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Fair Value Measurement

Comments to be received by 28 September 2009



International
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Exposure Draft
FAIR VALUE MEASUREMENT

Comments to be received by 28 September 2009

ED/2009/5

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CONTENTS

*paragraphs***INTRODUCTION AND INVITATION TO COMMENT****[DRAFT] INTERNATIONAL FINANCIAL REPORTING STANDARD X
FAIR VALUE MEASUREMENT**

CORE PRINCIPLE	1
SCOPE	2–3
MEASUREMENT	4–55
Fair value	4–33
The asset or liability	5–6
The transaction	7–12
Market participants	13–14
The price	15–16
Application to assets: highest and best use	17–21
Application to assets: valuation premise	22–24
Application to liabilities: general principles	25–28
Application to liabilities: non-performance risk	29–30
Application to liabilities: restrictions	31
Application to equity instruments	32–33
Fair value at initial recognition	34–37
Valuation techniques	38–40
Inputs to valuation techniques	41–42
Fair value hierarchy	43–55
Level 1 inputs	45–50
Level 2 inputs	51–52
Level 3 inputs	53–54
Inputs based on bid and ask prices	55
DISCLOSURES	56–61
EFFECTIVE DATE AND TRANSITION	62–64
APPENDICES:	
A Defined terms	
B Application guidance	
C Present value techniques	
D Amendments to other IFRSs	

FAIR VALUE MEASUREMENT

APPROVAL OF FAIR VALUE MEASUREMENT BY THE BOARD

BASIS FOR CONCLUSIONS *(see separate booklet)*

ILLUSTRATIVE EXAMPLES *(see separate booklet)*

Introduction

Reasons for publishing the exposure draft

The proposed IFRS defines fair value, establishes a framework for measuring fair value and requires disclosures about fair value measurements.

IFRSs require some assets, liabilities and equity instruments to be measured at fair value. However, guidance on measuring fair value has been added to IFRSs piecemeal over many years as the International Accounting Standards Board or its predecessor decided that fair value was an appropriate measurement or disclosure basis in a particular situation.

As a result, guidance on measuring fair value is dispersed across many IFRSs and it is not always consistent. Furthermore, the current guidance is incomplete, in that it provides neither a clear measurement objective nor a robust measurement framework. The Board believes that this adds unnecessary complexity to IFRSs and contributes to diversity in practice.

The Board's objectives for publishing the proposed IFRS are:

- (a) to establish a single source of guidance for all fair value measurements required or permitted by IFRSs to reduce complexity and improve consistency in their application;
- (b) to clarify the definition of fair value and related guidance in order to communicate the measurement objective more clearly; and
- (c) to enhance disclosures about fair value to enable users of financial statements to assess the extent to which fair value is used and to inform them about the inputs used to derive those fair values.

The proposed IFRS does not require additional fair value measurements.

Main features of the draft IFRS

The draft IFRS defines fair value as 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).

In the absence of an actual transaction at the measurement date, a fair value measurement assumes a hypothetical transaction in the most advantageous market for the asset or liability.

FAIR VALUE MEASUREMENT

A fair value measurement requires an entity to determine:

- (a) the particular asset or liability that is the subject of the measurement (consistently with its unit of account).
- (b) for an asset, the valuation premise that is appropriate for the measurement (consistently with its highest and best use).
- (c) the most advantageous market for the asset or liability.
- (d) 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 in pricing the asset or liability and the level of the fair value hierarchy within which the inputs are categorised.

Invitation to comment

The International Accounting Standards Board invites comments on any aspect of the exposure draft of its proposed IFRS *Fair Value Measurement*. It would particularly welcome answers to the questions set out below. Comments are most helpful if they:

- (a) respond to the questions as stated,
- (b) indicate the specific paragraph or paragraphs to which the comments relate,
- (c) contain a clear rationale, and
- (d) describe any other approaches the Board should consider, if applicable.

Respondents need not comment on all of the questions and are encouraged to comment on any additional issues.

The Board will consider all comments received in writing by **28 September 2009**. In considering the comments, the Board will base its conclusions on the merits of the arguments for and against each approach, not on the number of responses supporting each approach.

The Board plans to hold public round-table meetings after the comment deadline with selected respondents. Please indicate whether you are interested in taking part in a round-table meeting.

Definition of fair value and related guidance

Question 1

The exposure draft proposes defining fair value as ‘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) (see paragraph 1 of the draft IFRS and paragraphs BC15–BC18 of the Basis for Conclusions). This definition is relevant only when fair value is used in IFRSs.

Is this definition appropriate? Why or why not? If not, what would be a better definition and why?

Scope

Question 2

In three contexts, IFRSs use the term ‘fair value’ in a way that does not reflect the Board’s intended measurement objective in those contexts:

- (a) In two of those contexts, the exposure draft proposes to replace the term ‘fair value’ (the measurement of share-based payment transactions in IFRS 2 *Share-based Payment* and reacquired rights in IFRS 3 *Business Combinations*) (see paragraph BC29 of the Basis for Conclusions).
- (b) The third context is the requirement in paragraph 49 of IAS 39 *Financial Instruments: Recognition and Measurement* that the fair value of a financial liability with a demand feature is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid (see paragraph 2 of the draft IFRS and paragraph BC29 of the Basis for Conclusions). The exposure draft proposes not to replace that use of the term ‘fair value’, but instead proposes to exclude that requirement from the scope of the IFRS.

Is the proposed approach to these three issues appropriate? Why or why not? Should the Board consider similar approaches in any other contexts? If so, in which context and why?

The transaction

Question 3

The exposure draft proposes that a fair value measurement assumes that the transaction to sell the asset or transfer the liability takes place in the most advantageous market to which the entity has access (see paragraphs 8–12 of the draft IFRS and paragraphs BC37–BC41 of the Basis for Conclusions).

Is this approach appropriate? Why or why not?

Question 4

The exposure draft proposes that an entity should determine fair value using the assumptions that market participants would use in pricing the asset or liability (see paragraphs 13 and 14 of the draft IFRS and paragraphs BC42–BC45 of the Basis for Conclusions).

Is the description of market participants adequately described in the context of the definition? Why or why not?

Application to assets: highest and best use and valuation premise

Question 5

The exposure draft proposes that:

- (a) the fair value of an asset should consider a market participant's ability to generate economic benefit by using the asset or by selling it to another market participant who will use the asset in its highest and best use (see paragraphs 17–19 of the draft IFRS and paragraph BC60 of the Basis for Conclusions).
- (b) the highest and best use of an asset establishes the valuation premise, which may be either 'in use' or 'in exchange' (see paragraphs 22 and 23 of the draft IFRS and paragraphs BC56 and BC57 of the Basis for Conclusions).
- (c) the notions of highest and best use and valuation premise are not used for financial assets and are not relevant for liabilities (see paragraph 24 of the draft IFRS and paragraphs BC51 and BC52 of the Basis for Conclusions).

Are these proposals appropriate? Why or why not?

Question 6

When an entity uses an asset together with other assets in a way that differs from the highest and best use of the asset, the exposure draft proposes that the entity should separate the fair value of the asset group into two components: (a) the value of the assets assuming their current use and (b) the amount by which that value differs from the fair value of the assets (ie their incremental value). The entity should recognise the incremental value together with the asset to which it relates (see paragraphs 20 and 21 of the draft IFRS and paragraphs BC54 and BC55 of the Basis for Conclusions).

Is the proposed guidance sufficient and appropriate? If not, why?

Application to liabilities: general principles

Question 7

The exposure draft proposes that:

- (a) a fair value measurement assumes that the liability is transferred to a market participant at the measurement date (see paragraph 25 of the draft IFRS and paragraphs BC67 and BC68 of the Basis for Conclusions).
- (b) if there is an active market for transactions between parties who hold a financial instrument as an asset, the observed price in that market represents the fair value of the issuer's liability. An entity adjusts the observed price for the asset for features that are present in the asset but not present in the liability or vice versa (see paragraph 27 of the draft IFRS and paragraph BC72 of the Basis for Conclusions).
- (c) if there is no corresponding asset for a liability (eg for a decommissioning liability assumed in a business combination), an entity estimates the price that market participants would demand to assume the liability using present value techniques or other valuation techniques. One of the main inputs to those techniques is an estimate of the cash flows that the entity would incur in fulfilling the obligation, adjusted for any differences between those cash flows and the cash flows that other market participants would incur (see paragraph 28 of the draft IFRS).

Are these proposals appropriate? Why or why not? Are you aware of any circumstances in which the fair value of a liability held by one party is not represented by the fair value of the financial instrument held as an asset by another party?

Application to liabilities: non-performance risk and restrictions

Question 8

The exposure draft proposes that:

- (a) the fair value of a liability reflects non-performance risk, ie the risk that an entity will not fulfil the obligation (see paragraphs 29 and 30 of the draft IFRS and paragraphs BC73 and BC74 of the Basis for Conclusions).
- (b) the fair value of a liability is not affected by a restriction on an entity's ability to transfer the liability (see paragraph 31 of the draft IFRS and paragraph BC75 of the Basis for Conclusions).

Are these proposals appropriate? Why or why not?

Fair value at initial recognition

Question 9

The exposure draft lists four cases in which the fair value of an asset or liability at initial recognition might differ from the transaction price. An entity would recognise any resulting gain or loss unless the relevant IFRS for the asset or liability requires otherwise. For example, as already required by IAS 39, on initial recognition of a financial instrument, an entity would recognise the difference between the transaction price and the fair value as a gain or loss only if that fair value is evidenced by observable market prices or, when using a valuation technique, solely by observable market data (see paragraphs 36 and 37 of the draft IFRS, paragraphs D27 and D32 of Appendix D and paragraphs BC76–BC79 of the Basis for Conclusions).

Is this proposal appropriate? In which situation(s) would it not be appropriate and why?

Valuation techniques

Question 10

The exposure draft proposes guidance on valuation techniques, including specific guidance on markets that are no longer active (see paragraphs 38–55 of the draft IFRS, paragraphs B5–B18 of Appendix B, paragraphs BC80–BC97 of the Basis for Conclusions and paragraphs IE10–IE21 and IE28–IE38 of the draft illustrative examples).

Is this proposed guidance appropriate and sufficient? Why or why not?

Disclosures

Question 11

The exposure draft proposes disclosure requirements to enable users of financial statements to assess the methods and inputs used to develop fair value measurements and, 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 (see paragraphs 56–61 of the draft IFRS and paragraphs BC98–BC106 of the Basis for Conclusions).

Are these proposals appropriate? Why or why not?

Convergence with US GAAP

Question 12

The exposure draft differs from Statement of Financial Accounting Standards No. 157 *Fair Value Measurements* (SFAS 157) in some respects (see paragraph BC110 of the Basis for Conclusions). The Board believes that these differences result in improvements over SFAS 157.

Do you agree that the approach that the exposure draft proposes for those issues is more appropriate than the approach in SFAS 157? Why or why not? Are there other differences that have not been identified and could result in significant differences in practice?

Other comments

Question 13

Do you have any other comments on the proposals in the exposure draft?

