

# Fair Value Measurement



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# Introduction



# What is the objective of AASB 13?

**AASB 13 (issued in 2011) sets out a framework for measuring fair value in a single standard, and answers:**

**#1:**  
What is meant by “fair value”?

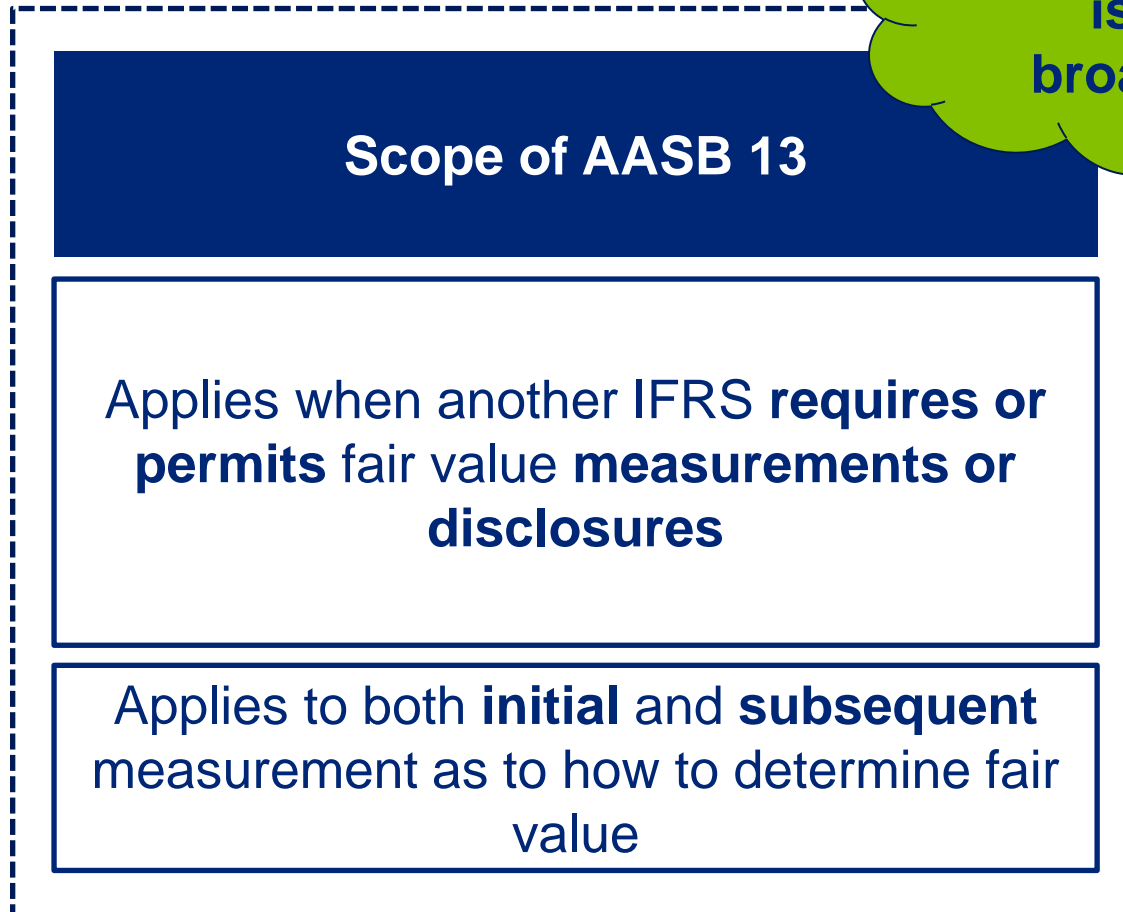
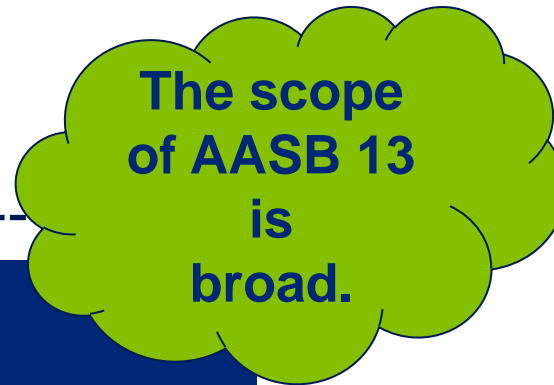
**#2:**  
How should an entity measure fair value?

