NZ IFRS 13: FAIR VALUE MEASUREMENT (1 OF 2)

Effective Periods Beginning
1 January 2013

SCOPE AND SCOPE EXEMPTIONS

NZ IFRS 13 applies when another IFRS requires or permits fair value measurements (both initial and subsequent) or disclosures about fair value measurements, except as detailed below:

Exemption from both **measurement** and **disclosure** requirements:

- Share-based payment transactions within the scope of NZ IFRS 2 *Share-based Payment*
- Leasing transactions within the scope of NZ IFRS 16 *Leases*
- Measurements that have some similarities to fair value, but are not fair value, such as:
  - Net realisable value in NZ IAS 2 *Inventories*
  - Value-in-use in NZ IAS 36 *Impairment of Assets*.

Exemption from **disclosure** requirements only:

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

DEFINITION OF FAIR VALUE

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.

Price

The price is determined at measurement date under current market conditions (i.e. an exit price).

This is regardless of whether that price is directly observable or estimated using another valuation technique.

Asset or liability

Fair value considers specific characteristics:

- Asset condition and location
- Any restrictions on the sale.

Transaction

Is assumed to takes place either in:

- The **principal market** (i.e. market with the greatest volume and level of activity), or in the absence of a principal market
- The **most advantageous market** (i.e. the market that maximises /minimises the amount received/ paid, after transaction and transport costs).

Market participants

Fair value of an asset or liability is measured using the assumptions that market participants would use when pricing the asset or liability (assuming they act in their own economic best interest)

Market participants do **not** need to be identified.

APPLICATION TO NON-FINANCIAL ASSETS

Highest and best use (HBU)

Fair value measurement of non-financial assets considers a **market participant's** ability (**not** the entity's) to either:

- Generate economic benefits by using the asset in its HBU
- Sell the asset to another market participant who would then use the asset in its HBU.

Factors to consider in determining HBU:

- Physically possible
- Legally permitted
- Financially viable.

Valuation premise - stand alone

If the HBU is on a stand-alone basis:

- Fair value is the price that would be received in a current sale, to a market participant, that would use the asset on a standalone basis.

Valuation premise - combination

If the HBU is in combination with other assets:

- Fair value is the price that would be received in a current sale, to market participants, assuming the asset will be used in combination with those assets (which are also assumed to be available to the market participants).

APPLICATION TO LIABILITIES AND AN ENTITY'S OWN EQUITY INSTRUMENTS

General principles

Liabilities: Assume that these would remain outstanding and the market participant transferee would be required to fulfil the obligation. The liability would not be settled with the counterparty or otherwise extinguished on the measurement date.

Entity's own equity instruments: Assume that these would remain outstanding and the market participant transferee would take on the rights and responsibilities associated with the instrument. The instrument would not be cancelled or otherwise extinguished on measurement date.

Whether held (or not held) by other parties as assets

When a quoted price for the transfer of an identical (or a similar) liability or entity's own equity instrument is not available, and that identical (or similar) item is held by another party as an asset:

- Measure the fair value of from the perspective of a market participant that holds the identical item as an asset at the measurement date, by:
  - Using the quoted price in an active market for the identical item, or if not available
  - Using other observable inputs, or if not available
  - Using another valuation technique (i.e. income approach, or market approach).

When a quoted price for the transfer of an identical (or a similar) liability or entity's own equity instrument is not available, and that identical (or similar) item is not held by another party as an asset:

- Measure the fair value using a valuation technique from the perspective of a market participant that either:
  - Owes the liability
  - Has issued the claim on equity.

Restriction preventing transfer

The inclusion of a separate input (or an adjustment to other inputs) relating to the existence of a restriction that prevents the transfer of the item liability or entity's own equity instrument, is **not permitted** when determining fair value.

The effect of such a restriction is either implicitly or explicitly included in the other inputs to the fair value measurement.

Liabilities - Non-performance risk, and liabilities with a demand feature

Non-performance risk (NPR)

- NPR is reflected in the fair value of a liability and includes (but is not limited to) an entity's own credit risk
- NPR is assumed to be the same before and after the transfer of the liability
- NPR considers the effect of an entity's credit risk and any other factors that might influence the likelihood that the obligation will or will not be fulfilled. That effect may differ depending on the liability, for example:
  - Whether the liability is an obligation to deliver cash (a financial liability), or an obligation to deliver goods or services (a non-financial liability)
  - The terms of credit enhancements related to the liability, if any.

Liabilities with a demand feature (i.e. a 'demand deposit')

Fair value is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.

TIER 2 NZ IFRS RDR REPORTERS

NZ IFRS RDR Reporters must comply fully with the recognition and measurement principles of NZ IFRS 13. However, there are certain disclosure exemptions available.

NZ IFRS 13: FAIR VALUE MEASUREMENT (2 OF 2)

APPLICATION TO FINANCIAL ASSETS AND FINANCIAL LIABILITIES WITH OFFSETTING POSITIONS IN MARKET RISKS OR COUNTERPARTY CREDIT RISK

An entity that holds a group of financial assets and financial liabilities is exposed to:

i. Market risks
ii. Credit risk of each of the counterparties.