FAIR VALUE MEASUREMENT

[Draft] International Financial Reporting Standard X *Fair Value Measurement* ([draft] IFRS X) is set out in paragraphs 1–64 and Appendices A–D. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in Appendix A are in *italics* the first time they appear in the [draft] Standard. Definitions of other terms are given in the Glossary for International Financial Reporting Standards. [Draft] IFRS X should be read in the context of its core principle and the Basis for Conclusions, the *Preface to International Financial Reporting Standards* and the *Framework for the Preparation and Presentation of Financial Statements*. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

[Draft] International Financial Reporting Standard X Fair Value Measurement

Core principle

- 1 *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.*^{*}

Scope

- 2 This [draft] IFRS applies to IFRSs that require or permit fair value measurements or disclosures, except that it does not replace the requirement in paragraph 49 of IAS 39 *Financial Instruments: Recognition and Measurement*.[†]
- 3 This [draft] IFRS explains how to measure fair value. It does not require additional fair value measurements.

Measurement

Fair value

- 4 The following paragraphs discuss aspects of the core principle:
- (a) the asset or liability (paragraphs 5 and 6)
 - (b) the transaction (paragraphs 7–12)
 - (c) market participants (paragraphs 13 and 14)
 - (d) the price (paragraphs 15 and 16)
 - (e) application to assets (paragraphs 17–24)

* The core principle focuses on assets and liabilities because they are a primary subject of accounting measurement. However, as discussed in paragraphs 32 and 33, the core principle shall also be applied when measuring the fair value of equity instruments.

† Paragraph 49 of IAS 39 states that the fair value of a financial liability with a demand feature (eg a demand deposit) is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid. In all other respects, an entity shall apply this [draft] IFRS when measuring the fair value of such a liability.

- (f) application to liabilities (paragraphs 25–31)
- (g) application to equity instruments (paragraphs 32 and 33).

The asset or liability

- 5 **A fair value measurement is for a particular asset or liability. Therefore, the measurement shall consider the characteristics of the asset or liability (eg the condition and location of the asset and restrictions, if any, on its sale or use) if market participants would consider those characteristics when determining the price for the asset or liability at the measurement date.**
- 6 The asset or liability might be a stand-alone asset or liability (eg a financial instrument or an operating asset) or a group of assets or liabilities (eg a cash-generating unit or a business) depending on the *unit of account* prescribed by IFRSs applicable to the asset or liability or group of assets or liabilities.

The transaction

- 7 A fair value measurement assumes that the asset or liability is exchanged in an orderly transaction between market participants to sell the asset or transfer the liability at the measurement date. An orderly transaction is a transaction that assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (eg a forced liquidation or distress sale).
- 8 **A fair value measurement shall assume that the transaction to sell the asset or transfer the liability takes place in the most advantageous market to which the entity has access. The most advantageous market is 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 considering transaction costs and transport costs.**
- 9 Because different entities (and businesses within those entities) with different activities enter into transactions in different markets, the most advantageous market for the same asset or liability might be different for different entities. Therefore, the most advantageous market (and thus, market participants) shall be considered from the perspective of the reporting entity.

- 10 An entity need not undertake an exhaustive search of all possible markets to identify the most advantageous market. The market in which the entity would normally enter into a transaction for the asset or liability is presumed to be the most advantageous market.
- 11 In the absence of evidence to the contrary, an entity may assume that the *principal market* for the asset or liability is the most advantageous market, provided that the entity can access the principal market.^{*} The principal market is the market with the greatest volume and level of activity for the asset or liability. Regardless of the market used, an entity shall apply the fair value hierarchy as described in paragraphs 43 and 44.
- 12 In the absence of an actual transaction to sell the asset or transfer the liability at the measurement date, a fair value measurement assumes a hypothetical transaction at that date, considered from the perspective of a market participant that holds the asset or owes the liability. That hypothetical transaction notion establishes a basis for estimating the price to sell the asset or to transfer the liability. Because the transaction is hypothetical, it is necessary to consider the characteristics of market participants who would enter into a transaction for the asset or liability.

Market participants

- 13 Market participants are buyers and sellers in the most advantageous market for the asset or liability that are:
- (a) independent of each other,[†] ie they are not related parties (as defined in IAS 24 *Related Party Disclosures*);
 - (b) knowledgeable, ie they are sufficiently informed to make an investment decision and are presumed to be as knowledgeable as the reporting entity about the asset or liability;
 - (c) able to enter into a transaction for the asset or liability; and
 - (d) willing to enter into a transaction for the asset or liability, ie they are motivated but not forced or otherwise compelled to do so.

* Although an entity must have access to the market at the measurement date, it does not need to be able to sell the particular asset or transfer the particular liability on that date, eg if there is a restriction on the sale of the asset (see paragraphs 46 and 47).

† The reporting entity is a market participant, but it is not the only market participant to consider when measuring fair value.

- 14 **The fair value of the asset or liability shall be measured using the assumptions that market participants would use in pricing the asset or liability. In developing those assumptions, an entity need not identify specific market participants. Rather, the entity shall identify characteristics that distinguish market participants generally, considering factors specific to:**
- (a) **the asset or liability,**
 - (b) **the most advantageous market for the asset or liability and**
 - (c) **market participants with whom the reporting entity would enter into a transaction in that market.**

The price

- 15 Fair value is the price that would be received to sell an asset or paid to transfer a liability in the most advantageous market at the measurement date (an exit price), whether that price is directly observable or estimated using a valuation technique. In the absence of an observable market to provide pricing information, an entity shall consider the characteristics of market participants who would enter into a transaction for the asset or liability.
- 16 Although transaction costs are considered when determining the most advantageous market, the price used to measure the fair value of the asset or liability shall not be adjusted for those costs.^{*} Transaction costs are the incremental direct costs to sell the asset or transfer the liability.[†] Transaction costs are not a characteristic of the asset or liability; rather, they are specific to the transaction and will differ depending on how an entity enters into a transaction for an asset or liability. Transaction costs do not include the costs that would be incurred to transport an asset to or from its most advantageous market. If location is a characteristic of the asset (as might be the case for a commodity), the price in the most advantageous market shall be adjusted for the costs, if any, that would be incurred to transport the asset to or from that market.

* Transaction costs shall be accounted for in accordance with other relevant IFRSs.

† Incremental costs to sell the asset or transfer the liability refer to those costs that are directly attributable to the disposal of an asset or transfer of a liability. They are essential to that transaction and would not have been incurred by an entity had the decision to sell the asset (or transfer the liability) not been made (similar to costs to sell, as defined in IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*).

Application to assets: highest and best use

- 17 A fair value measurement considers a market participant's ability to generate economic benefit by using the asset or by selling it to another market participant who will use the asset in its *highest and best use*. Highest and best use refers to the use of an asset by market participants that would maximise the value of the asset or the group of assets and liabilities (eg a business) within which the asset would be used, considering uses of the asset that are physically possible, legally permissible and financially feasible at the measurement date. A use that is:
- (a) physically possible takes into account the physical characteristics of the asset that market participants would consider when pricing the asset (eg the location or size of a property).
 - (b) legally permissible takes into account any legal restrictions on the use of the asset that market participants would consider when pricing the asset (eg the zoning regulations applicable to a property).
 - (c) financially feasible takes into account whether a use of the asset that is physically possible and legally permissible generates adequate income or cash flows (taking into consideration the costs of converting the asset to that use) to produce an investment return that market participants would require from an investment in that asset put to that use.
- 18 Highest and best use is determined from the perspective of market participants, even if the reporting entity intends a different use. However, an entity need not perform an exhaustive search for other potential uses if there is no evidence to suggest that the current use of an asset is not its highest and best use.
- 19 The highest and best use of an asset acquired in a business combination might differ from the intended use of the asset by the acquirer. For competitive or other reasons, the acquirer may intend not to use an acquired asset actively or it may not intend to use the asset in the same way as other market participants. This might be the case for some acquired intangible assets, eg an acquired trademark that competes with an entity's own trademark. Nevertheless, an entity shall measure the fair value of the asset assuming its highest and best use by market participants.

FAIR VALUE MEASUREMENT

- 20 In some cases, an entity uses an asset together with other assets in a way that differs from the highest and best use of the asset. For example, an entity might operate a factory on a parcel of land even though the highest and best use of the land is to demolish the factory and build residential property. In such cases, the fair value of the asset group has the following components:
- (a) the value of the assets assuming their current use. This value differs from fair value when the current use of the assets is not their highest and best use. However, this value reflects all other factors market participants would consider when determining the price for the assets.
 - (b) the amount by which the fair value of the assets differs from their value in their current use (ie the incremental value of the asset group).
- 21 An entity shall recognise the incremental value described in paragraph 20(b) together with the asset to which it relates. Using the example in paragraph 20, the incremental value relates to the entity's ability to convert the land from its current use as an industrial property to its highest and best use as a residential property. Accordingly, the fair value of the land comprises its value assuming its current use plus the incremental value described in paragraph 20(b). The amount attributed to the factory reflects its current use as noted in paragraph 20(a). An entity shall account for the assets in accordance with the IFRSs applicable to those assets.

Application to assets: valuation premise

- 22 The highest and best use of the asset establishes the valuation premise used to measure the fair value of the asset. Specifically:
- (a) The highest and best use of the asset is 'in use' if the asset would provide maximum value to market participants principally through its use in combination with other assets and liabilities as a group (as installed or otherwise configured for use). If the highest and best use of the asset is in use, the fair value of the asset shall be measured using an *in-use valuation premise*. When using an in-use valuation premise, the fair value of the asset is measured on the basis of the price that would be received in a current transaction to sell the asset assuming that the asset would be used with other assets and liabilities as a group and that those assets and liabilities (complementary assets and liabilities) would be available to market participants. Assumptions about the highest and best use of the

asset shall be consistent for all of the assets of the group within which it would be used.

- (b) The highest and best use of the asset is 'in exchange' if the asset would provide maximum value to market participants principally on a stand-alone basis. If the highest and best use of the asset is in exchange, the fair value of the asset shall be measured using an *in-exchange valuation premise*. Using an in-exchange valuation premise, the fair value of the asset is the price that would be received in a current transaction to sell the asset to market participants who would use the asset on a stand-alone basis.

23 Because the highest and best use of the asset is determined on the basis of its use by market participants, fair value reflects the assumptions that market participants would use in pricing the asset, whether using an in-use or an in-exchange valuation premise. Both the in-use valuation premise and the in-exchange valuation premise assume that the asset is sold individually, ie not as part of a group of assets or a business. However, the in-use valuation premise assumes that market participants will use the asset in combination with other assets or liabilities, and that those assets and liabilities are available to those market participants.

24 An entity shall use an in-exchange valuation premise when measuring the fair value of a financial asset. The fair value of a financial asset determined using the in-exchange valuation premise reflects any benefits that market participants would derive from holding that asset in a diversified portfolio. As a result, the in-use valuation premise is not relevant for financial assets.

Application to liabilities: general principles

25 A fair value measurement assumes that the liability is transferred to a market participant at the measurement date (the liability continues and the market participant transferee would be required to fulfil it; it is not settled with the counterparty or otherwise extinguished).

26 In many cases, there will not be an observable market price for the transfer of a liability. In such cases, an entity shall measure the fair value of a liability using the same methodology that the counterparty would use to measure the fair value of the corresponding asset.