**#3**  
What should be disclosed about fair value measurements?

# Scope of AASB 13



# What is the scope of AASB 13?



# The scope of AASB 13 is broad

**Business  
Combinations**

**Financial  
Instruments**

**Investment  
Property**

**Non-current Assets  
Held for Sale  
Discontinued  
Operations**

**Impairment of  
assets**

**Biological  
assets**

**Property, Plant  
and Equipment**

**Intangible  
assets**

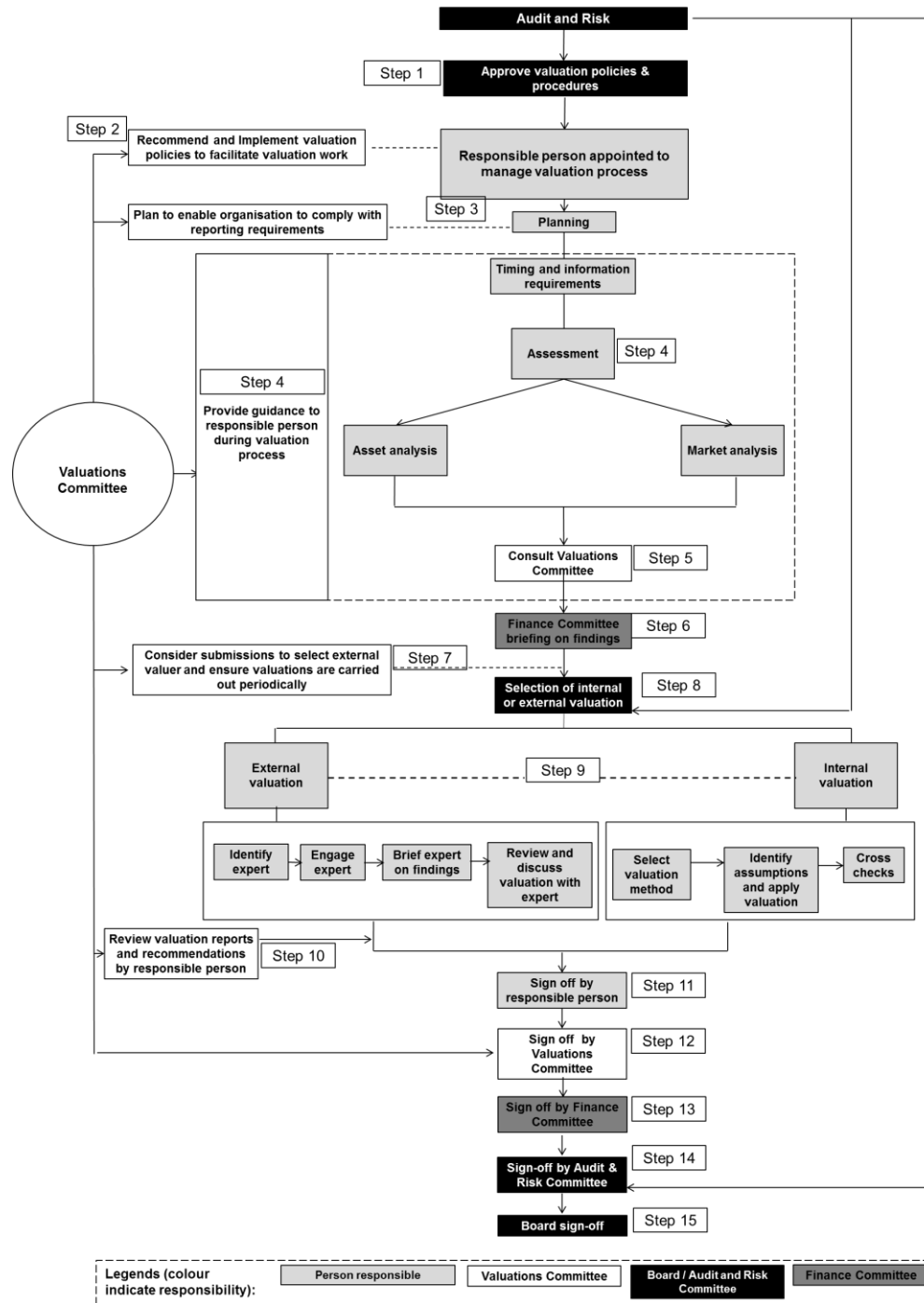
**Revenue**

# Process and controls





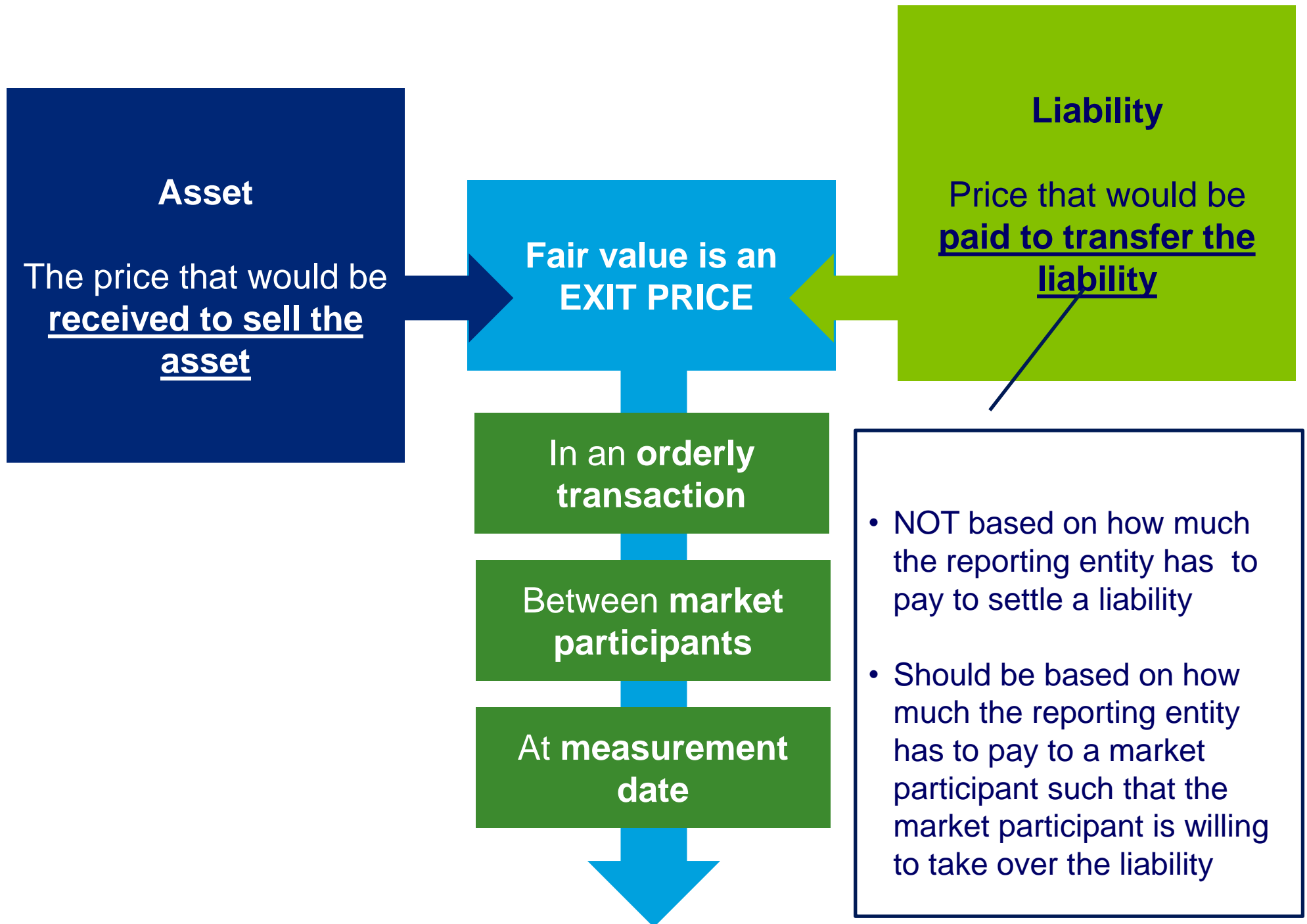
# Process and controls



# Definition of fair value and key principles



# Definition of fair value



# What should be considered in determining fair value?

## Unit of account

- What is being measured?
- What is the appropriate **unit of account**? Is it the same as the basis for valuation?

## Market

- What is the principal (or if none exists, the most advantageous) market?

