, with relevant computations, how Jayach should fair value the above asset and liability under IFRS 13. (10 marks)



December 2018 Q1 (b)

Multi PLC measures its properties at fair value and such properties include land and building classified as property, plant and equipment and investment properties. The finance director is unhappy about the valuations carried out as at 31 March 2018. The details of such valuations for each property are as follows.

(i) Kadawatha property (land) – a donor has given this land to Multi PLC to construct a walking path and a play area for children in 2016. The donor has specified in the title transfer documents that the land should be used only for this purpose even if the land is sold to another party. The adjoining land was sold closer to the year-end at Rs. 600,000 per perch. Multi PLC valued the land using this price per perch.

(ii) Kelaniya property (land) – this land is located closer to the Kelaniya river and was affected by floods during the heavy rain seasons. Due to the unavailability of recent prices of nearby lands, the per perch price of Rs. 1 million pertaining to a recently sold land in Kelaniya facing the Colombo-Kandy main road was used in valuing this land of Multi PLC.

(iii) Ratmalana property (land and building) – this property has been rented out to another party for a period of 30 years and rent is subject to annual revision. Multi PLC has used several valuation techniques to arrive at the fair value.

1. Combination of cost approach and market approach

- Cost approach

Building – Rs. 25 million (this was estimated using the cost that would be required if a new building was constructed at the reporting date).

- Market approach

Land – Rs. 30 million (this value was estimated using the current prices of similar lands in the neighborhood).

2. Income approach

The present value technique was used to estimate the value of the entire property amounting to Rs. 70 million. In doing this, rent income and expense for the current financial year have been used as the cash flows for the future years and discounted using a long term treasury bond rate (i.e. risk-free rate).

Since the income approach gave a higher value, that value has been incorporated to the financial statements.

Required:

Evaluate each of the above valuations in accordance with the principles set out in SLFRS 13, Fair value measurement. (13 marks)

June 2018 Q2

(d) TEL (Pvt) Ltd has included the following note in its financial statements for the year ended 31 March 2018 in relation to the fair value hierarchy of fair value measurement of assets.

Asset	Level 1	Level 2	Level 3
	Rs.'000	Rs.'000	Rs.'000
Available for sale investments			
Unquoted equity	-	67,800	-
Investment in Treasury Bills	-	-	132,500
Investment properties	1,124,800	-	-

Notes:

(i) Fair value of unquoted equity was determined using a valuation technique that considered the share price of a similar quoted company. The resulted value was reduced by 25% for non-marketability.

(ii) Investment in Treasury Bills was valued using yield curves and interest rates published by the Central Bank of Sri Lanka.

(iii) Investment properties were valued based on the prices of recent market transactions of properties in the same area with substantial adjustments to reflect the condition of the property.

Required:

Evaluate the appropriateness of classification of the above assets in the fair value hierarchy. (4 marks)

June 2017 Q1

(b) You have been provided with an independent valuation report of a land held in Colombo by SCP. The land is an investment property, and is measured at fair value. The independent actuary has used the concept of "highest and best use" in determining the valuation amount.

Required:

(i) Advise the board of directors of SCP regarding the concept of "highest and best use". (4 marks)

(ii) State the required disclosure when the "highest and best use" of an asset differs from its current use. (2 marks)