* The fair value of an asset in use is determined on the basis of the use of the asset together with other assets and liabilities as a group (consistently with its highest and best use from the perspective of market participants), even if the asset is aggregated (or disaggregated) at a different level when applying other IFRSs.

FAIR VALUE MEASUREMENT

- 27 If there is an active market for transactions between parties who hold debt securities as an asset, the observed price in that market also represents the fair value of the issuer's liability. An entity shall adjust the observed price for the asset for features that are present in the asset but not present in the liability, or vice versa. For example, in some cases the observed price for an asset reflects a combined price for a package comprising both the amounts due from the issuer and a third-party credit enhancement. In such cases, the objective is to estimate the fair value of the issuer's liability, not the price of the combined package. Thus, the entity would adjust the observed price for the asset to exclude the effect of the third-party credit enhancement, a feature that is not present in the liability.
- 28 If there is no corresponding asset for a liability (eg for a decommissioning liability assumed in a business combination), an entity shall estimate the price that market participants would demand to assume the liability using present value techniques (see Appendix C) or other valuation techniques (see paragraphs 38–40). When using a present value technique, an entity must, among other things, estimate the future cash outflows that market participants would incur in fulfilling the obligation. An entity may estimate those future cash outflows by:
- (a) estimating the cash flows the entity would incur in fulfilling the obligation;
 - (b) excluding cash flows, if any, that other market participants would not incur; and
 - (c) including cash flows, if any, that other market participants would incur but the entity would not incur.

Although the technique is based, in part, on a settlement notion (ie cash flows incurred to fulfil the obligation), it produces the same price that would be paid to transfer a liability at the measurement date, provided that technique is applied in a manner consistent with Appendix C. This is because a market participant transferee would assume the same obligation to fulfil the liability. An entity need not undertake exhaustive efforts to determine the cash flows in (b) and (c) above. However, an entity shall not ignore information about market participant assumptions that is reasonably available.

Application to liabilities: non-performance risk

- 29 The fair value of a liability reflects the effect of *non-performance risk*, which is the risk that an entity will not fulfil an obligation. Non-performance risk is assumed to be the same before and after the transfer of the liability. This is because market participants would not enter into a transaction that changes the non-performance risk associated with the liability without reflecting that change in the price. For example, a creditor would not generally permit a debtor to transfer its obligation to another party of lower credit standing, nor would a transferee of higher credit standing be willing to assume the obligation using the same terms negotiated by the transferor (debtor) if those terms reflect the transferor's lower credit standing.
- 30 Non-performance risk includes, but may not be limited to, an entity's own credit risk. When measuring the fair value of a liability, an entity shall consider the effect of its credit risk (credit standing) and any other risk factors that might influence the likelihood that the obligation will not be fulfilled. That effect may differ depending on the liability, eg whether the liability is an obligation to deliver cash (a financial liability) or an obligation to deliver goods or services (a non-financial liability), and the terms of credit enhancements related to the liability, if any.

Application to liabilities: restrictions

- 31 A restriction on an entity's ability to transfer a liability to another party does not affect the fair value of the liability. This is because the fair value of a liability is a function of the requirement to fulfil the obligation. A market participant transferee would be required to fulfil the obligation and would take that into account when determining the price it would demand to assume the liability from the entity.*

Application to equity instruments

- 32 As with assets and liabilities, the objective of a fair value measurement of an equity instrument is to estimate an exit price at the measurement date.

* Because the transfer is hypothetical, it is necessary to consider the characteristics of market participants who would enter into a transaction for the liability.

- 33 However, although the objective is the same, the issuer of an equity instrument can exit from that instrument only if the instrument ceases to exist or if the entity repurchases the instrument from the holder. For this reason, an entity shall measure the fair value of its equity instrument from the perspective of a market participant who holds the instrument as an asset.

Fair value at initial recognition

- 34 When an asset is acquired or a liability is assumed in an exchange transaction for that asset or liability, the transaction price is the price paid to acquire the asset or received to assume the liability (often referred to as an entry price). In contrast, the fair value of the asset or liability represents the price that would be received to sell the asset or paid to transfer the liability (an exit price). Entities do not necessarily sell assets at the prices paid to acquire them. Similarly, entities do not necessarily transfer liabilities at the prices received to assume them. In some cases, eg in a business combination, there is not a transaction price for each individual asset or liability. Likewise, sometimes there is not an exchange transaction for the asset or liability, eg when biological assets regenerate.
- 35 Although conceptually entry prices and exit prices are different, in many cases an entry price of an asset or liability will equal the exit price (eg when on the transaction date the transaction to buy an asset would take place in the market in which the asset would be sold). In such cases, the fair value of an asset or liability at initial recognition equals the entry (transaction) price.
- 36 In determining whether fair value at initial recognition equals the transaction price, an entity shall consider factors specific to the transaction and the asset or liability. For example, the transaction price is the best evidence of the fair value of an asset or liability at initial recognition unless:
- (a) the transaction is between related parties.
 - (b) the transaction takes place under duress or the seller is forced to accept the price in the transaction. For example, that might be the case if the seller is experiencing financial difficulty.
 - (c) the unit of account represented by the transaction price is different from the unit of account for the asset or liability measured at fair value. For example, that might be the case if the asset or liability measured at fair value is only one of the elements in the transaction, the transaction includes unstated rights and privileges

that are separately measured or the transaction price includes transaction costs.

- (d) the market in which the transaction takes place is different from the market in which the entity would sell the asset or transfer the liability, ie the most advantageous market. For example, those markets might be different if the entity is a securities dealer that transacts in different markets with retail customers (retail market) and with other securities dealers (inter-dealer market).
- 37 If an IFRS requires or permits an entity to measure an asset or liability initially at fair value and the transaction price differs from fair value, the entity recognises the resulting gain or loss in profit or loss unless the IFRS requires otherwise.

Valuation techniques

- 38 The objective of using a valuation technique is to estimate the price at which an orderly transaction would take place between market participants at the measurement date. Valuation techniques consistent with the market approach, income approach or cost approach shall be used to measure fair value. The main aspects of those approaches are summarised below:
- (a) The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities (including a business). For example, valuation techniques consistent with the market approach often use market multiples derived from a set of comparables. Multiples might be in ranges with a different multiple for each comparable. The selection of the appropriate multiple within the range requires judgement, considering factors (qualitative and quantitative) specific to the measurement. Valuation techniques consistent with the market approach include matrix pricing. Matrix pricing is a mathematical technique used principally to value debt securities without relying exclusively on quoted prices for the specific securities, but relying on the securities' relationship to other benchmark quoted securities.
 - (b) The income approach uses valuation techniques to convert future amounts (eg cash flows or income and expenses) to a single present (discounted) amount. The fair value measurement is determined on the basis of the value indicated by current market expectations about those future amounts. Those valuation techniques include present value techniques (see Appendix C); option pricing models,

FAIR VALUE MEASUREMENT

such as the Black-Scholes-Merton formula (a closed form model) and a binomial model (a lattice model), which incorporate present value techniques and reflect both the time value and intrinsic value of an option; and the multi-period excess earnings method, which is used to measure the fair value of some intangible assets.

- (c) The cost approach reflects the amount that would currently be required to replace the service capacity of an asset (often referred to as current replacement cost). From the perspective of a market participant (seller), the price that would be received for the asset is based on the cost to a market participant (buyer) to acquire or construct a substitute asset of comparable utility, adjusted for obsolescence. Obsolescence encompasses physical deterioration, functional (technological) obsolescence and economic (external) obsolescence, and is broader than depreciation for financial reporting purposes (an allocation of historical cost) or tax purposes (based on specified service lives). The current replacement cost approach is generally appropriate for measuring the fair value of tangible assets using an in-use valuation premise because a market participant would not pay more for an asset than the amount for which it could replace the service capacity of that asset.

39 An entity shall use valuation techniques that are 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. Periodically, an entity shall calibrate the valuation technique(s) used to prices from observable current market transactions in the same asset or liability (at initial recognition, this might be the transaction price). In some cases, a single valuation technique will be appropriate (eg when valuing an asset or a liability using quoted prices in an active market for identical assets or liabilities). In other cases, multiple valuation techniques will be appropriate (eg as might be the case when valuing a cash-generating unit). If multiple valuation techniques are used to measure fair value, the results (respective indications of fair value) shall be evaluated and weighted, as appropriate, considering the reasonableness of the range of values indicated by those results. A fair value measurement is the point within that range that is most representative of fair value in the circumstances.

40 Valuation techniques used to measure fair value shall be consistently applied. However, a change in a valuation technique or its application (eg a change in its weighting when multiple valuation techniques are used) is appropriate if the change results in a measurement that is equally or more representative of fair value in the circumstances. That

might be the case if, for example, new markets develop, new information becomes available, information previously used is no longer available or valuation techniques improve. Revisions resulting from a change in the valuation technique or its application shall be accounted for as a change in accounting estimate in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Inputs to valuation techniques

- 41 In this [draft] IFRS, 'inputs' refer broadly to the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk, eg the risk inherent in a particular valuation technique used to measure fair value (such as a pricing model) or the risk inherent in the inputs to the valuation technique. Inputs may be observable or unobservable:
- (a) *Observable inputs* are inputs that are developed on the basis of available market data and reflect the assumptions that market participants would use when pricing the asset or liability.
 - (b) *Unobservable inputs* are inputs for which market data are not available and that are developed on the basis of the best information available about the assumptions that market participants would use when pricing the asset or liability.
- 42 Valuation techniques used to measure fair value shall maximise the use of relevant observable inputs and minimise the use of unobservable inputs. In some cases an entity may determine that observable inputs require significant adjustment based on unobservable data and thus the fair value measurement would be categorised in a lower level of the fair value hierarchy. For example, the entity may determine that an income approach valuation technique that maximises the use of relevant observable inputs and minimises the use of unobservable inputs is equally representative of fair value as (or more representative of fair value than) a market approach valuation technique that would require significant adjustments using unobservable inputs.

Fair value hierarchy

- 43 To increase consistency and comparability in fair value measurements and the related disclosures, this [draft] IFRS establishes a fair value hierarchy that prioritises into three levels (see paragraphs 45–54) the inputs to valuation techniques used to measure fair value. The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in

FAIR VALUE MEASUREMENT

active markets for identical assets or liabilities (Level 1 inputs) and the lowest priority to unobservable inputs (Level 3 inputs). In some cases, the inputs used to measure the fair value of an asset or a liability might be categorised in different levels of the fair value hierarchy. The fair value measurement is categorised in its entirety in the same level of the fair value hierarchy as the lowest level input that is significant to the entire measurement. Assessing the significance of a particular input to the entire measurement requires judgement, considering factors specific to the asset or liability.

- 44 The availability of relevant inputs and their relative subjectivity might affect the selection of appropriate valuation techniques. However, the fair value hierarchy prioritises the inputs to valuation techniques, not the valuation techniques used to measure fair value. For example, a fair value measurement developed using a present value technique might be categorised within Level 2 or Level 3, depending on the inputs that are significant to the entire measurement and the level in the fair value hierarchy within which those inputs are categorised. If observable inputs require significant adjustment using unobservable inputs, the resulting measurement is a Level 3 measurement.