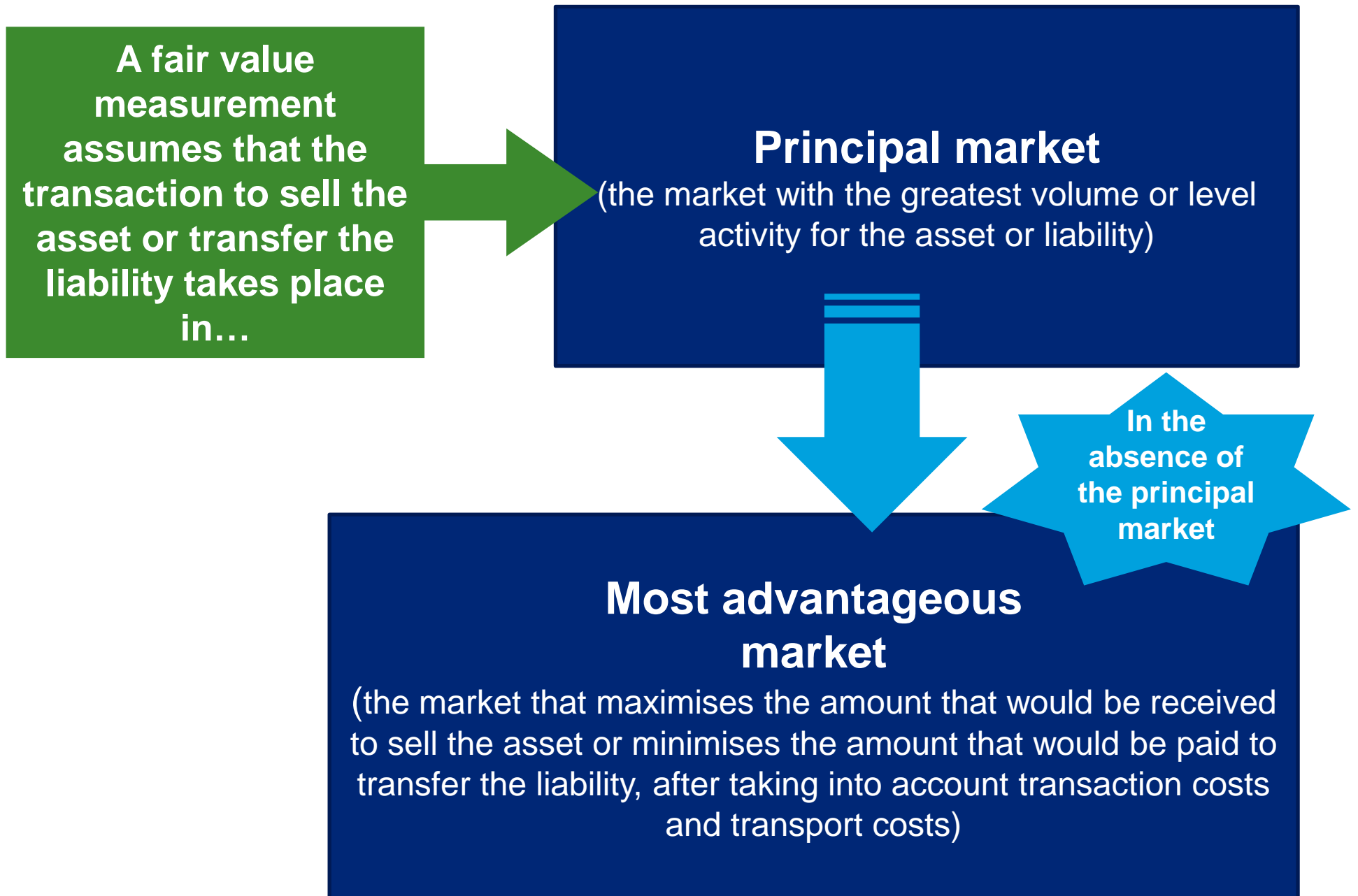
## Assumptions

- What **assumptions** would market participants in the principal (or the most advantageous) market take into account when pricing the asset or liability?
- What **characteristics** of the asset or liability would market participants take into account?

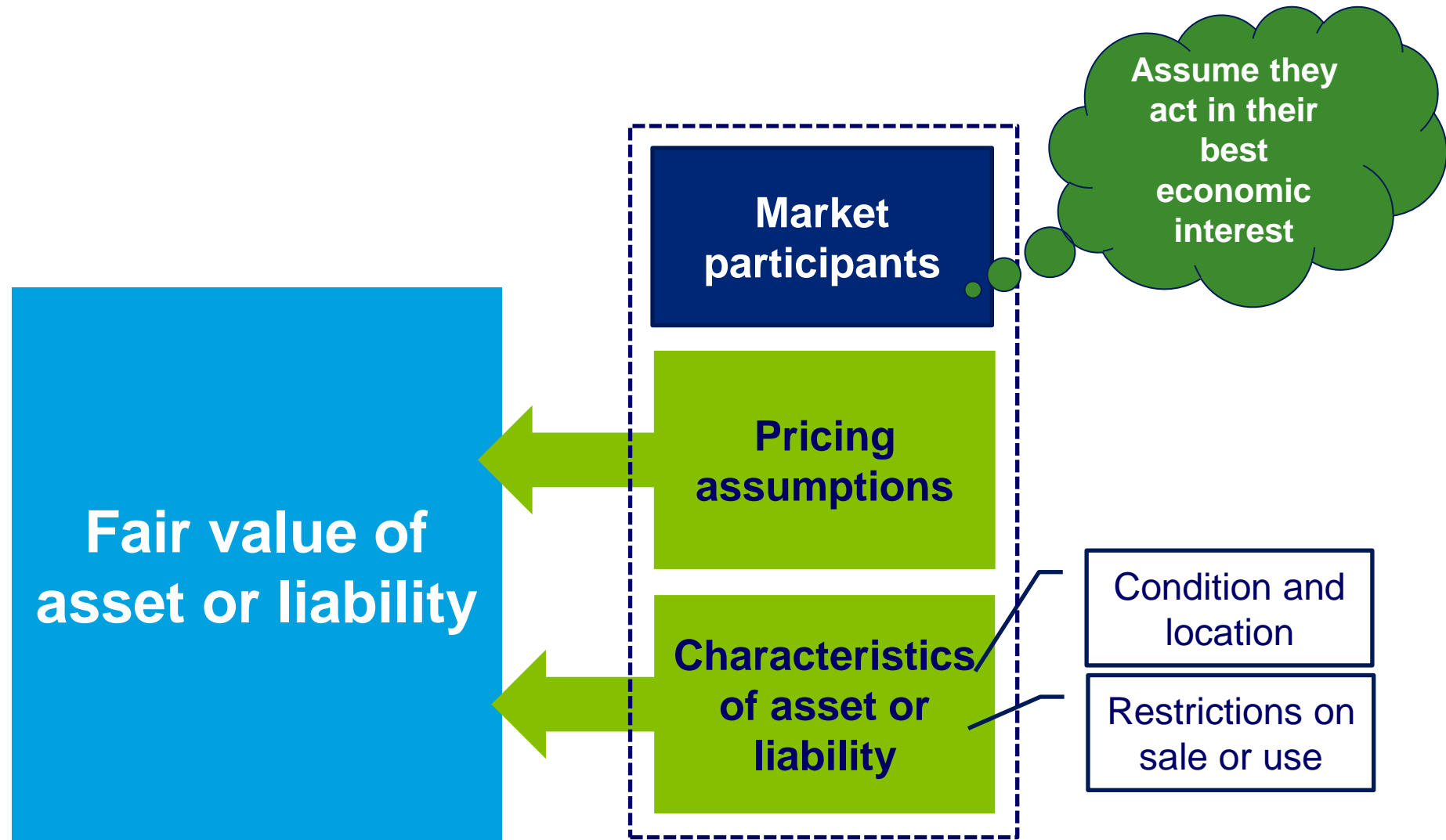
## Inputs and valuation techniques

- What **inputs** are available and could be used in determining the fair value? What is (are) the appropriate **valuation technique(s)**?

# The market



# The Price: Characteristics of the asset or liability



# Initial measurement



# Fair value vs.. transaction price

In many cases, the transaction price will equal the fair value (e.g., on the transaction date, the transaction to buy an asset takes place in the market in which the asset would be sold)

AASB 13 requires us to take into account factors that are specific to the transaction and to the asset or liability.

Transaction price might not equal fair value if...

