

IFRS 13- FAIR VALUE MEASUREMENT

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I. INTRODUCTION

IFRS 13 Fair Value Measurement was issued by IASB on 12th May 2011. The point of using fair value measure is to allow accounting to provide information that is both useful and relevant. (Rankin & Others 2012). Traditionally accounting has mostly used a valuation concept known as modified historical costs as the key measurement foundation. In other words IFRS requires that companies account for and report many assets and liabilities on the basis of acquisition price. IFRS has increasingly called for use of fair values measurements in the financial statements. Fair values information may be more useful than historical cost for certain types of assets and liabilities and in certain industries. (kieso & others 2011).

Many IFRS standards require you to measure the fair value of some items. Just name the examples: financial Instruments, Biological assets, assets held for sale and many other. In the past there was a limited guidance on how to set fair value; the guidance was speared throughout the standards and often very conflicting. Therefore, IFRS 13 Fair Value Measurement was issued. (ifrsbox.com). IFRS 13 Fair Value Measurement applies to IFRSs that require or permit fair value measurements or disclosures and measuring fair value and requires disclosures about fair value measurement.

Fair value measurement has considerable effects on financial ratios, especially upon and slightly after the crisis. The effect on volatility of financial markets has been tested too. A powerful growth of the financial markets, its increasing deregulation and globalization, the growing organizational complexity of these institutions, their corporate and capital partnerships, which increase their overall exposure to risk as well as the intense development of financial services, all of which are becoming more accessible to a wider circle of investors. (Carmen GiroGiana Bonaci et al.). IFRS 13 applies to annual period beginning on or after 1st January 2013. (www.iasplus.com).

II. Objective

This IFRS:

- (a) Defines fair value;
- (b) Sets out in a single IFRS a framework for measuring fair value; and
- (c) Requires disclosures about fair value measurements.

Fair value is a market-based measurement, not an entity-specific measurement. For some assets and liabilities, observable market transactions or market information might be available. For other assets and liabilities, observable market transactions and market information might not be available. However, the objective of a fair value measurement in both cases is the same—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 (i.e. an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability).

III. Scope

This IFRS 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 as specified in paragraphs. The measurement and disclosure requirements of this IFRS do not apply to the following:

- (a) share-based payment transactions within the scope of IFRS 2 Share-based Payment;
- (b) Leasing transactions within the scope of IAS 17 Leases; and
- (c) Measurements that have some similarities to fair value but are not fair value, such as net realisable value in IAS 2 Inventories or value in use in IAS 36 Impairment of Assets.

The disclosures required by this IFRS are not required for the following:

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

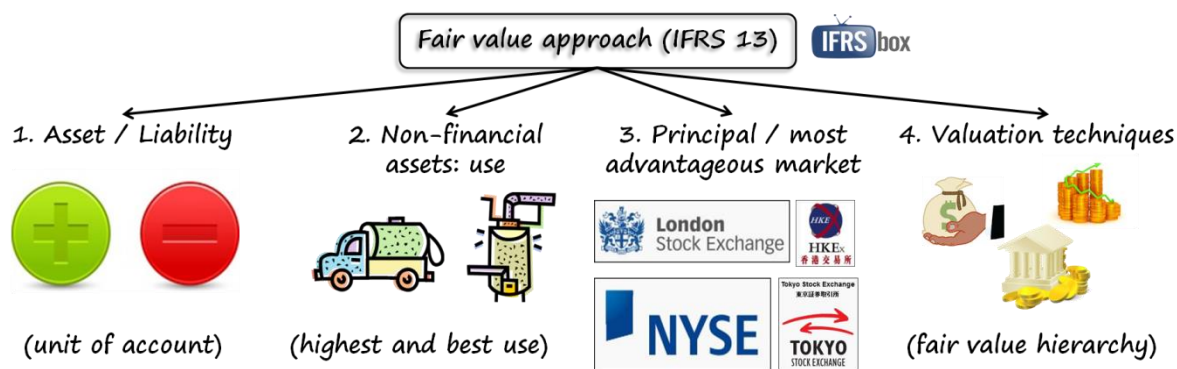
The fair value measurement framework described in this IFRS applies to both initial and subsequent measurement if fair value is required or permitted by other IFRSs.