Level 1 inputs

- 45 *Level 1 inputs* are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.
- 46 Although an entity must have access to the market at the measurement date, it does not need to be able to sell the particular asset or transfer the particular liability on that date, eg if there is a restriction on the sale of the asset. However, the entity must be able to access the market when the restriction ceases to exist.
- 47 If a market participant would consider a restriction on the sale of an asset when determining the price for the asset, an entity shall adjust the quoted price to reflect the effect of that restriction. Such an adjustment is not a Level 1 input and, if the adjustment is significant, the measurement would be categorised in a lower level of the fair value hierarchy.
- 48 An active market for the asset or liability is 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. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available, except as discussed in paragraphs 49 and 50.

- 49 If an entity holds a large number of similar assets or liabilities (eg debt securities) that are measured at fair value, a quoted price in an active market might be available but not readily accessible for each of those assets or liabilities individually. In that case, as a practical expedient, an entity may measure fair value using an alternative pricing method that does not rely exclusively on quoted prices (eg matrix pricing). However, the use of an alternative pricing method results in a lower level fair value measurement.
- 50 In some situations, a quoted price in an active market might not represent fair value at the measurement date. That might be the case if, for example, significant events (principal-to-principal transactions, brokered trades or announcements) take place after the close of a market but before the measurement date. An entity shall establish and consistently apply a policy for identifying those events that might affect fair value measurements. However, if the quoted price is adjusted for new information, the adjustment results in a lower level fair value measurement.

Level 2 inputs

- 51 *Level 2 inputs* are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (ie as prices) or indirectly (ie derived from prices). If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. Level 2 inputs include the following:
- (a) quoted prices for similar assets or liabilities in active markets
 - (b) quoted prices for identical or similar assets or liabilities in markets that are not active (paragraph B5 provides examples of factors that may indicate that a market is not active)
 - (c) inputs other than quoted prices that are observable for the asset or liability (eg interest rates and yield curves observable at commonly quoted intervals, volatilities, prepayment speeds, loss severities, credit risks and default rates)
 - (d) inputs that are derived principally from or corroborated by observable market data by correlation or other means (market-corroborated inputs).
- 52 Adjustments to Level 2 inputs will vary depending on factors specific to the asset or liability. Those factors include the condition or location of the asset, the extent to which the inputs relate to items that are comparable to the asset or liability, and the volume and level of activity

in the markets within which the inputs are observed. An adjustment that is significant to the entire measurement might result in a Level 3 measurement, depending on where the inputs used to determine the adjustment are categorised in the fair value hierarchy.

Level 3 inputs

- 53 *Level 3 inputs* are inputs for the asset or liability that are not based on observable market data (unobservable inputs). Unobservable inputs shall be 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. However, the fair value measurement objective remains the same, ie an exit price from the perspective of a market participant that holds the asset or owes the liability. Therefore, unobservable inputs shall reflect the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk.
- 54 Unobservable inputs shall be developed using the best information available in the circumstances, which might include an entity's own data. In developing unobservable inputs, an entity may begin with its own data, which shall be adjusted if reasonably available information indicates that (a) other market participants would use different data or (b) there is something particular to the entity that is not available to other market participants (eg an entity-specific synergy), and the entity is able to quantify these adjustments. An entity need not undertake exhaustive efforts to obtain information about market participant assumptions. However, an entity shall not ignore information about market participant assumptions that is reasonably available.

Inputs based on bid and ask prices

- 55 If an input used to measure fair value is based on bid and ask prices (eg in a dealer market), the price within the bid-ask spread that is most representative of fair value in the circumstances shall be used to measure fair value, regardless of where the input is categorised in the fair value hierarchy (Level 1, 2 or 3). This [draft] IFRS does not preclude the use of mid-market pricing or other pricing conventions used by market participants as a practical expedient for fair value measurements within a bid-ask spread. If a bid-ask spread for an asset or a liability is not observable directly or indirectly (eg a bid-ask spread for a similar asset or liability), an entity need not undertake exhaustive efforts to estimate a bid-ask spread.

Disclosures

- 56 **For assets and liabilities measured at fair value, an entity shall disclose information that enables users of its financial statements to assess the methods and inputs used to develop those measurements and, 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.**
- 57 To meet the objectives in paragraph 56, an entity shall (except as otherwise specified below) determine how much detail to disclose, how much emphasis to place on different aspects of the disclosure requirements, how much aggregation or disaggregation to undertake, and whether users need any additional information to evaluate the quantitative information disclosed. At a minimum, an entity shall disclose the following information for each class of assets and liabilities:
- (a) the fair value measurement at the end of the reporting period.
 - (b) the level of the fair value hierarchy within which the fair value measurements are categorised in their entirety (Level 1, 2 or 3).
 - (c) for assets and liabilities held at the reporting date, any significant transfers between Level 1 and Level 2 of the fair value hierarchy and the reasons for those transfers. Transfers into each level shall be disclosed and discussed separately from transfers out of each level. For this purpose, significance shall be judged with respect to profit or loss, and total assets or total liabilities.
 - (d) the methods and the inputs used in the fair value measurement and the information used to develop those inputs. If there has been a change in valuation technique (eg changing from a market approach to an income approach), the entity shall disclose that change, the reasons for making it, and its effect on the fair value measurement.
 - (e) for fair value measurements categorised within Level 3 of the fair value hierarchy, a reconciliation from the opening balances to the closing balances, disclosing separately changes during the period attributable to the following:
 - (i) total gains or losses for the period recognised in profit or loss, and a description of where they are presented in the statement of comprehensive income or the separate income statement (if presented).

FAIR VALUE MEASUREMENT

- (ii) total gains or losses for the period recognised in other comprehensive income.
 - (iii) purchases, sales, issues and settlements (each of those types of change disclosed separately).
 - (iv) transfers into or out of Level 3 (eg transfers attributable to changes in the observability of market data) and the reasons for those transfers. For significant transfers, transfers into Level 3 shall be disclosed and discussed separately from transfers out of Level 3. For this purpose, significance shall be judged with respect to profit or loss, and total assets or total liabilities.
- (f) the amount of the total gains or losses for the period in (e)(i) above included in profit or loss that are attributable to gains or losses relating to those assets and liabilities held at the reporting date, and a description of where those gains or losses are presented in the statement of comprehensive income or the separate income statement (if presented).
- (g) for fair value measurements categorised within Level 3 of the fair value hierarchy, if changing one or more of the inputs to reasonably possible alternative assumptions would change fair value significantly, an entity shall state that fact and disclose the effect of those changes. An entity shall disclose how it calculated those changes. For this purpose, significance shall be judged with respect to profit or loss, and total assets or total liabilities.
- 58 For each class of assets and liabilities not measured at fair value in the statement of financial position, but for which the fair value is disclosed, an entity shall disclose the fair value by the level of the fair value hierarchy.
- 59 For each class of liability measured at fair value after initial recognition, an entity shall disclose:
- (a) the amount of change, during the period and cumulatively, in the fair value of the liability that is attributable to changes in the non-performance risk of that liability, and the reasons for that change.
 - (b) how the entity estimated the amount in paragraph 59(a) attributable to changes in the non-performance risk of the liability.
 - (c) the difference between the liability's carrying amount and the amount of economic benefits the entity is required to sacrifice to

satisfy the obligation (eg for a contractual liability, this would be the amount the entity is contractually required to pay to the holder of the obligation).

- 60 If an asset is used together with other assets and its highest and best use differs from its current use (see paragraphs 20 and 21), an entity shall disclose, by class of asset:
- (a) the value of the assets assuming their current use (ie the amount that would be their fair value if the current use were the highest and best use).
 - (b) the amount by which the fair value of the assets differs from their value in their current use (ie the incremental value of the asset group).
 - (c) the reasons the assets are being used in a manner that differs from their highest and best use.
- 61 An entity shall present the quantitative disclosures required by this [draft] IFRS in a tabular format unless another format is more appropriate.

Effective date and transition

- 62 A entity shall apply this [draft] IFRS for annual periods beginning on or after [date to be inserted after exposure]. Earlier application is permitted. If an entity applies the [draft] IFRS for an earlier period, it shall disclose that fact.
- 63 This [draft] IFRS shall be applied prospectively as of the beginning of the annual period in which it is initially applied.
- 64 The disclosure requirements of this [draft] IFRS need not be applied in comparative information provided for periods before initial application of the [draft] IFRS.

Appendix A Defined terms

This appendix is an integral part of the [draft] IFRS.

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.
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.
highest and best use	The use of an asset by market participants that would maximise the value of the asset or the group of assets and liabilities (eg a business) within which the asset would be used.
International Financial Reporting Standards (IFRSs)	Standards and Interpretations adopted by the International Accounting Standards Board (IASB). They comprise: <ul style="list-style-type: none"> (a) International Financial Reporting Standards; (b) International Accounting Standards; and (c) Interpretations developed by the International Financial Reporting Interpretations Committee (IFRIC) or the former Standing Interpretations Committee (SIC).
in-exchange valuation premise	A basis used to determine the fair value of an asset that provides maximum value to market participants principally on a stand-alone basis.
in-use valuation premise	A basis used to determine the fair value of an asset that provides maximum value to market participants principally through its use in combination with other assets and liabilities as a group (as installed or otherwise configured for use).
Level 1 inputs	Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 inputs	Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (ie as prices) or indirectly (ie derived from prices).
Level 3 inputs	Inputs for the asset or liability that are not based on observable market data (unobservable inputs).
market participants	Buyers and sellers in the most advantageous market for the asset or liability that are: <ul style="list-style-type: none">(a) independent of each other, ie they are not related parties as defined in IAS 24 <i>Related Party Disclosures</i>;(b) knowledgeable, ie they are sufficiently informed to make an investment decision and are presumed to be as knowledgeable as the reporting entity about the asset or liability;(c) able to enter into a transaction for the asset or liability; and(d) willing to enter into a transaction for the asset or liability, ie they are motivated but not forced or otherwise compelled to do so.
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 considering transaction costs and transport costs.
non-performance risk	The risk that an entity will not fulfil an obligation.
observable inputs	Inputs that are developed on the basis of available market data and reflect the assumptions that market participants would use when pricing the asset or liability.
orderly transaction	A transaction that assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (eg a forced liquidation or distress sale).

FAIR VALUE MEASUREMENT

principal market	The market with the greatest volume and level of activity for the asset or liability.
transport costs	The costs that would be incurred to transport an asset to or from its most advantageous market.
unit of account	The level at which an asset or liability is aggregated or disaggregated in IFRSs.
unobservable inputs	Inputs for which market data are not available and that are developed on the basis of the best information available about the assumptions that market participants would use when pricing the asset or liability.

Appendix B

Application guidance

This appendix is an integral part of the [draft] IFRS.

The fair value measurement approach

- B1 The objective of a fair value measurement is to determine the price that would be received to sell an asset or paid to transfer a liability at the measurement date. A fair value measurement requires an entity to determine:
- (a) the particular asset or liability that is the subject of the measurement (consistently with its unit of account).
 - (b) for an asset, the valuation premise that is appropriate for the measurement (consistently with its highest and best use).
 - (c) the most advantageous market for the asset or liability.
 - (d) 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 in pricing the asset or liability and the level of the fair value hierarchy within which the inputs are categorised.