Transaction is between related parties (i.e., transactions may include capital contribution / distribution element)

Transaction takes place under duress or the seller is forced to accept the price in the transaction

Unit of account represented by the transaction price differs from the unit of account for the asset or liability measured at fair value (e.g., a business combination situation)

The market in which the transaction takes place is different from the principal (or most advantageous) market



# Application of fair value measurement to non-financial assets



# Non-financial assets

A fair value measurement of a non-financial asset should take into account a **market participant's ability** to generate economic benefits **by using the asset in its highest and best use** OR **by selling it to another market participant that would use the asset in its highest and best use**

## Highest and best use:

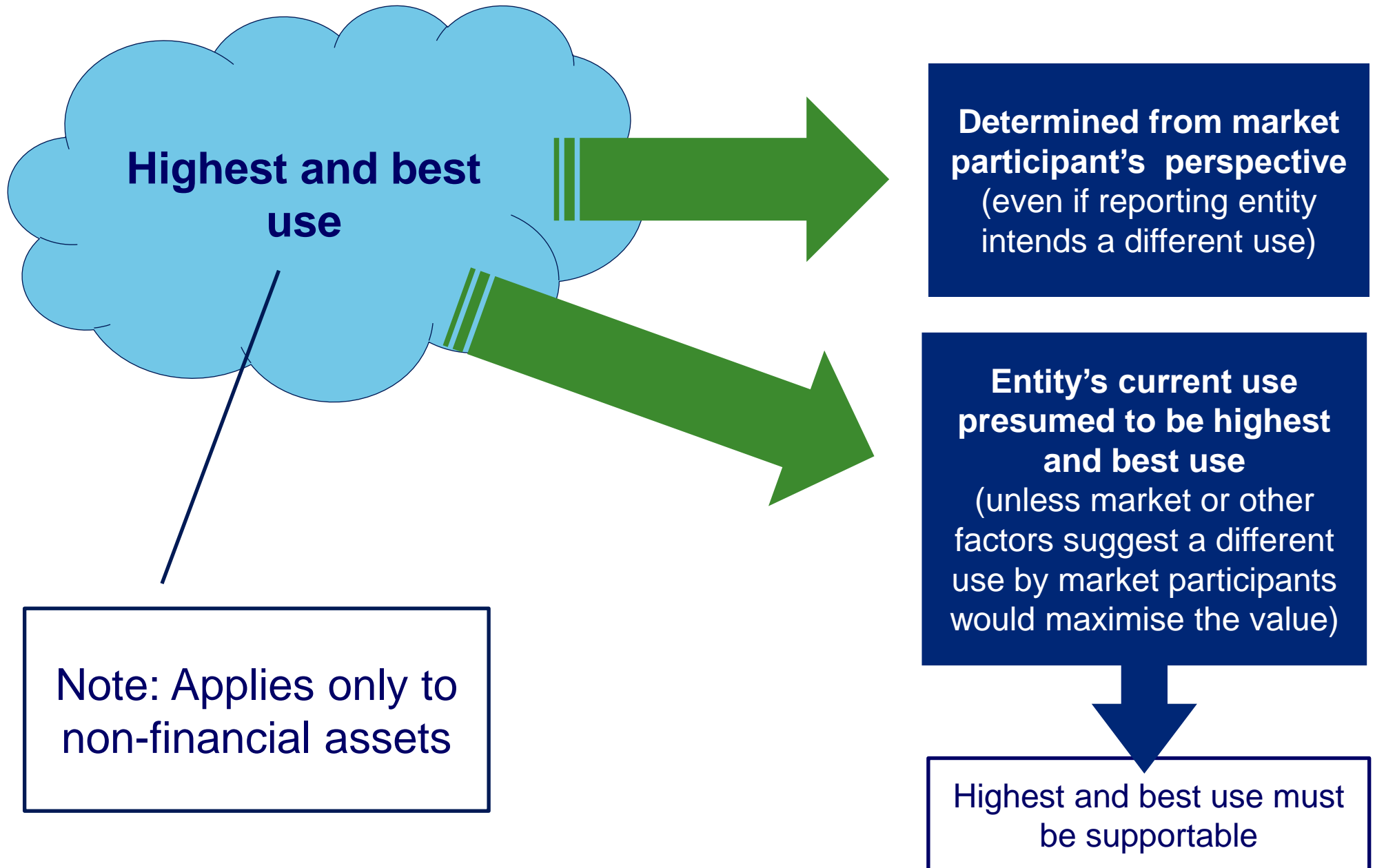
the use by market participants that would maximise the value of the asset or the group of assets and liabilities within which the asset would be used

**Physically possible?**  
(location or size of the asset)

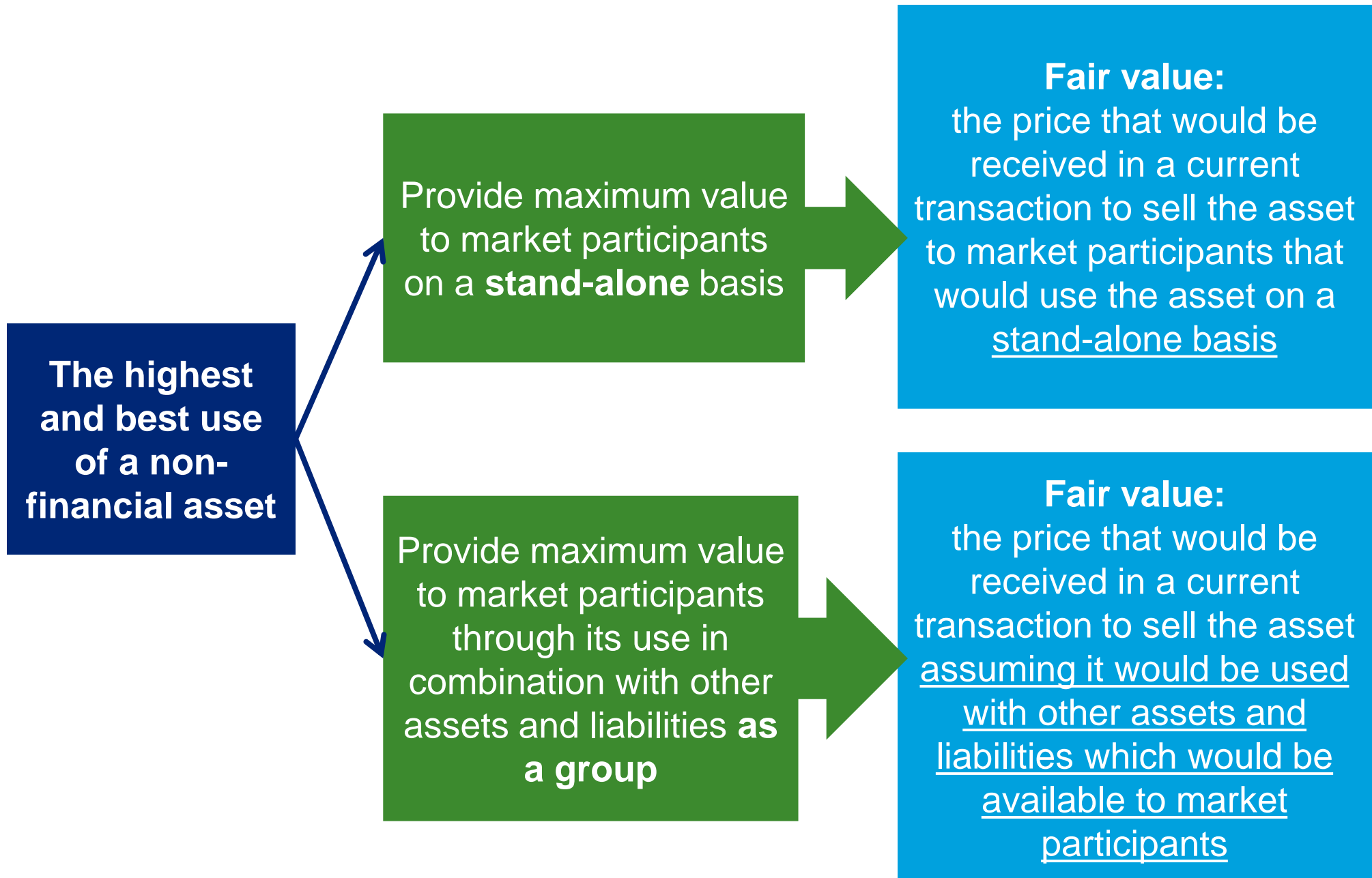
**Legally permissible?**  
(legal restrictions on the use of the asset)