IV. Provisions & Measurement:

Definition of Fair Value: This IFRS defines fair value as “the price that would be received to sell an asset (or) paid to transfer a liability in orderly transaction between market participants at the measurement date”. This definition of fair value is sometimes referred to as an “exit price.”

The FV standard provides principles regarding

1. Assets & Liabilities.
2. Transaction
3. Market participants
4. Price
5. Application for non-financial assets.
6. Application for liabilities and an equity own equity Instruments.



Source: (ifrsbox.com-ifrs-13-fair-value-measurements)

V. Valuation Techniques:

An equity shall use valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs (IFRS 13:61). The objective of using valuation techniques is to estimate the price at which an orderly transaction to sell the asset or to transfer liability would take place between market participants at the measurement date under current market conditions.

IFRS13 describes three main valuation techniques/approaches to measuring the fair value of assets and liabilities:

1. Market approach
2. Cost approach
3. Income approach(www.iasplus.org)

a. Market Approach:

Market approach uses prices and other relevant information generated by market transaction involving identical/comparable (similar) assets, liabilities or a group of assets and liabilities such as a business. (IFRS 13:B5)

For example, valuation techniques consistent with the market approach often use market multiples derived from a set of comparable. Multiples might be in ranges for each comparable. The selection of appropriate multiple within the range judgment, considering qualitative and quantitative factors specific to the measurement.

The market approach includes the use of matrix pricing. Matrix pricing is a mathematical technique that may be used to value debt securities by relying on the securities relationship to other benchmark quoted prices and is commonly used to price bonds (PWC).

b. Cost Approach:

Cost approach reflects the amount that would be required currently to replace “service capacity’ of an asset (often required to as current replacement cost).

The cost approach is based on an estimated of the cost of replacing the ‘service capacity” of the asset under consideration. This is what is known as the current replacement cost in accounting theory. This cost is calculated not based on a new asset, rather an asset that would substitute to derive comparable benefit, taking into account the ‘obsolescence’ of the current asset. However, this also means that where a market is inactive, alternative valuation method are available to an entity. In practice this would mean that the market approach is most likely to be preferred (Kieso & others 2011).

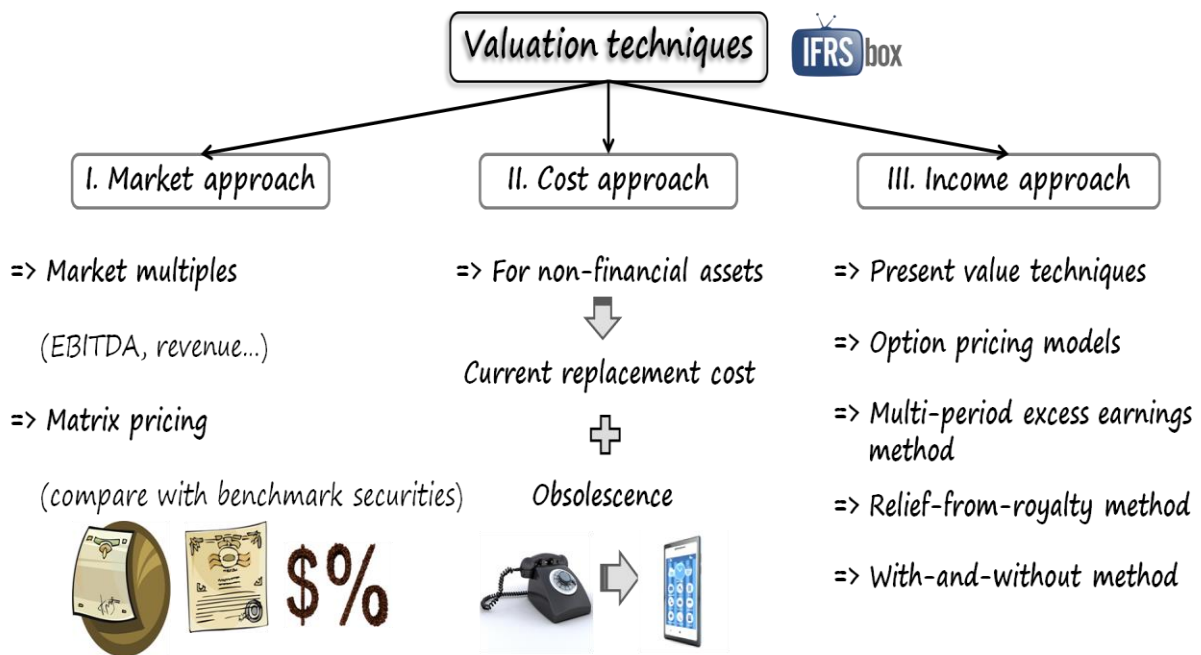
c. Income Approach:

Income approach converts future amounts (e.g.; cash flow or income and expenses) to a single current (i.e. discounted) amount. The fair value measurement is determined on the basis of

the value indicated by current market expectations about those future amounts. In the absence of a market price the expected net income/expense should proxy for a market price (Kieso & others 2011)

Those valuation techniques include for example the following:

- a. Present value technique (IFRS13; B12-B30)
- b. Option pricing models such as the black-Scholes -Merton formula or a binomial model (i.e. Lattic model), that incorporate present value technique and reflect both the time value and the intrinsic value of an option.
- c. The multi-period excess earnings method, which is used to measure four values of some intangible assets.



Source: (ifrsbox.com/ifrs-13-fair-value-measurement)

VI. Fair value hierarchy:

To increase consistency and comparability in FVM's and related disclosures, this IFRS establishes a FV Hierarchy that categorizes into three levels the inputs to valuation techniques used to measure FV. The highest priority is given to level 1 inputs and lowest priority to level 3 inputs.

An entity must maximize the use of level 1 inputs and minimize the use of level 3 inputs (IFRS 13:72)

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date (IFRS 13:76)

Examples: quotes price of shares traded on stock exchange

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

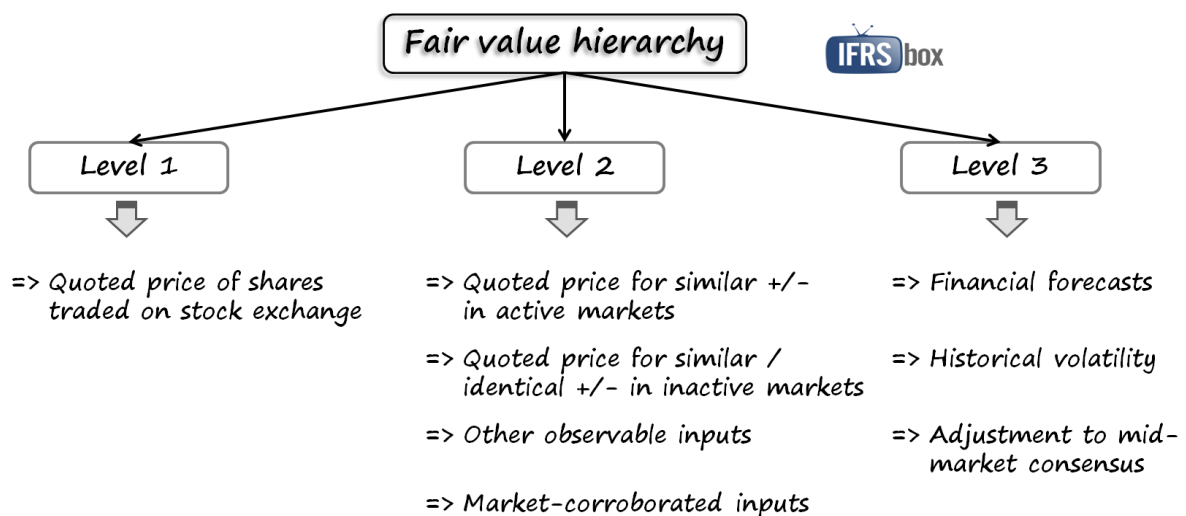
Example:

1. Quoted price for similar +/- in active markets.
2. Quoted price for similar/identical +/- in inactive markets.
3. Other observable inputs.

Level 3: Level 3 inputs are unobservable inputs for the asset/liability

Example:

- Financial forecast
- Historical volatility
- Financial forecast
- Historical volatility (www.eu.europa)



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