In-use valuation premise

- B2 When measuring the fair value of a non-financial asset in use, the effect of using an in-use valuation premise depends on the circumstances. For example:
- (a) the fair value of the asset might be the same whether using an in-use or an in-exchange valuation premise. That might be the case if the asset is a business that market participants would continue to operate. In that case, the transaction would involve the business in its entirety. The use of the assets as a group in an ongoing business would generate synergies that would be available to market participants (market participant synergies).
 - (b) the in-use valuation premise might be incorporated in the fair value of the asset through adjustments to the value of the asset 'in exchange'. That might be the case if the asset is a machine and the fair value measurement is determined using an observed price for a similar machine (not installed or otherwise configured for

FAIR VALUE MEASUREMENT

use), adjusted for transport and installation costs so that the fair value measurement reflects the current condition and location of the machine (installed and configured for use).

- (c) the in-use valuation premise might be incorporated into the fair value of the asset through the market participant assumptions used to measure the fair value of the asset. For example, if the asset is work-in-progress inventory that is unique and market participants would convert the inventory into finished goods, the fair value of the inventory would assume that market participants have or would acquire any specialised machinery necessary to convert the inventory into finished goods.
- (d) the in-use valuation premise might be incorporated into the valuation technique used to measure the fair value of the asset. That might be the case when using the multi-period excess earnings method to measure the fair value of some intangible assets because that valuation technique specifically considers the contribution of any complementary assets in the group in which such an intangible asset would be used.
- (e) in more limited situations, when an entity uses an asset within a group of assets, the entity might measure the asset at an amount that approximates its fair value in use when allocating the fair value of the asset group to the individual assets of the group. That might be the case if the valuation involves real property and the fair value of improved property (an asset group) is allocated to its component assets (such as land and improvements).

Fair value hierarchy

Level 2 input

- B3 Examples of Level 2 inputs for particular assets and liabilities follow.
- (a) *Receive-fixed, pay-variable interest rate swap based on the LIBOR swap rate.* A Level 2 input would include the LIBOR swap rate if that rate is observable at commonly quoted intervals for the full term of the swap.
 - (b) *Receive-fixed, pay-variable interest rate swap based on a foreign-denominated yield curve.* A Level 2 input would include the swap rate based on a foreign-denominated yield curve that is observable at commonly quoted intervals for substantially the full term of the swap. That would be the case if the term of the swap is 10 years and that rate is

observable at commonly quoted intervals for 9 years, provided that any reasonable extrapolation of the yield curve for year 10 would not be significant to the fair value measurement of the swap in its entirety.

- (c) *Receive-fixed, pay-variable interest rate swap based on a specific bank's prime rate.* A Level 2 input would include the bank's prime rate derived through extrapolation if the extrapolated values are corroborated by observable market data, for example, by correlation with an interest rate that is observable over substantially the full term of the swap.
- (d) *Three-year option on exchange-traded shares.* A Level 2 input would include the implied volatility for the shares derived through extrapolation to year 3 if (i) prices for one-year and two-year options on the shares are observable and (ii) the extrapolated implied volatility of a three-year option is corroborated by observable market data for substantially the full term of the option. In that case, the implied volatility could be derived by extrapolating from the implied volatility of the one-year and two-year options on the shares and corroborated by the implied volatility for three-year options on comparable entities' shares, provided that correlation with the one-year and two-year implied volatilities is established.
- (e) *Licensing arrangement.* For a licensing arrangement that is acquired in a business combination and was recently negotiated with an unrelated party by the acquired entity (the party to the licensing arrangement), a Level 2 input would include the royalty rate at inception of the arrangement.
- (f) *Finished goods inventory at a retail outlet.* For finished goods inventory that is acquired in a business combination, a Level 2 input would include either a price to customers in a retail market or a wholesale price to retailers in a wholesale market, adjusted for differences between the condition and location of the inventory item and the comparable (similar) inventory items so that the fair value measurement reflects the price that would be received in a transaction to sell the inventory to another retailer that would complete the requisite selling efforts. Conceptually, the fair value measurement will be the same, whether adjustments are made to a retail price (downward) or to a wholesale price (upward). Generally, the price that requires the least amount of subjective adjustments shall be used for the fair value measurement.

FAIR VALUE MEASUREMENT

- (g) *Building held and used.* A Level 2 input would include the price per square metre for the building (a valuation multiple) derived from observable market data, eg multiples derived from prices in observed transactions involving comparable (similar) buildings in similar locations.
- (h) *Cash-generating unit.* A Level 2 input would include a valuation multiple (eg a multiple of earnings or revenue or a similar performance measure) derived from observable market data, eg multiples derived from prices in observed transactions involving comparable (similar) businesses, considering operational, market, financial and non-financial factors.

Level 3 inputs

B4 Examples of Level 3 inputs for particular assets and liabilities follow.

- (a) *Long-dated currency swap.* A Level 3 input would include interest rates in a specified currency that are not observable and cannot be corroborated by observable market data at commonly quoted intervals or otherwise for substantially the full term of the currency swap. The interest rates in a currency swap are the swap rates calculated from the respective countries' yield curves.
- (b) *Three-year option on exchange-traded shares.* A Level 3 input would include historical volatility, ie the volatility for the shares derived from the shares' historical prices. Historical volatility typically does not represent current market participant expectations about future volatility, even if it is the only information available to price an option.
- (c) *Interest rate swap.* A Level 3 input would include an adjustment to a mid-market consensus (non-binding) price for the swap developed using data that are not directly observable and cannot otherwise be corroborated by observable market data.
- (d) *Decommissioning liability assumed in a business combination.* A Level 3 input would include a current estimate of the cash outflows to be paid to fulfil the obligation developed using the entity's own data if there is no reasonably available information that indicates that market participants would use different assumptions. That Level 3 input would be used in a present value technique together with other inputs, eg (i) a current risk-free discount rate that adjusts the estimated future cash outflows for the time value of money or a credit-adjusted risk-free rate if the effect of the entity's credit

standing on the fair value of the liability is reflected in the discount rate rather than in the estimate of future cash outflows and (ii) an estimate of the premium, if any, that market participants would require for bearing risk arising from the obligation (the risk premium) and to generate the profit they would require for undertaking to fulfil the obligation. The risk premium takes into account the uncertainty inherent in the estimate of the future cash outflows (ie the price market participants would require for bearing the risk of possible variations in the amount or timing of the cash flows).

- (e) *Cash-generating unit.* A Level 3 input would include a financial forecast (eg of cash flows or profit or loss) developed using the entity's own data if there is no reasonably available information that indicates that market participants would use different assumptions.

Not active markets and transactions that are not orderly

B5 The presence of the following factors may indicate that a market is not active:

- (a) there has been a significant decrease in the volume and level of activity for the asset or liability when compared with normal market activity for the asset or liability (or similar assets or liabilities).
- (b) there are few recent transactions.
- (c) price quotations are not based on current information.
- (d) price quotations vary substantially over time or among market-makers (eg some brokered markets).
- (e) indices that previously were highly correlated with the fair values of the asset or liability are demonstrably uncorrelated with recent indications of fair value for that asset or liability.
- (f) there is a significant increase in implied liquidity risk premiums, yields or performance indicators (such as delinquency rates or loss severities) for observed transactions or quoted prices when compared with the entity's estimate of expected cash flows, considering all available market data about credit and other non-performance risk for the asset or liability.
- (g) there is a wide bid-ask spread or significant increase in the bid-ask spread.

FAIR VALUE MEASUREMENT

- (h) there is a significant decline or absence of a market for new issues (ie primary market) for the asset or liability (or similar assets or liabilities).
- (i) little information is released publicly (eg a principal-to-principal market).

An entity evaluates the significance and relevance of the factors (together with other pertinent factors) to determine whether, on the basis of the evidence available, a market is not active.

- B6 If an entity concludes that a market is not active, transactions or quoted prices in that market may not be determinative of fair value (eg there may be transactions that are not orderly). Further analysis of the transactions or quoted prices is needed, and a significant adjustment to the transactions or quoted prices may be necessary to measure fair value. Significant adjustments also may be necessary in other circumstances (eg when a price for a similar asset requires significant adjustment to make it more comparable to the asset being measured or when the price is stale).
- B7 This [draft] IFRS does not prescribe a methodology for making significant adjustments to transactions or quoted prices. Paragraphs 38–40 discuss the use of valuation techniques when measuring fair value. Regardless of the valuation technique used, an entity includes appropriate risk adjustments, including a risk premium reflecting the amount market participants would demand because of the risk (uncertainty) inherent in the cash flows of an asset or liability (see paragraph C5). Otherwise, the measurement would not faithfully represent fair value. In some cases, determining the appropriate risk premium might be difficult. However, the degree of difficulty alone is not a sufficient basis on which to exclude a risk adjustment. The risk premium should be reflective of an orderly transaction between market participants at the measurement date under current market conditions.
- B8 If a market is not active, a change in valuation technique or the use of multiple valuation techniques may be appropriate (eg the use of a market approach and a present value technique). When weighting indications of fair value resulting from the use of multiple valuation techniques, an entity considers the reasonableness of the range of fair value estimates. The objective is to determine the point within the range that is most representative of fair value under current market conditions. A wide range of fair value estimates may be an indication that further analysis is needed.

- B9 Even when a market is not active, the objective of a fair value measurement remains the same. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (ie not a forced liquidation or distress sale) between market participants at the measurement date under current market conditions.
- B10 Measuring fair value in a market that is not active depends on the facts and circumstances and requires the use of significant judgement. An entity's intention to continue to hold the asset or liability is not relevant when measuring fair value because fair value is a market-based measurement, not an entity-specific measurement.
- B11 Even if a market is not active, it is not appropriate to conclude that all transactions in that market are not orderly (ie are forced or distress sales). Circumstances that may indicate that a transaction is not orderly include, but are not limited to the following:
- (a) there was not adequate exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities under current market conditions.
 - (b) there was a usual and customary marketing period, but the seller marketed the asset or liability to a single market participant.
 - (c) the seller is in or near bankruptcy or receivership (ie distressed) or the seller was required to sell to meet regulatory or legal requirements (ie forced).
 - (d) the transaction price is an outlier when compared with other recent transactions for the same or similar asset or liability.
- An entity evaluates the circumstances to determine whether, on the weight of the evidence available, the transaction is orderly.
- B12 If the evidence indicates that a transaction is not orderly, an entity places little, if any, weight (compared with other indications of fair value) on that transaction price when measuring fair value or estimating market risk premiums.
- B13 If the evidence indicates that a transaction is orderly, an entity considers that transaction price when measuring fair value or estimating market risk premiums. The amount of weight placed on that transaction price when compared with other indications of fair value will depend on the facts and circumstances such as the size of the transaction, the comparability of the transaction to the asset or liability being measured and the proximity of the transaction to the measurement date.