**Financially feasible?**  
(ability to generate adequate income or cash flows to produce an investment return that market participants expect)

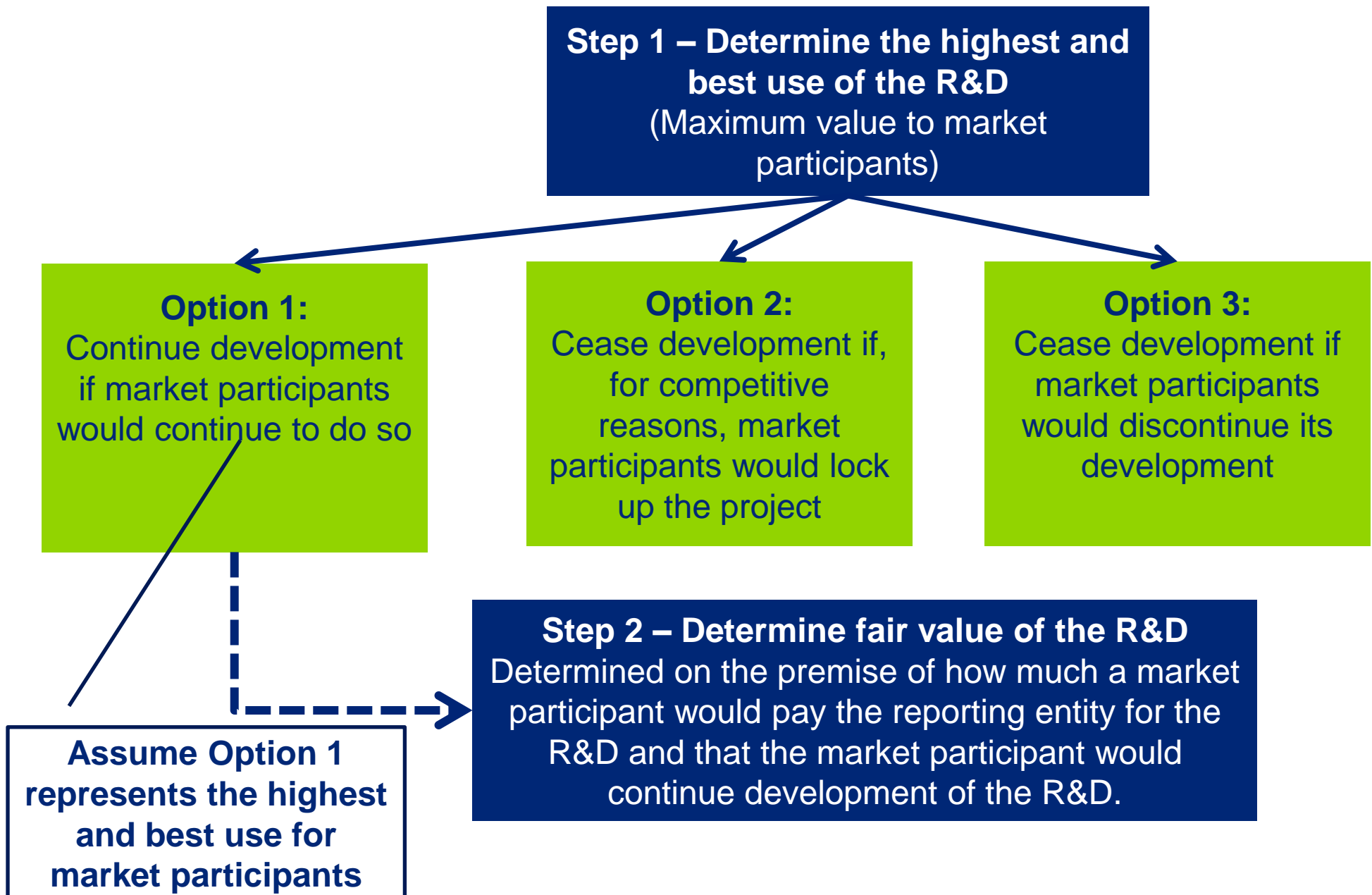
# Non-financial assets



# Valuation premise for non-financial assets



# Applying the valuation premise: Example



# Valuation techniques



# Valuation techniques

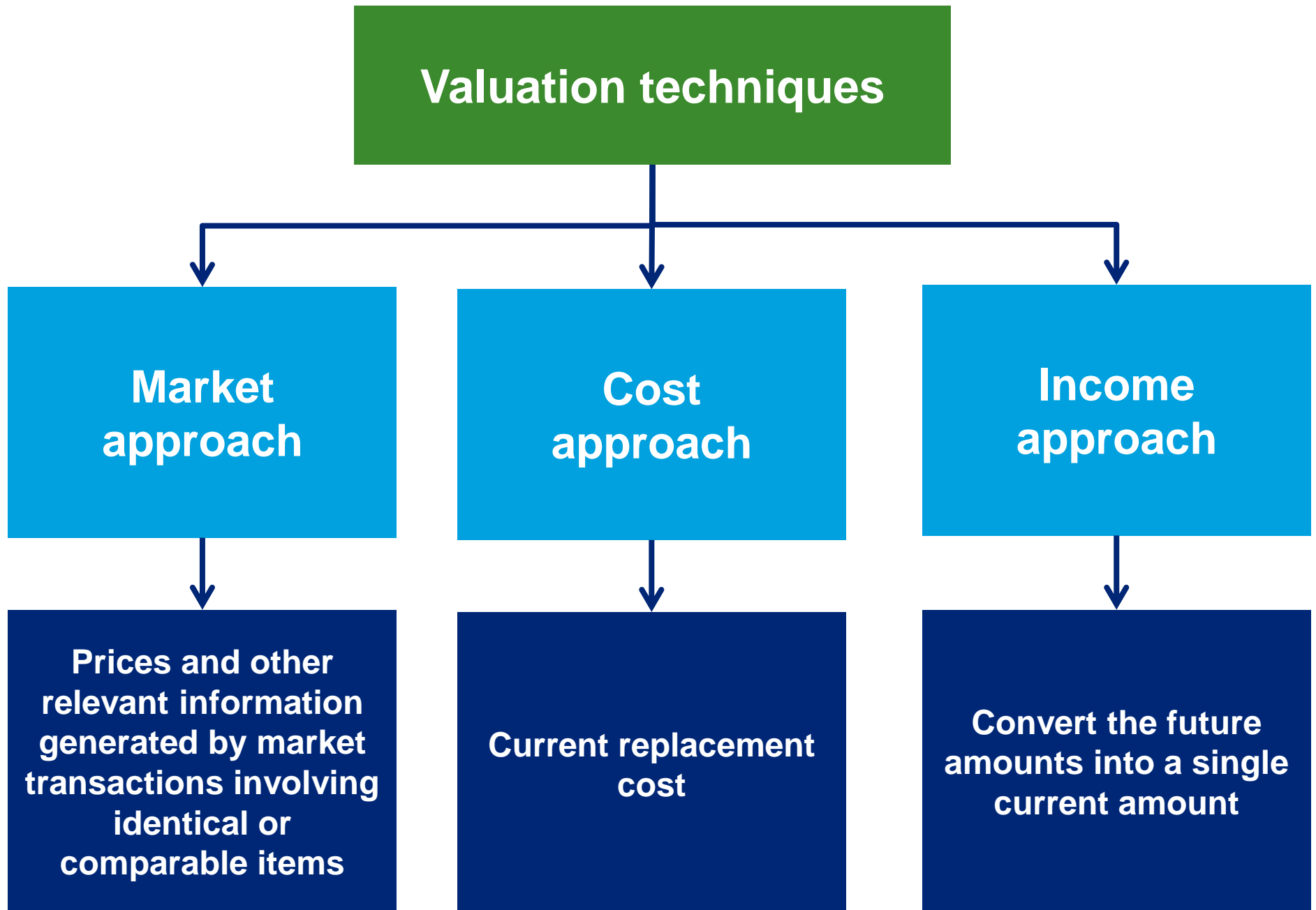
## Valuation techniques

- No rules as to which valuation technique(s) must be used
- Select the most appropriate technique in the circumstances, for which sufficient data is available
- Apply consistently
- Change in technique = change in accounting estimate (AASB 8)

## Inputs

- Maximise use of relevant observable inputs
- Minimise use of unobservable inputs
- Select inputs that are consistent with characteristics of asset or liability (from market participant perspective)
- Consider:
  - Location and condition
  - Restrictions on sale or use

# Valuation techniques





# Income approach



## Valuation techniques include:

- Present value techniques;
- Option pricing models (e.g., the Black-Scholes-Merton formula or a binomial model)
- The multi-period excess earnings method (normally used to measure the fair value of some intangible assets)

# Present value techniques



## Capture all of the following elements:

- An estimate of future cash flows for the asset or liability being measured
- Expectations about possible variations in the amount and timing of the cash flows representing the uncertainty inherent in the cash flows
- The time value of money (i.e., a risk-free interest rate)
- The price for bearing the uncertainty inherent in the cash flows (i.e., a risk premium)
