Appendix A to ITC

Overview of the Principles of IFRS 13 *Fair Value Measurement*

1. On 12 May 2011 the International Accounting Standards Board (IASB) issued IFRS 13 *Fair Value Measurement*, setting out the principles for the measurement and disclosure of fair value in financial statements.

2. IFRS 13 defines fair value and provides guidance on the measurement of fair value as well as on the disclosures required to enable users of the accounts to understand the valuation techniques applied in measuring fair value.

3. IFRS 13 is designed to apply to assets and liabilities covered by those IFRS standards that currently permit or require measurement at fair value (with some exceptions).

4. The standard defines fair value as being 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 (IFRS 13, paragraph 9). The key principle is that a fair value measurement represents an exit price of an asset or liability from the perspective of market participants at the measurement date. As the standard is based on the perspective of market participants rather than the entity that is holding the asset or that owes the liability the fair value of the item does not take into account the entity's intentions for the asset, liability or equity. This differs from the Code where property, plant and equipment is required to be measured at existing use.

5. The standard requires that a fair value measurement is based on a hypothetical transaction that would take place in the principal or (in its absence) the most advantageous market (IFRS 13, paragraph 16).

6. The standard also requires an entity to include disclosures supporting fair value measurements – in particular where fair value has been calculated using valuation techniques that are not derived from market information on exit prices (for example where such information is not available).

7. IFRS 13 will apply prospectively in the Code from 1 April 2015.

Measurement for Non-Financial Assets

8. A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use from a market participant's perspective even if this is not how the asset is currently used by the entity (IFRS 13, paragraph 27). The highest and best use of an asset takes into account three criteria ie the use of the asset that is:

   - Physically possible – the physical characteristics that market participants would take into account when pricing the asset (for example size and location);

   - Legally permissible – legal restrictions on the use of the asset that market participants would take into account when pricing the asset (eg prevention of development of protected land); and

   - Financially feasible – taking into consideration the first two criteria, the highest and best use of the asset should generate an investment return that market participants would require from an investment in that asset put to that use. (IFRS 13, paragraph 28).

Measurement for Liabilities

9. IFRS 13 stipulates that a fair value measurement assumes that a financial or a non-financial liability is transferred to a market participant at the measurement date. This assumes that a liability would remain outstanding and the market participant would fulfil the obligation. The liability would not be settled with the counterparty or extinguished on the measurement date.

Valuation Techniques

10. IFRS 13 does not prescribe the valuation techniques that must be used in any particular circumstance. The valuation technique used to measure fair value should be appropriate for the circumstances and should be a technique for which sufficient data is available. The standard specifies that there are three widely used valuation techniques, the market approach, the cost approach and the income approach. It requires an entity to use one or more of the techniques to measure the asset or liability.

11. IFRS 13 uses a fair value hierarchy which prioritises the inputs used in a fair value measurement:

    - Level 1 inputs – quoted prices (unadjusted) in an active market for identical assets and liabilities that the entity can access at the measurement date;
    - Level 2 inputs – inputs other than quoted prices included within Level 1that are observable for the asset or liability, either directly or indirectly (for example, non-quoted prices in an active market for similar assets and liabilities); and
    - Level 3 inputs – unobservable market inputs.

    The standard requires the valuation techniques that maximise the use of relevant observable inputs (level 1) and minimise the use of unobservable inputs (level 3).

Disclosure Requirements

12. IFRS 13 contains comprehensive disclosure requirements from a principles basis. The objective of the disclosures for assets and liabilities measured at fair value is to provide information that allows users of the financial statements to assess the methods and inputs used to develop these measurements. For recurring fair value measurements (ie those measurements that arise from assets and liabilities at each reporting date) using significant unobservable inputs (ie level 3 in the hierarchy) the disclosures are designed to allow users to understand effect of the measurement on profit and loss (Surplus or Deficit on the Provision of Services) or other comprehensive income (Other Comprehensive Income and Expenditure).