FAIR VALUE MEASUREMENT

- B14 If an entity does not have sufficient information to conclude whether a transaction is orderly, it considers the transaction price when measuring fair value or estimating market risk premiums. However, that transaction price may not be determinative of fair value (ie the transaction price is not necessarily the sole or primary basis for measuring fair value or estimating market risk premiums). When an entity does not have sufficient information to conclude whether particular transactions are orderly, the entity places less weight on those transactions.
- B15 An entity need not undertake exhaustive efforts to determine whether a transaction is orderly but it shall not ignore information that is reasonably available. When an entity is a party to a transaction it is presumed to have sufficient information to conclude whether the transaction is orderly.

Quoted prices provided by third parties

- B16 When an entity is measuring fair value, this [draft] IFRS does not preclude the use of quoted prices provided by third parties, such as pricing services or brokers, when the entity has determined that the quoted prices provided by those parties are determined in accordance with this [draft] IFRS.
- B17 If a market is not active, an entity must evaluate whether the quoted prices are based on current information that reflects orderly transactions or a valuation technique that reflects market participant assumptions (including assumptions about risks). In weighting a quoted price as an input to a fair value measurement, an entity places less weight (when compared with other indications of fair value that are based on transactions) on quotes that do not reflect the result of transactions.
- B18 Furthermore, the nature of a quote (eg whether the quote is an indicative price or a binding offer) should be considered when weighting the available evidence, with more weight given to quotes based on binding offers.

Appendix C

Present value techniques

This appendix is an integral part of the [draft] IFRS.

Introduction

- C1 This appendix provides information about using present value techniques to measure fair value. This guidance focuses on a traditional or discount rate adjustment technique and an expected cash flow (expected present value) technique. This guidance neither prescribes the use of one specific present value technique nor limits the use of present value techniques to measure fair value to the techniques discussed. The present value technique used to measure fair value will depend on facts and circumstances specific to the asset or liability being measured (eg whether prices for comparable assets or liabilities can be observed in the market) and the availability of sufficient data.

The components of a present value measurement

- C2 Present value (an application of the income approach) is a tool used to link uncertain future amounts (cash flows or values) to a present amount using a discount rate that is consistent with value maximising behaviour. A fair value measurement of an asset or liability, using present value, shall capture the following elements from the perspective of market participants at the measurement date:
- (a) an estimate of future cash flows for the asset or liability being measured
 - (b) expectations about possible variations in the amount and/or timing of the cash flows representing the uncertainty inherent in the cash flows
 - (c) the time value of money, represented by the rate on risk-free monetary assets that have maturity dates or durations that coincide with the period covered by the cash flows and pose neither uncertainty in timing nor risk of default to the holder (risk-free interest rate)
 - (d) the price for bearing the uncertainty inherent in the cash flows (risk premium)
 - (e) other factors that would be considered by market participants in the circumstances.

General principles

- C3 Present value techniques differ in how they capture those elements. However, the following general principles govern the application of any present value technique used to estimate fair value:
- (a) Cash flows and discount rates shall reflect assumptions that market participants would use when pricing the asset or liability.
 - (b) Cash flows and discount rates shall consider only the features of the asset or liability being measured.
 - (c) To avoid double-counting or omitting the effects of risk factors, discount rates shall reflect assumptions that are consistent with those inherent in the cash flows.*
 - (d) Assumptions about cash flows and discount rates shall be internally consistent. For example, nominal cash flows (that include the effect of inflation) shall be discounted at a rate that includes the effect of inflation. The nominal risk-free interest rate includes the effect of inflation. Real cash flows (that exclude the effect of inflation) shall be discounted at a rate that excludes the effect of inflation. Similarly, after-tax cash flows shall be discounted using an after-tax discount rate. Pre-tax cash flows shall be discounted at a rate consistent with those cash flows.
 - (e) Discount rates shall be consistent with the underlying economic factors of the currency in which the cash flows are denominated.

Risk and uncertainty

- C4 A fair value measurement, using present value, is made under conditions of uncertainty because the cash flows used are estimates rather than known amounts. In many cases, both the amount and timing of the cash flows will be uncertain. Even contractually fixed amounts, such as the payments on a loan, will be uncertain if there is risk of default.

* For example, a discount rate that reflects expectations about future defaults is appropriate if using contractual cash flows of a loan (discount rate adjustment technique). That same rate would not be used if using expected (probability-weighted) cash flows (expected present value technique) because the expected cash flows already reflect assumptions about future defaults; instead, a discount rate that is commensurate with the risk inherent in the expected cash flows shall be used.

- C5 Risk-averse market participants generally seek compensation for bearing the uncertainty inherent in the cash flows of an asset or liability (risk premium). A fair value measurement shall include a risk premium reflecting the amount market participants would demand because of the risk (uncertainty) in the cash flows. Otherwise, the measurement would not faithfully represent fair value. In some cases, determining the appropriate risk premium might be difficult. However, the degree of difficulty alone is not sufficient reason to exclude a risk adjustment.
- C6 Present value techniques differ in how they adjust for risk and in the type of cash flows they use. For example:
- (a) the discount rate adjustment technique (see paragraphs C7–C11) uses contractual, promised or most likely cash flows and a discount rate that includes an adjustment for both (i) the effect of the difference between those cash flows and the expected cash flows and (ii) the risk premium that market participants require for bearing the risk that the actual cash flows may ultimately differ from the expected cash flows.
 - (b) Method 1 of the expected present value technique (see paragraph C14) uses risk-adjusted expected cash flows and a risk-free rate.
 - (c) Method 2 of the expected present value technique (see paragraph C15) uses expected cash flows and a discount rate adjusted to include the risk premium that market participants require (this rate is different from the rate used in the discount rate adjustment technique).

Discount rate adjustment technique

- C7 The discount rate adjustment technique uses a single set of cash flows from the range of possible estimated amounts, whether contractual or promised (as is the case for a bond) or most likely cash flows. In all cases, those cash flows are conditional upon the occurrence of specified events (eg contractual or promised cash flows for a bond are conditional on the event of no default by the debtor). The discount rate used in the discount rate adjustment technique is derived from observed rates of return for comparable assets or liabilities that are traded in the market. Accordingly, the contractual, promised or most likely cash flows are discounted at an observed or estimated market rate for such conditional cash flows (market rate of return).

FAIR VALUE MEASUREMENT

- C8 The discount rate adjustment technique requires an analysis of market data for comparable assets or liabilities. Comparability is established by considering the nature of the cash flows (eg whether the cash flows are contractual or non-contractual and are likely to respond similarly to changes in economic conditions), as well as other factors (eg credit standing, collateral, duration, restrictive covenants and liquidity). Alternatively, if a single comparable asset or liability does not fairly reflect the risk inherent in the cash flows of the asset or liability being measured, it may be possible to derive a discount rate using data for several comparable assets or liabilities in conjunction with the risk-free yield curve (a 'build-up' approach).
- C9 To illustrate a build-up approach, assume that Asset A is a contractual right to receive CU800* in one year (no timing uncertainty). There is an established market for comparable assets, and information about those assets, including price information, is available. Of those comparable assets:
- (a) Asset B is a contractual right to receive CU1,200 in one year and has a market price of CU1,083. Thus, the implied annual rate of return (one-year market rate of return) is 10.8 per cent $[(CU1,200/CU1,083) - 1]$.
 - (b) Asset C is a contractual right to receive CU700 in two years and has a market price of CU566. Thus, the implied annual rate of return (two-year market rate of return) is 11.2 per cent $[(CU700/CU566)^{0.5} - 1]$.
 - (c) All three assets are comparable as regards risk (dispersion of possible pay-offs and credit).
- C10 On the basis of the timing of the contractual payments to be received for Asset A (one year for Asset B versus two years for Asset C), Asset B is deemed more comparable to Asset A. Using the contractual payment to be received for Asset A (CU800) and the one-year market rate derived from Asset B (10.8 per cent), the fair value of Asset A is CU722 (CU800/1.108). Alternatively, in the absence of available market information for Asset B, the one-year market rate could be derived from Asset C using the build-up approach. In that case, the two-year market rate indicated by Asset C (11.2 per cent) would be adjusted to a one-year market rate using the term structure of the risk-free yield curve. Additional information and analysis

* In this [draft] IFRS monetary amounts are denominated in 'currency units (CU)'

might also be required to determine whether the risk premium for one-year and two-year assets is the same. If it is determined that the risk premium for one-year and two-year assets is not the same, the two-year market rate of return would be further adjusted for that effect.

- C11 In applying the discount rate adjustment technique to fixed claims, the adjustment for risk inherent in the cash flows of the asset or liability being measured is included in the discount rate. In some applications of the discount rate adjustment technique to cash flows that are not fixed claims, an adjustment to the cash flows also may be necessary to achieve comparability with the observed asset or liability from which the discount rate is derived.

Expected present value technique

- C12 The expected present value technique uses as a starting point a set of cash flows that, in theory, represents the probability-weighted average of all possible cash flows (expected cash flows). The resulting estimate is identical to expected value, which, in statistical terms, is the weighted average of a random variable's possible values where the respective probabilities are used as weights. Because all possible cash flows are probability-weighted, the resulting expected cash flow is not conditional upon the occurrence of any specified event (unlike the cash flows used in the discount rate adjustment technique).
- C13 In making an investment decision, risk-averse market participants would consider the risk that the actual cash flows may ultimately differ from the expected cash flows. Portfolio theory distinguishes between two types of risk. The first is risk specific to a particular asset or liability, also referred to as unsystematic (diversifiable) risk. The second is general market risk, also referred to as systematic (non-diversifiable) risk. The systematic or non-diversifiable risk of an asset (or liability) refers to the amount by which the asset (or liability) increases the variance of a diversified portfolio when it is added to that portfolio. Portfolio theory holds that in a market in equilibrium, market participants will be compensated only for bearing the systematic or non-diversifiable risk inherent in the cash flows. (In markets that are inefficient or out of equilibrium, other forms of return or compensation might be available.)
- C14 Method 1 of the expected present value technique adjusts the expected cash flows for the systematic (market) risk by subtracting a cash risk premium (risk-adjusted expected cash flows). These risk-adjusted expected cash flows represent a certainty-equivalent cash flow, which is discounted at a risk-free interest rate. A certainty-equivalent cash flow

FAIR VALUE MEASUREMENT

refers to an expected cash flow (as defined), adjusted for risk so that a market participant is indifferent to trading a certain cash flow for an expected cash flow. For example, if a market participant were willing to trade an expected cash flow of CU1,200 for a certain cash flow of CU1,000, the CU1,000 is the certainty equivalent of the CU1,200 (the CU200 would represent the cash risk premium). In that case, the market participant would be indifferent as to the asset held.

- C15 In contrast, Method 2 of the expected present value technique adjusts for systematic (market) risk by adding a risk premium to the risk-free interest rate. Accordingly, the expected cash flows are discounted at a rate that corresponds to an expected rate associated with probability-weighted cash flows (expected rate of return). Models used for pricing risky assets, such as the Capital Asset Pricing Model, can be used to estimate the expected rate of return. Because the discount rate used in the discount rate adjustment technique is a rate of return relating to conditional cash flows, it is likely to be higher than the discount rate used in Method 2 of the expected present value technique, which is an expected rate of return relating to expected or probability-weighted cash flows.
- C16 To illustrate Methods 1 and 2, assume that an asset has expected cash flows of CU780 in one year based on the possible cash flows and probabilities shown below. The applicable risk-free interest rate for cash flows with a one-year horizon is 5 per cent, and the systematic risk premium for an asset with the same risk profile is 3 per cent.