- Other factors that market participants would take into account in the circumstances
- For a liability, the non-performance risk relating to that liability, including the entity's own credit risk

# Present value techniques

## General principles:

- Cash flows and discount rates should reflect assumptions that market participants would use when pricing the asset or liability
- Cash flows and discount rates should take into account only the factors attributable to the concerned asset or liability
- **To avoid double-counting or omitting the effects of risk factors**
- Assumptions about cash flows and discount rates should be internally consistent
- Discount rates should be consistent with the underlying economic factors of the currency in which the cash flows are denominated

*For example, if contractual cash flows of a loan are used, the discount rate should reflect the uncertainty in expectations about future defaults.*

*However, if expected cash flows are used, that discount rate should not be used.*

# Single approach vs. multiple approaches?

## Single vs. multiple approach?

AASB 13—neither requires entities to use multiple approaches in all situations nor supports the use of a single approach in all circumstances

## Factors to consider

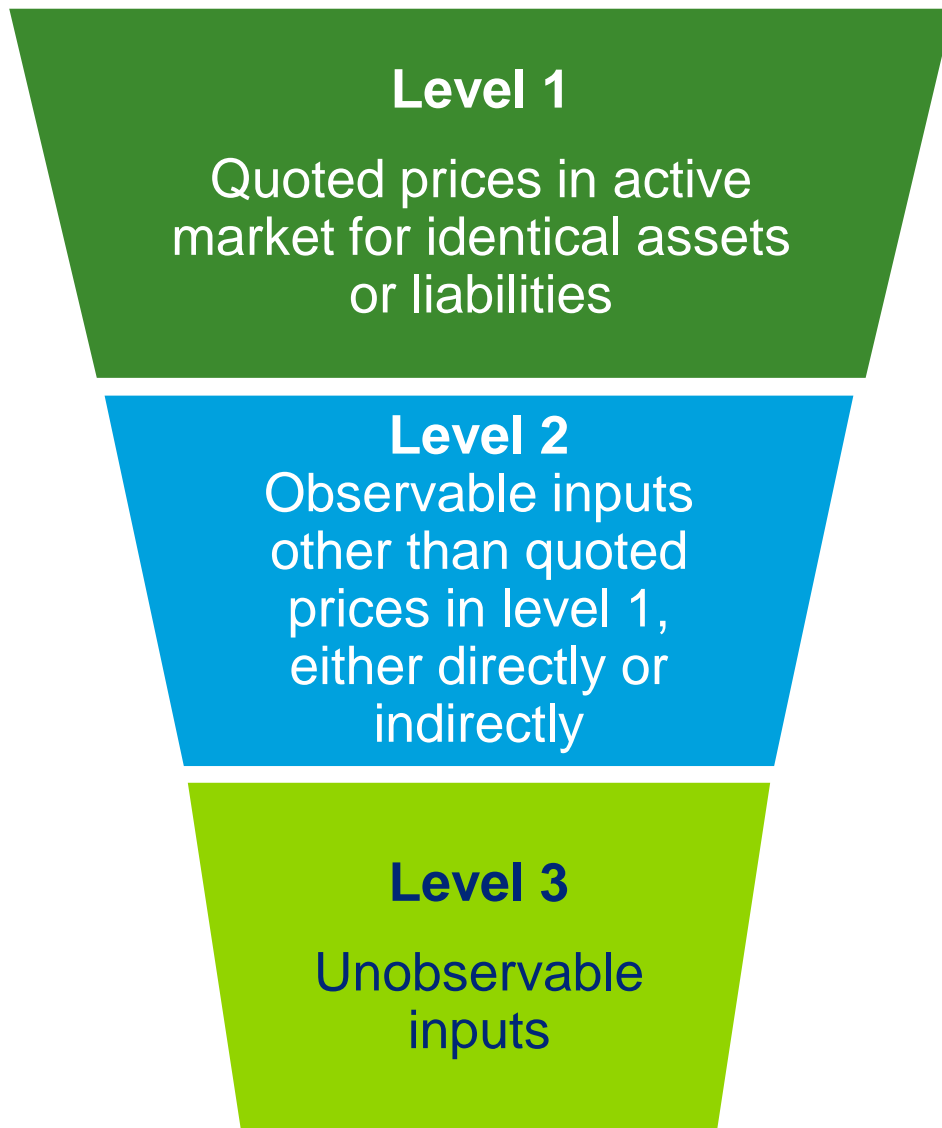
- The appropriateness (i.e., relevance and applicability of each valuation technique)
- Whether there is sufficient reliable data available to support a particular approach
- Comparative level of the alternative approaches in the fair value hierarchy
- Any significant decline in volume and level of market activity
- View of market participants on the relevance of valuation techniques

