Straight away
IFRS bulletin from PwC

IASB and FASB issue guidance on fair value measurement and disclosure

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What is the issue?

The IASB has completed its joint project with the FASB on fair value measurement, issued as IFRS 13, 'Fair value measurement'.

IFRS 13 explains how to measure fair value and aims to enhance fair value disclosures; it does not say when to measure fair value or require additional fair value measurements.

Although the project converges IFRS and US GAAP on how to measure fair value, there will continue to be differences in certain respects, including when fair value measurements are required and when day 1 gains and losses can be recognised.

Key provisions

Scope

The guidance in IFRS 13 does not apply to transactions within the scope of IFRS 2, 'Share-based payment', or IAS 17, 'Leases', or to certain other measurements that are required by other standards and are similar to, but are not, fair value (for example, value in use in IAS 36, 'Impairment of assets').

Definition of fair value

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price).

The fair value of a liability therefore reflects non-performance risk (that is, own credit risk).

Principal or most advantageous market

A fair value measurement assumes that the transaction to sell the asset or transfer the liability takes place in the principal market for the asset or liability or, in the absence of a principal market, in the most advantageous market for the asset or liability.

The principal market is the market with the greatest volume and level of activity for the asset or liability that can be accessed by the entity.

Market participant assumptions

Fair value is measured using the same assumptions and taking into account the same characteristics of the asset or liability as market participants would. Fair value is a market-based, not entity-specific measurement.

Highest and best use

For non-financial assets only, fair value is determined based on the highest and best use of the asset as determined by a market participant.

Bid and ask prices

The use of bid prices for asset positions and ask prices for liability positions is permitted if those prices are most representative of fair value in the circumstances, but it is not required.

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Fair value hierarchy

Fair value measurements are categorised into a three-level hierarchy, based on the type of inputs to the valuation techniques used, as follows:

- Level 1 inputs are quoted prices in active markets for items identical to the asset or liability being measured. Consistent with current IFRS, if there is a quoted price in an active market (that is, a Level 1 input), an entity uses that price without adjustment when measuring fair value;
- Level 2 inputs are other observable inputs; and
- Level 3 inputs are unobservable inputs, but that nevertheless must be developed to reflect the assumptions that market participants would use when determining an appropriate price for the asset or liability.

Each fair value measurement is categorised based on the lowest level input that is significant to it.

Disclosures

The guidance includes enhanced disclosure requirements that could result in significantly more work for reporting entities. These requirements are similar to those in IFRS 7, 'Financial instruments: Disclosures', but apply to all assets and liabilities measured at fair value, not just financial ones.

The required disclosures include:

- information about the hierarchy level into which fair value measurements fall;
- transfers between Levels 1 and 2;
- methods and inputs to the fair value measurements and changes in valuation techniques; and
- additional disclosures for Level 3 measurements that include a reconciliation of opening and closing balances, quantitative information about unobservable inputs and assumptions used, a description of the valuation processes in place, and qualitative discussion about the sensitivity of recurring Level 3 measurements.

Transition and effective date

IFRS 13 is effective for annual periods beginning on or after 1 January 2013, with earlier application permitted. It is applied prospectively as of the beginning of the annual period in which it is initially applied.

The disclosure requirements of the new guidance do not need to be applied in comparative information for periods before initial application of IFRS 13.

Am I affected?

Almost all entities use fair value measurements and will therefore be subject to the new requirements. Some changes may be required (for example, bid/ask spread and inclusion of own credit risk) to those fair value measurements today, which will largely affect financial institutions and investment entities. However, there are enhanced disclosure requirements that will be required by all entities.

What do I need to do?

Preparers should begin by evaluating the nature and extent of the fair value measurements that they are currently required to make under IFRS. Management will need to determine which, if any, of the measurement techniques used will have to change as a result of the new guidance, and what additional disclosures will be necessary.