Possible cash flows	Probability	Probability-weighted cash flows
CU500	15%	CU75
CU800	60%	CU480
CU900	25%	CU225
Expected cash flows		CU780

- C17 In this simple illustration, the expected cash flows (CU780) represent the probability-weighted average of the three possible outcomes. In more realistic situations, there could be many possible outcomes. However, it is not always necessary to consider distributions of literally all possible cash flows using complex models and techniques to apply the expected present value technique. Rather, it should be possible to develop a limited number of discrete scenarios and probabilities that capture the array of possible cash flows. For example, an entity might use realised cash flows for some relevant past period, adjusted for changes in

circumstances occurring subsequently (eg changes in external factors, including economic or market conditions, industry trends and competition as well as changes in internal factors affecting the entity more specifically), considering the assumptions of market participants.

- C18 In theory, the present value (fair value) of the asset's cash flows is the same (CU722) whether determined under Method 1 or Method 2, as indicated below. Specifically:
- (a) under Method 1, the expected cash flows are adjusted for systematic (market) risk. In the absence of market data directly indicating the amount of the risk adjustment, such adjustment could be derived from an asset pricing model using the concept of certainty equivalents. For example, the risk adjustment (cash risk premium of CU22) could be determined using the systematic risk premium of 3 per cent ($CU780 - [CU780 \times (1.05/1.08)]$), which results in risk-adjusted expected cash flows of CU758 (CU780 - CU22). The CU758 is the certainty equivalent of CU780 and is discounted at the risk-free interest rate (5 per cent). The present value (fair value) of the asset is CU722 (CU758/1.05).
 - (b) under Method 2, the expected cash flows are not adjusted for systematic (market) risk. Rather, the adjustment for that risk is included in the discount rate. Thus, the expected cash flows are discounted at an expected rate of return of 8 per cent (the 5 per cent risk-free interest rate plus the 3 per cent systematic risk premium). The present value (fair value) of the asset is CU722 (CU780/1.08).
- C19 When using an expected present value technique to measure fair value, either Method 1 or Method 2 could be used. The selection of Method 1 or Method 2 will depend on facts and circumstances specific to the asset or liability being measured, the extent to which sufficient data are available and the judgements applied.

Appendix D Amendments to other IFRSs

The amendments in this [draft] appendix shall be applied for annual periods beginning on or after [date to be inserted after the exposure period]. If an entity applies this [draft] IFRS for an earlier period, it shall apply these amendments for that earlier period. Amended paragraphs are shown with new text underlined and deleted text struck through.

Change in definition

- D1 In IFRSs 1 and 3–5 and IASs 2, 16–21, 32 and 39–41 the definition of *fair value* is replaced with:

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. (See [draft] IFRS X *Fair Value Measurement*.)

- D2 In IAS 36 the definition of *fair value less costs to sell* is replaced with:

Fair value less costs to sell is the price that would be received to sell an asset or cash-generating unit in an orderly transaction between market participants at the measurement date, less the costs of disposal.

- D3 In IAS 38 the definition of *fair value of an asset* is replaced with the definition of *fair value* as described above.

IFRS 2 *Share-based Payment*

- D4 In the Introduction and the IFRS all instances of the term *fair value* are replaced with the term *market-based value*.

- D5 The definition of *fair value* is deleted and the following definition is added:

Market-based value is the price that would be received or paid to sell an asset, transfer a liability, or exchange an equity instrument, in an orderly transaction between market participants at the measurement date, not taking into account market participants' assumptions for vesting conditions and reload features.

- D6 As a consequence, in the following paragraphs of other IFRSs *fair value* is replaced with references to *market-based value*:

IFRS 1	Paragraph D2
IAS 33	Paragraph 47A, Example 5A

IFRS 3 *Business Combinations* (as revised in 2008)

- D7 Paragraph 29 is amended as follows:
- 29 The acquirer shall measure the value of a reacquired right recognised as an intangible asset on the basis of the remaining contractual term of the related contract, ~~even if regardless of whether~~ market participants would consider potential ~~contractual~~ renewals of the contract in determining its fair value. Paragraphs B35 and B36 provide related application guidance.
- D8 Paragraph 30 is amended as follows:
- 30 The acquirer shall measure a liability or an equity instrument related to the replacement of an acquiree's share-based payment awards with share-based payment awards of the acquirer in accordance with the method in IFRS 2 *Share-based Payment*. ~~(This IFRS refers to the result of that method as the 'market-based measure' of the award.)~~
- D9 In Appendix B paragraphs B43 and B46 are amended as follows:
- B43 For competitive or other reasons, the acquirer may intend not to use an acquired asset, for example, a research and development intangible asset, or it may intend to use the asset in a way that is different from the way in which other market participants would use it. Nevertheless, the acquirer shall measure the asset in accordance with [draft] IFRS X at fair value determined in accordance with its use by other market participants, reflecting its highest and best use in accordance with the appropriate valuation premise, both initially and when determining fair value less cost to sell for subsequent impairment testing.
- B46 In a business combination achieved without the transfer of consideration, the acquirer must substitute the acquisition-date fair value of its interest in the acquiree for the acquisition-date fair value of the consideration transferred to measure goodwill or a gain on a bargain purchase (see paragraphs 32-34). ~~The acquirer should measure the acquisition-date fair value of its interest in the~~

~~acquiree using one or more valuation techniques that are appropriate in the circumstances and for which sufficient data are available. If more than one valuation technique is used, the acquirer should evaluate the results of the techniques, considering the relevance and reliability of the inputs used and the extent of the available data. The acquirer shall determine the acquisition-date fair value of its investment in the acquiree in accordance with [draft] IFRS X.~~

IFRS 7 Financial Instruments: Disclosures

D10 Paragraphs 27–27B are deleted.

D11 Paragraph 28 is amended as follows:

28 ~~If the market for a financial instrument is not active, an entity establishes its fair value using a valuation technique (see paragraphs AG74–AG79 of IAS 39). Nevertheless, the best evidence of fair value at initial recognition is the transaction price (ie the fair value of the consideration given or received), unless conditions described in paragraph AG76 of IAS 39 are met. It follows that there could be a difference between the fair value at initial recognition and the amount that would be determined at that date using the valuation technique. If such a difference exists, an entity shall disclose, by class of financial instrument: In some cases, an entity does not recognise a gain or loss on initial recognition of a financial asset or financial liability because the fair value is neither evidenced by observable current market transactions in the same instrument (ie without modification or repackaging) nor based on a valuation technique whose variables include only data from observable markets (see paragraph AG76 of IAS 39). In such cases, the entity shall disclose by class of financial asset or financial liability:~~

- (a) ~~its accounting policy for recognising the~~ difference between the fair value at initial recognition and the transaction price in profit or loss to reflect a change in factors (including time) that market participants would consider in setting a price (see paragraph AG76(b) of IAS 39); ~~and~~
- (b) the aggregate difference yet to be recognised in profit or loss at the beginning and end of the period and a reconciliation of changes in the balance of this difference. This disclosure should be made by level in the fair value hierarchy in which the fair value measurement is categorised.

- (c) the reason(s) why the entity determined that the transaction price was not the best evidence of fair value, including a description of the evidence that supports the fair value.

D12 Paragraph 28A is added:

28A When an entity recognises a gain or loss on initial recognition of a financial asset or financial liability at a fair value that differs from the transaction price (see paragraph AG76 of IAS 39), the entity shall disclose the gain or loss separately for each class of financial asset or financial liability by the level in the fair value hierarchy in which the fair value measurement is categorised.

IAS 1 Presentation of Financial Statements

D13 In IAS 1, paragraph 133 is amended as follows:

133 Other IFRSs require the disclosure of some of the assumptions that would otherwise be required in accordance with paragraph 125. For example, IAS 37 requires disclosure, in specified circumstances, of major assumptions concerning future events affecting classes of provisions. [Draft] IFRS ~~7 X Fair Value Measurement~~ requires disclosure of significant assumptions the entity uses in estimating the fair values of ~~financial~~ assets and ~~financial~~ liabilities that are carried at fair value. ~~IAS 16 requires disclosure of significant assumptions that the entity uses in estimating the fair values of revalued items of property, plant and equipment.~~

IAS 2 Inventories

D14 In IAS 2, paragraph 7 is amended as follows:

7 Net realisable value refers to the net amount that an entity expects to realise from the sale of inventory in the ordinary course of business. ~~Fair value reflects the amount for which the same inventory could be exchanged between knowledgeable and willing buyers and sellers in the marketplace.~~ Fair value reflects the price in an orderly transaction between market participants to sell the same inventory in the most advantageous market for that inventory. The former is an entity-specific value; the latter is not. Net realisable value for inventories may not equal fair value less costs to sell.

IAS 16 Property, Plant and Equipment

D15 Paragraphs 32 and 33 are deleted.

D16 Paragraphs 72 and 77 are amended as follows:

72 The consideration receivable on disposal of an item of property, plant and equipment is recognised initially at its fair value. If payment for the item is deferred, ~~the consideration received is recognised initially at the cash price equivalent. The difference between the nominal amount of the consideration and the cash price equivalent~~ the difference between the nominal amount of the consideration and its fair value is recognised as interest revenue in accordance with IAS 18 reflecting the effective yield on the receivable.

77 **If items of property, plant and equipment are stated at revalued amounts, the following shall be disclosed in addition to the disclosure requirements of IFRS X:**

- (a) **the effective date of the revaluation;**
- (b) **whether an independent valuer was involved;**
- (c) ~~[deleted] the methods and significant assumptions applied in estimating the items' fair values;~~
- (d) ~~[deleted] the extent to which the items' fair values were determined directly by reference to observable prices in an active market or recent market transactions on arm's length terms or were estimated using other valuation techniques;~~
- (e) **for each revalued class of property, plant and equipment, the carrying amount that would have been recognised had the assets been carried under the cost model; and**
- (f) **the revaluation surplus, indicating the change for the period and any restrictions on the distribution of the balance to shareholders.**

IAS 18 Revenue

D17 Paragraphs 10 and 11 are amended as follows:

10 The amount of revenue arising on a transaction is usually determined by agreement between the entity and the buyer or user of the asset. It is measured at the fair value of the consideration received or receivable, ~~taking into account~~ the consideration

received or receivable takes into account the amount of any trade discounts and volume rebates allowed by the entity.

- 11 In most cases, the consideration is in the form of cash or cash equivalents and the amount of revenue is the amount of cash or cash equivalents received or receivable. However, when the inflow of cash or cash equivalents is deferred, the fair value of the consideration may be less than the nominal amount of cash received or receivable. For example, an entity may provide interest free credit to the buyer or accept a note receivable bearing a below-market interest rate from the buyer as consideration for the sale of goods. When the arrangement effectively constitutes a financing transaction, the fair value of the consideration is determined in accordance with [draft] IFRS X, by discounting all future receipts using an imputed rate of interest. The imputed rate of interest is the more clearly determinable of either:
- (a) ~~the prevailing rate for a similar instrument of an issuer with a similar credit rating; or~~
 - (b) ~~a rate of interest that discounts the nominal amount of the instrument to the current cash sales price of the goods or services.~~

The difference between the fair value and the nominal amount of the consideration is recognised as interest revenue in accordance with paragraphs 29 and 30 and in accordance with IAS 39.