**Judgement is required taking into account the relevant fact and circumstances**

# Fair value hierarchy

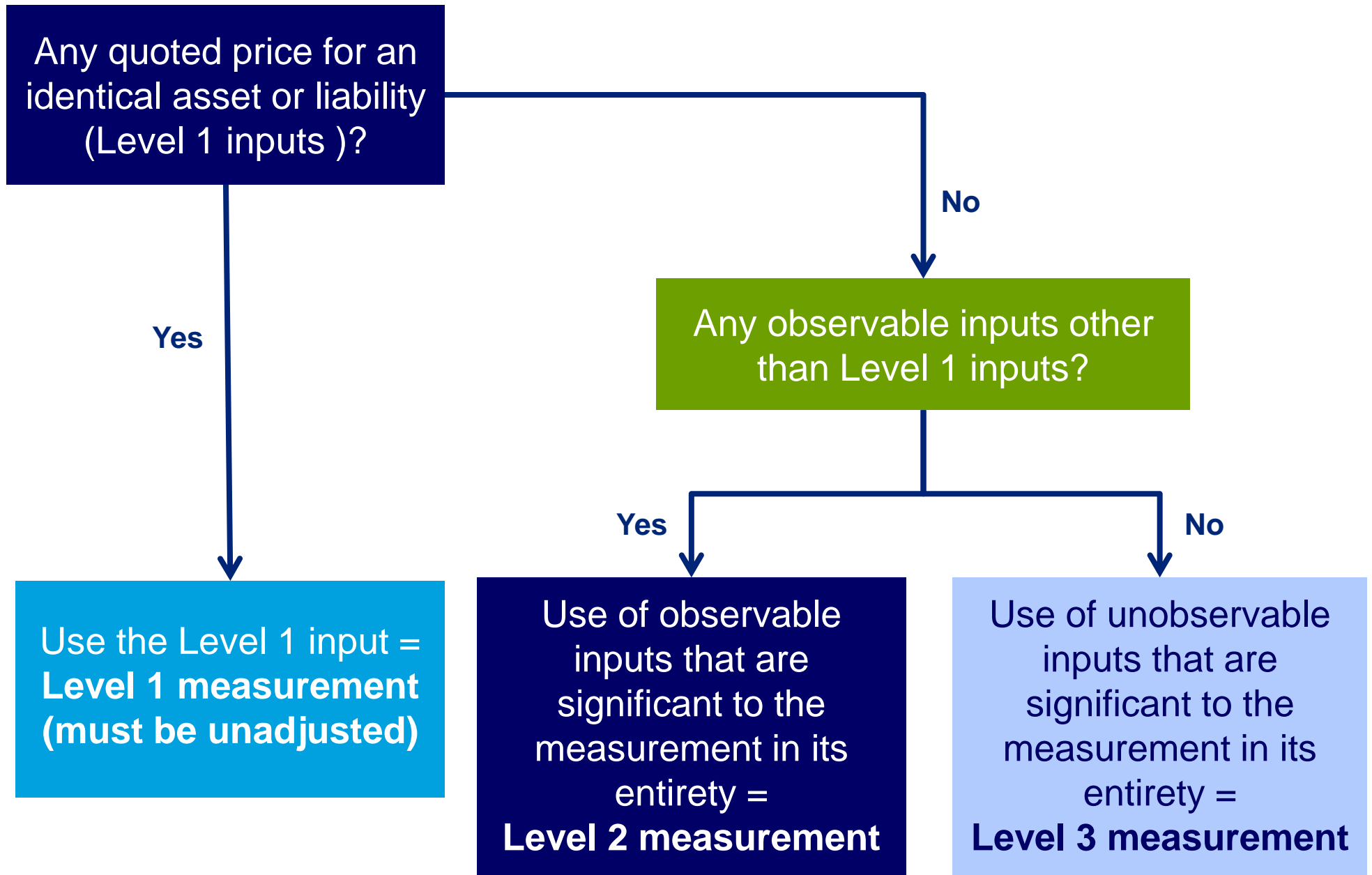


# Fair value hierarchy

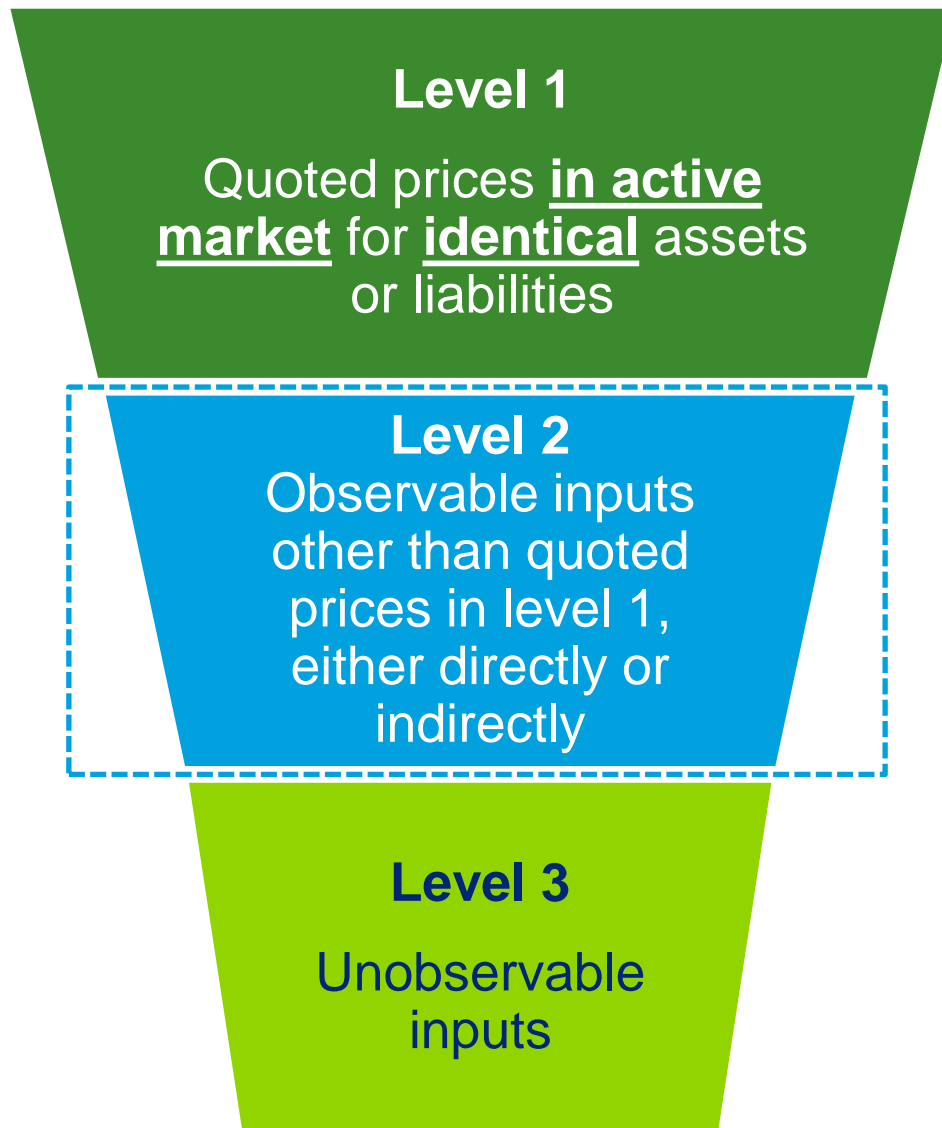


- The fair value hierarchy is applicable to both financial and non-financial items that are within the scope of AASB 13
- The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets and liabilities and the lowest priority to unobservable inputs
- The fair value measurement is categorised in its entirety based on the lowest level of significant input
- Fair value hierarchy depends on the inputs, not valuation techniques.

