# IFRS 13
## Fair value measurement

## 1. Objective

This Standard has a three-fold objective:

- to define the term “fair value”;
- to define a single framework for measurement in fair value;
- to require disclosures in the notes to the financial statements regarding fair value measurements.

This Standard applies when another IFRS requires or permits fair value measurements, except for the following areas:

- share-based payment transactions (refer to IFRS 2 – Share-based payment);
- leasing transactions (refer to IFRS 16 – Leases);
- net realizable value regarding inventories (refer to IAS 2 – Inventories);
- assets for which recoverable amount is fair values less costs of disposal (refer to IAS 36 – Impairment of assets).

## 2. Scope

Fair value is defined as the price that would be received from selling an asset, or the price that would be paid to transfer a liability, in an **orderly transaction between market participants**, at the measurement date. Measurement techniques under IFRS 13 are classified into three categories:

- The **market approach**: prices and other identical or comparable market transactions (e.g. that are similar) are used to determine fair value. This category also includes market multiple approaches or matrix-based approaches;
- The **cost-approach**: the amount that would be necessary to obtain the services provided by an asset on the date of the transaction is used to determine fair value;
- The **income approach**: this converts future amounts such as cash flows or expenses into a single discounted amount to determine fair value (a present value or discounted cash flow approach)

To determine the measurement of fair value, the following steps must be followed:

**I. Identify** clearly **the asset or the liability** to be valued, on a basis that is consistent with the unit of account specified in other IFRSs. These may be: non-financial assets, liabilities and equity instruments of the entity itself, assets and financial liabilities whose positions offset each another in the area of market risk or credit risk.

**II. Determine the highest and best use**, in other words, the behaviour of a market participant acting in its best economic interests, either by using the asset or liability in its existing economic use specific to this entity, or by selling it to a third party capable of optimizing its use (within the limits of what is legally possible, feasible and consistent with its cost). It should be noted that the value of the asset or liability under the participant's intended use or effective use may be different than that of another entity valuing this same asset or this same liability in its financial statements (a market-based measurement).

Example 1: A factory is located in a 10,000 m² park in the outlying regional area of a major city in a regional development zone. The factory has been incurring losses for several years and no buyers have shown any interest in this production unit (especially given the heavy environmental restrictions to continue operations in this area). Several developers, who have compared it to other development programs carried out in a comparable area, have estimated that dividing this land into 20 plots measuring 500 m² would result in a sales price of 100,000 per plot. What is the fair value of this asset?

Given the geographic location, it is unlikely that a company interested in purchasing it would be an industrial company. Most likely, it would be a property developer that would value this asset as development land. The fair value would then be unrelated to the existing factory activity. Instead, it would be related to the sales price of the industrial site as building land (after deducting any potential costs which would be required to ensure the suitability of the site for building homes or offices), for a total of 2,000,000 (20 X 100,000).

Example 2: Group X, an automotive equipment manufacturer, purchased a factory for 1,000,000 for strategic reasons (in order to support its main customers in a geographic area so as to prevent them from turning to X's competitors). At the time of the acquisition, three other companies put in bids for the factory at a price very close to the price offered by group X and in addition offered to use the industrial equipment for 100% of the time. However, group X intends to only use 60% of this factory's production capacity in the medium or even the long term. What is the initial value of this asset?

The fair value of the asset (initial price) equals 1,000,000 since three other companies bid to buy the factory for its optimal use (100% of the industrial capacity). Group X will then have to consider depreciating the asset to take into account the underutilization of the factory.

**III. Identify the principal market** corresponding to the one in which the highest volume or activity can be observed for the asset or the liability to be measured, as long as there is access to this market. If there is no primary market, the most advantageous market will be used (usually, the market in which the entity operates).

**IV. Measure the fair value** (as close as possible to observable market inputs) based on the following **hierarchy**:

- Level 1: price of an active market in which observable transactions take place regularly, with sufficient volume and frequency.
- Level 2: inputs that are directly or indirectly observable other than the price specified in Level 1 (for example the price in fairly inactive markets or inputs based on the existence of recent transactions).
- Level 3: unobservable inputs – this is the default level, and includes, for example, inputs specific to the entity, historic market data, estimated future cash flows, etc.

In a particular situation, the level of fair value, the level of initial inputs which maximizes the use of relevant observable inputs, and which minimizes the use of unobservable inputs, and will be based on the

Example 3: The asset valuation model chosen by an entity uses two Level 1 inputs, three Level 2 inputs and 1 Level 3 input. What is the overall fair value hierarchy level for this valuation?

Since the lowest level used in the model which is significant to the overall valuation is Level 3, the overall valuation is a level 3 and will require disclosures in the notes as required for this level.

# 3. Disclosure

An entity must disclose information regarding a number of aspects including:

- Details of the assets and liabilities measured at fair value:
  - ✓ may be applicable on a recurring basis, or on a non-recurring basis, or both, after initial recognition;
  - ✓ the level of the fair value hierarchy;
  - ✓ the initial inputs used to establish the fair values.
- For measurements of fair value carried out on a recurring basis using significant Level 3 unobservable inputs, the effect of these measurements on profit or loss or on other comprehensive income (OCI) for the period.