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THE ANANTROY BHATT KNOWLEDGE CENTRE



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Introduction to IFRS 13: Fair Value Measurement

IFRS 13:

- defines fair value
- sets out in a single IFRS a framework for measuring fair value
- requires disclosures about fair value measurements.

IFRS 13 applies when another IFRS requires or permits fair value measurements or disclosures about fair value measurements (and measurements, such as fair value less costs to sell, based on fair value or disclosures about those measurements), except for:

- share-based payment transactions within the scope of IFRS 2 Share-based Payment
- leasing transactions within the scope of IAS 17 Leases
- measurements that have some similarities to fair value but that are not fair value, such as net realisable value in IAS 2 Inventories or value in use in IAS 36 Impairment of Assets.

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Definitions

- **Fair value** = 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.
- **Active market** = A market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.
- **Exit price** = The price that would be received to sell an asset or paid to transfer a liability.
- **Highest and best use** = The use of a non-financial asset by market participants that would maximise the value of the asset or the group of assets and liabilities (e.g. a business) within which the asset would be used.
- **Most advantageous market** = The market that maximises the amount that would be received to sell the asset or minimises the amount that would be paid to transfer the liability, after taking into account transaction costs and transport costs.
- **Principal market** = The market with the greatest volume and level of activity for the asset or liability.

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Fair Value Hierarchy

IFRS 13 seeks to increase consistency and comparability in fair value measurements and related disclosures through a 'fair value hierarchy'. The hierarchy categorises the inputs used in valuation techniques into three levels. The hierarchy gives the highest priority to (unadjusted) quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs.

If the inputs used to measure fair value are categorised into different levels of the fair value hierarchy, the fair value measurement is categorised in its entirety in the level of the lowest level input that is significant to the entire measurement (based on the application of judgement).

Level One Inputs

Level 1 inputs are quoted prices in active markets for identical assets or liabilities that the entity can access at the measurement date. A quoted market price in an active market provides the most reliable evidence of fair value and is used without adjustment to measure fair value whenever available, with limited exceptions.

Level Two Inputs

Level 2 inputs are inputs other than quoted market prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 2 inputs include:

- quoted prices for similar assets or liabilities in active markets
- 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, for example: interest rates and yield curves observable at commonly quoted intervals, implied volatilities, credit spreads.

Level Three Inputs

Level 3 inputs are unobservable inputs for the asset or liability. Unobservable inputs are used to measure fair value to the extent that relevant observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. An entity develops unobservable inputs using the best information available in the circumstances, which might include the entity's own data, taking into account all information about market participant assumptions that is reasonably available.

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Measurement

Approach

The objective of a fair value measurement is to 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. A fair value measurement requires an entity to determine all of the following:

- the particular asset or liability that is the subject of the measurement (consistently with its unit of account)
- for a non-financial asset, the valuation premise that is appropriate for the measurement (consistently with its highest and best use)

- the principal (or most advantageous) market for the asset or liability
- the valuation technique(s) appropriate for the measurement, considering the availability of data with which to develop inputs that represent the assumptions that market participants would use when pricing the asset or liability and the level of the fair value hierarchy within which the inputs are categorised.

Guidance

IFRS 13 provides the guidance on the measurement of fair value, including the following:

- An entity takes into account the characteristics of the asset or liability being measured that a market participant would take into account when pricing the asset or liability at measurement date (e.g. the condition and location of the asset and any restrictions on the sale and use of the asset)
- Fair value measurement assumes an orderly transaction between market participants at the measurement date under current market
- Fair value measurement assumes a transaction taking place in the principal market for the asset or liability, or in the absence of a principal market, the most advantageous market for the asset or liability
- A fair value measurement of a non-financial asset takes into account its highest and best use
- A fair value measurement of a financial or non-financial liability or an entity's own equity instruments assumes it is transferred to a market participant at the measurement date, without settlement, extinguishment, or cancellation at the measurement date
- The fair value of a liability reflects non-performance risk (the risk the entity will not fulfil an obligation), including an entity's own credit risk and assuming the same non-performance risk before and after the transfer of the liability

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Valuation Techniques

An entity uses valuation techniques appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

The objective of using a valuation technique is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants and the measurement date under current market conditions. Three widely used valuation techniques are:

Market Approach

- uses prices and other relevant information generated by market transactions involving identical or comparable (similar) assets, liabilities, or a group of assets and liabilities (e.g. a business).

Cost Approach

- reflects the amount that would be required currently to replace the service capacity of an asset (current replacement cost).

Income Approach

- converts future amounts (cash flows or income and expenses) to a single current (discounted) amount, reflecting current market expectations about those future amounts.

In some cases, a single valuation technique will be appropriate, whereas in others multiple valuation techniques will be appropriate.

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Disclosures

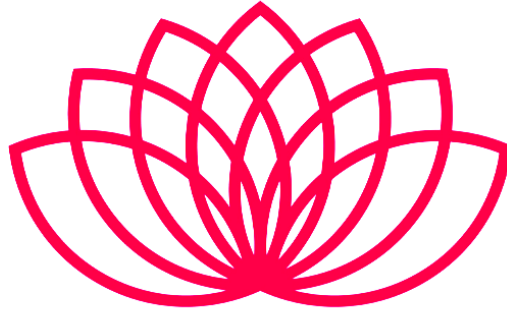
IFRS 13 requires an entity to disclose information that helps users of its financial statements assess both of the following:

- for assets and liabilities that are measured at fair value on a recurring or non-recurring basis in the statement of financial position after initial recognition, the valuation techniques and inputs used to develop those measurements.
- for fair value measurements using significant unobservable inputs (Level 3), the effect of the measurements on profit or loss or other comprehensive income for the period.

Disclosures Exemptions

The disclosure requirements are not required for:

- plan assets measured at fair value in accordance with IAS 19 Employee Benefits.
- retirement benefit plan investments measured at fair value in accordance with IAS 26 Accounting and Reporting by Retirement Benefit Plans.
- assets for which recoverable amount is fair value less costs of disposal in accordance with IAS 36 Impairment of Assets.



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