# Fair value hierarchy



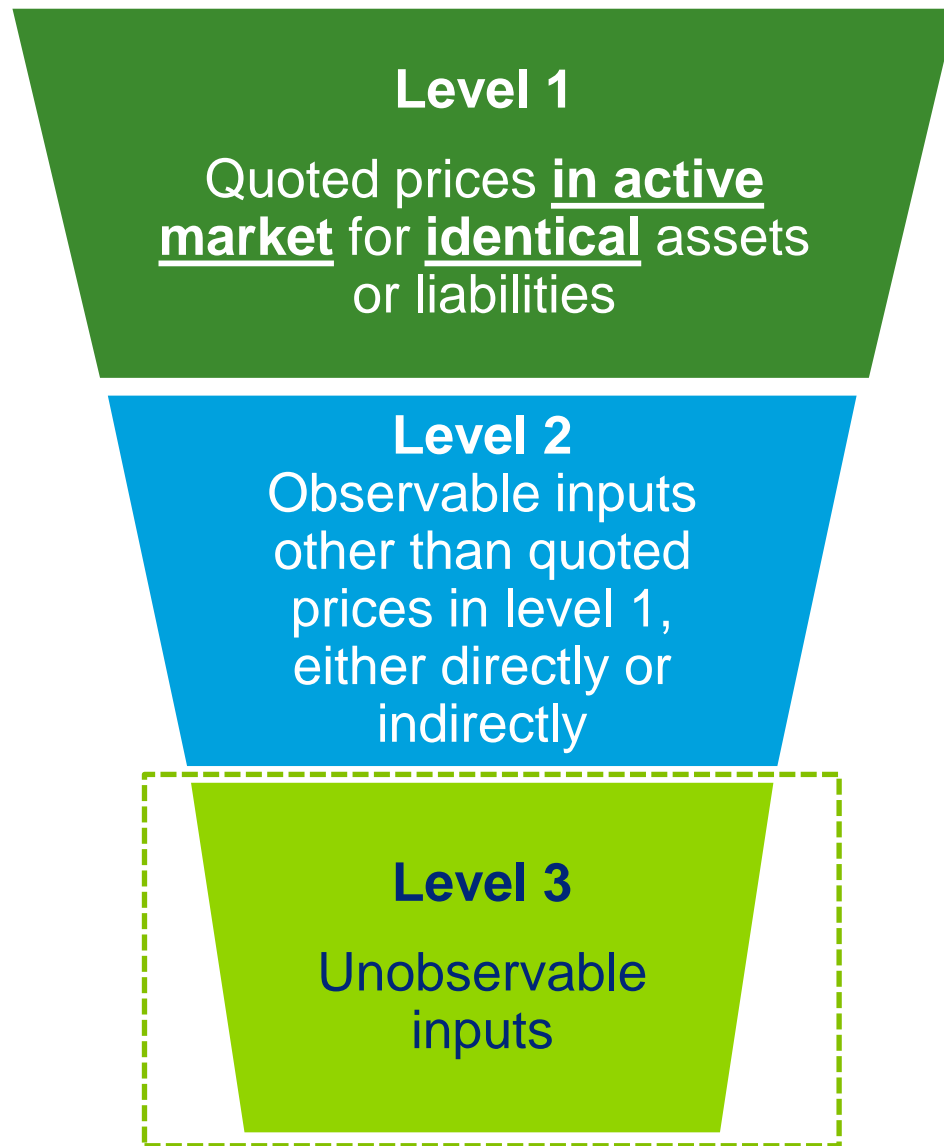
# Fair value hierarchy–Level 2



- If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for **substantially** the full term of the asset or liability
- Level 2 inputs include the following:
  - Quoted prices for similar assets or liabilities in active markets
  - Inputs other than quoted prices that are observable for the asset or liability (e.g., observable interest rates and yield curves).



# Fair value hierarchy–Level 3



- The fair value measurement objective remains the same—exit price
- Entities should try to select the most reliable among unobservable inputs
- The Level 3 measurement inputs should include risk inherent in the particular valuation technique and the risk inherent in the inputs to the valuation technique
- Examples of Level 3 inputs
  - Labour quotes for a particular job in determining the fair value of a decommissioning liability in a business combination
  - Profit/cash flow forecast used in determining the fair value of a cash-generating unit (e.g., cash flows or profit or loss forecast).

Who undertakes the valuation ?



# Who undertakes the valuation

Who

Management

- Do they have the relevant skills & expertise to prepare the calculation ?

External party

- How selected (are they independent?)
- what are their relevant skills, qualifications and expertise
- What instructions were issued

## Commissioning an external valuer

- ❖ Independence
- ❖ Expertise and qualifications
- ❖ Expert's involvement / knowledge or recent market transactions
- ❖ Cost and time considerations
- ❖ Rotation

# Disclosures



# Disclosures

## Recurring basis

Recurring fair value measurements of assets or liabilities are those that other AASBs require or permit in the statement of financial position at the end of each reporting period

### Examples

- Investment properties measured using the fair value model under AASB 140
- Financial assets at fair value through profit or loss (e.g., held-for-trading investments) under AASB 139/AASB 9
- Available-for-sale investments under AASB 139
- Property, plant and equipment/intangible assets measured using the revaluation model under AASB 116 / AASB 138
- Biological assets under AASB 141

## Disclosures under applicable standards

For example **AASB 116** – for revalued PPE the effective date of the revaluation, whether an independent valuer was involved etc

For impairment – various disclosures under **AASB 136**

For intangibles – **AASB 138**

# What to look for



# What to look for...

## *The role of directors & audit committees*

- Each director has a **duty of skill, competence and diligence** in understanding the company's financial report
- You should determine that **the information in the financial report is consistent with your knowledge** of the entities financial position and affairs
- The existence of an audit committee **does not** alter the need for directors to take responsibility for financial reports
- Although calculations supporting valuations (or impairment) of significant assets can be complex, you can review the cash flows and assumptions used in calculations prepared by management or experts for material assets **bearing in mind your knowledge of the business, the assets, the environment in which the company operates and the future prospects of the business.**



# Challenging the expert

## *Fair Value Measurement*

### What to look for

- What were the instructions given to independent valuers?
- Is the valuation AASB compliant?
- Methodology selected and the basis for that selection
- What are the key assumptions in the valuations?
- How are the assumptions developed?
- Are they reasonable assumptions?
- What is the impact of changes in key assumptions and why did they change?
- How sensitive is the valuation to changes in key assumptions?
- Areas where the expert has applied significant judgment
- **How to assess the reasonableness of valuations ?**

# Questions for the auditor



# Questions for the auditor

- Is there an appropriate valuation framework and are there appropriate processes and controls in place?
- How have models been developed / have they been checked for integrity?
- Is there adequate review of the valuations by persons independent of those undertaking the work?
- Was the valuation appropriately documented by management and provided on a timely basis?
- Have any concerns the auditor has raised previously been addressed?
- Does the auditor have the appropriate experience and expertise to review the fair values?
- Did the auditor engage any experts to review the work prepared by management or managements experts?
- Did the auditor demonstrate sufficient professional scepticism in challenging, rather than rationalising, cash flows and assumptions?
- Does the auditor have any concerns about the value of non-current assets?



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