Sesión de Interés Especial en pre conferencia: Pre conference Special Interest Session

Medición del Valor Razonable y otros temas transversales de medición
Fair Value Measurement and Other Cross-cutting Measurement Issues

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International Financial Reporting Standards

IFRS measurements: an overview

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IFRS®

Objective of IFRS financial reporting

Provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity (buy, sell, hold, provide loan/settle (OB 2))

…who cannot require reporting entities to provide information directly to them (OB 5)

…who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently (QC 32)

IFRS®

Objective of IFRS financial reporting
continued

- Investors', lenders' and other creditors' expectations about returns depend on their assessment of the amount, timing and uncertainty of (the prospects for) future net cash inflows to the entity.

Objective of IFRS financial reporting
continued

- To assess an entity's prospects for future net cash inflows, existing and potential investors, lenders and other creditors need information about:
  - the resources of the entity;
  - claims against the entity; and
  - stewardship—how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources
    - eg protecting the entity's resources from unfavourable effects of economic factors such as price and technological changes

Qualitative characteristics

- If financial information is to be useful, it must be relevant and faithfully represent what it purports to represent (ie fundamental qualities).
  - Financial information without both relevance and faithful representation is not useful, and it cannot be made useful by being more comparable, verifiable, timely or understandable.
- The usefulness of financial information is enhanced if it is comparable, verifiable, timely and understandable (ie enhancing qualities—less critical but still highly desirable)
  - Financial information that is relevant and faithfully represented may still be useful even if it does not have any of the enhancing qualitative characteristics.

Fundamental qualitative characteristics

- *Relevance*: capable of making a difference in users' decisions
  - predictive value (input to process to predict future cash flows)
  - confirmatory value (confirm/disconfirm prior cash flow expectations)
  - materiality (entity-specific—could affect a user's decision)
- *Faithful representation*: faithfully represents the phenomena it purports to represent
  - completeness (depiction including numbers and words)
  - neutrality (unbiased)
  - free from error

  Note: faithful representation replaces reliability

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Enhancing qualitative characteristics

- *Comparability*: like things look alike; different things look different
- *Verifiability*: knowledgeable and independent observers could reach consensus, but not necessarily complete agreement, that a depiction is a faithful representation
  - can be direct or indirect—check inputs, recalculate output
- *Timeliness*: having info in time to be capable of influencing decisions—generally older information is less useful
- *Understandability*: classify, characterise, and present information clearly and concisely

Cost constraint

- Reporting financial information imposes costs, and it is important that those costs are justified by the benefits of reporting that information.
- In applying the cost constraint, the IASB assesses whether the benefits of reporting particular information are likely to justify the costs incurred to provide and use that information.

Measurement concepts?

- Conceptual Framework
  - none—a list of measurement conventions (¶4.54–4.56)
- Conceptual Framework Discussion Paper (2013) (¶6.35)
  - a single measurement basis might not provide the most relevant information for users (but fewest possible bases is desirable);
  - for a particular asset should depend on how that asset contributes to future cash flows;
  - for a particular liability should depend on how the entity will settle or fulfil that liability; and
  - focus on financial position and performance.

How many IFRS measurements? *assets*

- Unmodified historical cost
  - – initial + subsequently for unimpaired—land, inventory, indefinite life intangible assets
- Modified historical cost
  - – depreciation-impairment model in IASs 16 + 38
- Fair value—IFRS 13
  - – IFRSs 3 + 9 & IAS 40 + FV less cost to sell in IASs 36 + 41
- Modified fair value
  - – IFRS 2 and revaluation model in IASs 16 + 38
- Others too: IAS 2 (NRV), 11, 12, 17, 29, 36 (VIU), IFRS 9 amortised cost…
- Mixture-measurement:
  - – equity method and effects of hedge accounting, IFRS 1 + transitional provisions

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Unmodified historical cost?
the 'concept' ¶4.55(a)

The unmodified historical cost of an asset is:

- the amount of cash or cash equivalents paid; or
- the fair value of the consideration given to acquire it at the time of its acquisition.

Fair value of an asset
the concept (IFRS 13)

- Fair value is the price that would be received to sell an asset in an orderly transaction (*not a forced sale*) between market participants (*market-based view*) at the measurement date (*current price*).
- Fair value is a market-based measurement (it is not an entity-specific measurement)
  - the entity's intention is not relevant
  - highest and best use principle 'reflects' value maximisation (highlighting opportunity costs)

Fair value measurement
example of regulatory ruling

Anglo-Eastern Plantations Plc (the company) for the year ended 31 December 2010

"The Conduct Committee's Financial Reporting Review Panel (FRRP) considered the company's **use of historical rather than current data to estimate the fair value of palm oil trees**, recognised in the balance sheet as biological assets. In its 2010 accounts the company valued its plantation estates using a discounted cash flow technique by estimating future sales proceeds of palm oil, deducting from this the estimated cash costs of production and discounting these estimated net cash flows. **The company used historical percentages to allocate the plantation estate values between land, palm oil trees and equipment.** However, an allocation on this basis does not achieve fair value for the biological asset, as required by IAS 41 'Agriculture'." (emphasis added)

Fair value measurement
example of regulatory ruling continued

"In its 2012 accounts, whilst the FRRP's enquiries were on-going, the company changed its valuation method to value land and biological assets separately and recorded its first prior year restatement. Land was valued by reference to market prices. The fair value of palm oil trees was valued using a similar discounted cash flow technique to the plantation estate method. However, the **estimated cash costs of production used historical, rather than current data, to estimate the cost of using the land** on which the palm oil trees are planted. As a consequence, the fair value of biological assets was over-stated.

Following further discussion with the FRRP, the company has used current market data to estimate the cost for the use of land in its discounted cash flow. This has given rise to a second prior period restatement, announced by the company today, that reduced the value of its biological assets at December 2012 by $37 million from $245 million to $208 million. Profit after tax for the year ended 31 December 2012 was reduced by $1.6 million. There was no impact on cash." (emphasis added)

Does seeing the big picture help answer some vexing questions?

Is it ‘shortcomings’ in recognition and measurement requirements for assets and liabilities that results in ‘counterintuitive’ knock-on effects for the reporting of subsequent transactions or events?

Thank you