If these are managed on either a market risk or a credit risk net exposure basis:

- The entity is permitted to apply an exception ('offsetting exemption') to NZ IFRS 13 for measuring fair value. Fair value would be based on the price:
  - Received to sell a net long position (i.e. an asset) for a particular risk exposure, or
  - To transfer a net short position (i.e. a liability) for a particular risk exposure in an orderly transaction between market participants.

Fair value of this 'offset group' of financial assets and financial liabilities is made consistently with how market participants would price the net risk exposure.

Offsetting exemption

Can only be used if the entity does all the following:

- Manages the offset group on the basis of net exposure to a particular market risk (or risks) or to the credit risk of a particular counterparty in accordance with the entity's documented risk management or investment strategy.
- Provides information on that basis about the offset group to the entity's key management personnel, as defined in NZ IAS 24 *Related Party Disclosures*.
- Is required (or has elected) to measure the offset group at fair value in the statement of financial position at the end of each reporting period.

The exception does not relate to presentation.

NZ IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* must be applied when using the offsetting exception.

(i) Exposure to market risk

When using the offsetting exception:

- Apply the price within the bid-ask spread that is most representative of fair value in the circumstances to the entity's net exposure to those market risks
- Ensure that the market risk (or risks) within the offset group are substantially the same:
  - Any basis risk resulting from the market risk parameters not being identical are taken into account in the fair value measurement of the financial assets / liabilities within the offset group
  - Similarly, the duration of the entity's exposure to a particular market risk (or risks) arising from the financial assets and financial liabilities of the offset group must be substantially the same.

(ii) Exposure to credit risk

When using the offsetting exception:

- Include the effect of the entity's net exposure to the credit risk of that counterparty's net exposure to the credit risk of the entity in the fair value measurement when market participants would take into account any existing arrangements that mitigate credit risk exposure in the event of default.

Fair value is required to reflect market participants' expectations about the likelihood that such an arrangement would be legally enforceable in the event of default.

FAIR VALUE AT INITIAL RECOGNITION

The transaction price is the price paid / received to acquire an asset or to assume a liability (i.e. entry price).

In contrast, fair value is the price that would be received to sell the asset or paid to transfer the liability (i.e. exit price).

However, in many cases the transaction price will equal the fair value - however it is still necessary to take into account factors specific to the transaction and to the asset or liability.

FAIR VALUE HIERARCHY

NZ IFRS 13 includes a fair value hierarchy that categorises the inputs to valuation techniques used to measure fair value into three (input) levels:

- **Level 1**: Observable quoted prices, in active markets
- **Level 2**: Quoted prices are not available but fair value is based on observable market data
- **Level 3**: Unobservable inputs.

The level of an item is based on its lowest input level.

RECURRING OR NON-RECURRING

NZ IFRS 13 requires specific disclosures based on whether fair value measurement is recurring (RFVM) or non-recurring (NRFVM).

RFVM and NRFVM are not defined in NZ IFRS 13.

However, in general:

- **RFVM**: Fair value measurement is required at reporting date by other NZ IFRSs (e.g. investment property, biological assets etc.)
- **NRFVM**: Fair value measurement is triggered by particular events/circumstances (e.g. assets held for sale under NZ IFRS 5 etc.).

UNIT OF ACCOUNT

In most cases, the unit of account is not specified by NZ IFRS 13.

Instead, the unit of account is specified by the NZ IFRS that permits or requires fair value measurement and disclosure of the item.

VALUATION TECHNIQUES

Must use appropriate valuation techniques in the circumstances and for which sufficient data are available to measure fair value.

Changes in the valuation technique or its application are accounted for as a change in accounting estimate in accordance with NZ IAS 8.

Inputs to valuation techniques

- Must aim to maximise the use of relevant observable inputs and minimise the use of unobservable inputs.
- If an asset/liability measured at fair value has both a bid and ask price, the price within the bid-ask spread that is most representative of fair value is used - regardless of where the input is categorised within the fair value hierarchy.

DISCLOSURE - TIER 1 REPORTERS (Tier 2 Reporters have certain exemptions)

Disclosure Requirement	RFVM	NRFVM	FV Disclosed
Fair value at reporting date	x	x	
Reasons for fair value measurement		x	
Fair value hierarchy level *i.e. Level 1, 2 or 3*	x	x	x
Transfers between Level 1 and 2 (including reasons for the transfer and the entity's policy transfer)	x		
Valuation technique, inputs, changes, reasons for change etc - Level 2 and 3	x	x	x
Level 3 valuation processes/policies	x	x	
Level 3 unobservable inputs	x	x	

Disclosure Requirement	RFVM	NRFVM	FV Disclosed
Level 3 reconciliation of total gains or losses in P&L and OCI, purchases, sales issues, settlements, and transfers	x		
Level 3 unrealised gains /losses recognised in P&L	x		
Level 3 sensitivity to changes in unobservable inputs (Qualitative for non-financial instruments, quantitative for financial instruments)	x		
Reasons if HBU differs from current use	x	x	x

FV Disclosed: Refers to items that are measured on a basis other than fair value, but where applicable NZ IFRSs require the items fair value to be determined and disclosed.

TRANSITION REQUIREMENTS

Refer to Appendix C of NZ IFRS 13.