IAS 19 Employee Benefits

- D18 Paragraphs 102, 104, and 104D are amended as follows:

- 102 The fair value of any plan assets is deducted in determining the amount recognised in the statement of financial position under paragraph 54. ~~When no market price is available, the fair value of plan assets is estimated; for example, by discounting expected future cash flows using a discount rate that reflects both the risk associated with the plan assets and the maturity or expected disposal date of those assets (or, if they have no maturity, the expected period until the settlement of the related obligation). The fair value of any plan assets is determined in accordance with [draft] IFRS X.~~
- 104 Where plan assets include qualifying insurance policies that exactly match the amount and timing of some or all of the benefits payable under the plan, as a practical expedient, the fair value of

those insurance policies is deemed to be the present value of the related obligations, as described in paragraph 54 (subject to any reduction required if the amounts receivable under the insurance policies are not recoverable in full).

104D If the right to reimbursement arises under an insurance policy that exactly matches the amount and timing of some or all of the benefits payable under a defined benefit plan, as a practical expedient, the fair value of the reimbursement right is deemed to be the present value of the related obligation, as described in paragraph 54 (subject to any reduction required if the reimbursement is not recoverable in full).

D19 Paragraph 120A(ea) is added as follows (paragraph 120A(e) is not proposed for amendment but is reproduced here to provide context):

120A An entity shall disclose the following information about defined benefit plans:

...

- (e) **a reconciliation of the opening and closing balances of the fair value of plan assets and of the opening and closing balances of any reimbursement right recognised as an asset in accordance with paragraph 104A showing separately, if applicable, the effects during the period attributable to each of the following:**
 - (i) **expected return on plan assets,**
 - (ii) **actuarial gains and losses,**
 - (iii) **foreign currency exchange rate changes on plans measured in a currency different from the entity's presentation currency,**
 - (iv) **contributions by the employer,**
 - (v) **contributions by plan participants,**
 - (vi) **benefits paid,**
 - (vii) **business combinations and**
 - (viii) **settlements.**
- (ea) the disclosures required by [draft] IFRS X for each category of plan assets disclosed in compliance with the requirement in (j) except as follows. If an entity adopting the deferred**

recognition model of recognising some changes in the value of plan assets and in the defined benefit obligation in periods after the period in which they occur, the entity shall disclose gains or losses on plan assets but need not distinguish between amounts recognised in profit or loss from amounts recognised in other comprehensive income as required by paragraph 57(e)(i), (e)(ii) and (f) of [draft] IFRS X.

IAS 26 Accounting and Reporting by Retirement Benefit Plans

D20 Paragraphs 32 and 33 are amended as follows:

32 Retirement benefit plan investments shall be carried at fair value determined in accordance with [draft] IFRS X *Fair Value Measurement*, except as specified in paragraph 33. ~~In the case of marketable securities fair value is market value.~~ Where plan investments are held for which an estimate of fair value is not possible disclosure shall be made of the reason why fair value is not used.

~~33 In the case of marketable securities fair value is usually market value because this is considered the most useful measure of the securities at the report date and of the investment performance for the period. Those securities that have a fixed redemption value and that have been acquired to match the obligations of the plan, or specific parts thereof, may be carried at amounts based on their ultimate redemption value assuming a constant rate of return to maturity. Where plan investments are held for which a reliable estimate of fair value cannot be determined, is not possible, such as total ownership of an entity, disclosure is made of the reason why fair value is not used. To the extent that investments are carried at amounts other than market value or fair value, fair value is generally also disclosed. Assets used in the operations of the fund are accounted for in accordance with the applicable IFRSs Standards.~~

IAS 33 Earnings per Share

D21 Paragraph 8 is amended as follows:

8 Terms defined in IAS 32 *Financial Instruments: Presentation* are used in this Standard with the meanings specified in paragraph 11 of IAS 32, unless otherwise noted. IAS 32 defines financial instrument,

financial asset, financial liability, ~~and~~ equity instrument ~~and fair value~~, and provides guidance on applying those definitions. [Draft] IFRS X Fair Value Measurement defines fair value and provides guidance on applying that definition.

IAS 34 Interim Financial Reporting

D22 Paragraph 16(k) is added as follows:

16 An entity shall include the following information, as a minimum, in the notes to its interim financial statements, if material and if not disclosed elsewhere in the interim financial report. The information shall normally be reported on a financial year-to-date basis. However, the entity shall also disclose any events or transactions that are material to an understanding of the current interim period:

...

(k) for financial instruments, the disclosures about fair value required by paragraphs 56-59 and 61 of [draft] IFRS X Fair Value Measurement and paragraphs 25, 26 and 28-30 of IFRS 7 Financial Instruments: Disclosures.

IAS 36 Impairment of Assets

D23 Paragraph 6 is amended as follows:

6 The following terms are used in this Standard with the meanings specified:

~~An active market is a market where all the following conditions exist:~~

~~(a) the items traded within the market are homogeneous;~~

~~(b) willing buyers and sellers can normally be found at any time; and~~

~~(c) prices are available to the public.~~

...

D24 Paragraphs 25-27 are deleted and paragraph 25A is added as follows:

25A Fair value is determined in accordance with [draft] IFRS X.

IAS 38 *Intangible Assets*

D25 The heading above paragraph 35 is amended as follows:

~~Measuring the fair value of an intangible asset acquired in a business combination~~

D26 Paragraphs 39–41 and 130E are deleted.

IAS 39 *Financial Instruments: Recognition and Measurement*

D27 Paragraph 43A is added. Paragraph 43 is not proposed for amendment but is included here for ease of reference:

43 When a financial asset or financial liability is recognised initially, an entity shall measure it at its fair value plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.

43A However, if the fair value of the financial asset or financial liability at initial recognition differs from the transaction price, the entity shall apply paragraph AG76.

D28 Paragraphs 48 and 48A are deleted.

D29 Paragraph 48B is added as follows:

48B An entity shall apply [draft] IFRS X to a holding of a financial instrument without adjusting the price per unit for the number of units held. For example, if there is a quoted price in an active market for a financial instrument, the fair value of the holding is the product of that price and the number of units held.

D30 In Appendix A, paragraphs AG46 and AG64 are amended as follows:

AG46 In estimating the fair values of the part that continues to be recognised and the part that is derecognised for the purposes of applying paragraph 27, an entity applies the fair value measurement requirements in paragraphs 48B and 49 and [draft] IFRS X AG69–AG82 in addition to paragraph 28.

AG64 The fair value of a financial instrument on initial recognition is normally the transaction price, (ie the fair value of the consideration given or received, (see also paragraph 36 of [draft]

FAIR VALUE MEASUREMENT

~~IFRS X and paragraph AG76). However, if part of the consideration given or received is for something other than the financial instrument, the fair value of the financial instrument is estimated in accordance with [draft] IFRS X, using a valuation technique (see paragraphs AG74–AG79). For example, the fair value of a long term loan or receivable that carries no interest can be estimated as the present value of all future cash receipts discounted using the prevailing market rate(s) of interest for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit rating. Any additional amount lent is an expense or a reduction of income unless it qualifies for recognition as some other type of asset.~~

D31 Paragraphs AG69–AG75 are deleted.

D32 Paragraph AG76 is amended as follows:

~~AG76 Therefore, a valuation technique (a) incorporates all factors that market participants would consider in setting a price and (b) is consistent with accepted economic methodologies for pricing financial instruments. Periodically, an entity calibrates the valuation technique and tests it for validity using prices from any observable current market transactions in the same instrument (ie without modification or repackaging) or based on any available observable market data. An entity obtains market data consistently in the same market where the instrument was originated or purchased. The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price (see paragraph 36 of [draft] IFRS X ie the fair value of the consideration given or received). If an entity determines that the fair value at initial recognition differs from the transaction price as mentioned in paragraph 43A, the entity shall measure unless the fair value of that instrument at that date as follows:~~

- ~~(a) at the measurement required by paragraph 43, if that fair value is evidenced by comparison with other observable current market transactions in the same instrument (ie without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets. An entity shall recognise the difference between the fair value at initial recognition and transaction price as a gain or loss.~~
- ~~(b) in all other cases, at the measurement required by paragraph 43, adjusted to defer the difference between the~~

fair value at initial recognition and the transaction price. After initial recognition, the entity shall recognise that deferred difference as a gain or loss only to the extent that it arises from a change in a factor (including time) that market participants would consider in setting a price.

- D33 Paragraphs AG76A-AG79 and AG82 are deleted.
- D34 As a consequence, in the following IFRSs cross-references to paragraphs AG69-AG79 are replaced with references to [draft] IFRS X:

IFRS 1	Paragraph D20
IFRS 7	Paragraph 28

IAS 40 *Investment Property*

- D35 Paragraphs 36-40, 42-49, 51 and 75(d) are deleted.
- D36 Paragraph 36A is added as follows:
- 36A The fair value of investment property is determined in accordance with [draft] IFRS X.
- D37 Paragraph 80 is amended as follows:
- 80 An entity that has previously applied IAS 40 (2000) and elects for the first time to classify and account for some or all eligible property interests held under operating leases as investment property shall recognise the effect of that election as an adjustment to the opening balance of retained earnings for the period in which the election is first made. In addition:**
- (a) **if the entity has previously disclosed publicly (in financial statements or otherwise) the fair value of those property interests in earlier periods (determined on a basis that satisfies the definition of fair value in paragraph 5 ~~and the guidance in paragraphs 36-52~~), the entity is encouraged, but not required:**
- (i) **to adjust the opening balance of retained earnings for the earliest period presented for which such fair value was disclosed publicly; and**
- (ii) **to restate comparative information for those periods; and**
- (b) ...

IAS 41 Agriculture

D38 Paragraph 8 is amended as follows:

8 The following terms are used in this Standard with the meanings specified:

~~An active market is a market where all the following conditions exist:~~

- ~~(a) the items traded within the market are homogeneous;~~
- ~~(b) willing buyers and sellers can normally be found at any time; and~~
- ~~(c) prices are available to the public.~~

...

D39 Paragraphs 9, 17–21 and 23 are deleted.

IFRIC 13 Customer Loyalty Programmes

D40 In the Application Guidance paragraph AG2 is amended as follows:

AG2 An entity may estimate the fair value of award credits by reference to the fair value of the awards for which they could be redeemed. The fair value of these awards would be reduced to take into account:

- (a) the fair value of awards that would be offered to customers who have not earned award credits from an initial sale; ~~and~~
- (b) the proportion of award credits that are not expected to be redeemed by customers; and
- (c) non-performance risk.

If customers can choose from a range of different awards, the fair value of the award credits will reflect the fair values of the range of available awards, weighted in proportion to the frequency with which each award is expected to be selected.

Approval of *Fair Value Measurement* by the Board

The exposure draft *Fair Value Measurement* was approved for publication by the fourteen members of the International Accounting Standards Board.

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