Brief facts of the enquiry:

The Accounting Standards Board received an enquiry which principally contained following two key questions:

a) Whether a company, being owner of an investment in its associate and the associate being a company listed on Pakistan Stock Exchange Limited (PSX), can use a valuation technique to estimate fair value of investment in associate under IFRS 13 (rather than determine its fair value based on quoted price available on PSX)?

The fair value so determined is to be used in determination of recoverable amount of such investment and impairment testing thereof under IAS 36.

b) Whether it is necessary to use the same method/technique for fair value determination in a year (which is to be used for determining recoverable amount of investee company under IAS 36) which was used in the preceding year?

Important facts about the matter are as follows:

- The matter pertained to separate financial statements of the entity wherein investment in associate is carried at cost and subject to impairment testing under IAS 36.

- The shares of associate are listed on stock exchange however trading volume of such shares viz-a-viz overall average trading volumes in PSX during the year is low. Further, the shares of associate are thinly traded in last week of the financial year to which financial statements relate.

Opinion

The Board noted that following paragraphs of IFRS 13 (Guidance) are pertinent in this matter:

Paragraph B37 of IFRS 13 (Guidance) states that,

*"**The fair value of an asset or a liability might be affected when there has been a significant decrease in the volume or level of activity for that asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities)**.*

***To determine whether**, on the basis of the evidence available, **there has been a significant decrease in the volume or level of activity for the asset or liability, an entity shall evaluate the significance and relevance of factors such as the following**:*

(a) There are few recent transactions.

(b) Price quotations are not developed using current information.

(c) Price quotations vary substantially either over time or among market-makers (e.g. some brokered markets).

(d) 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. [Refer: paragraph 82(d)]

(e) There is a significant increase in implied liquidity risk premiums, [Refer: paragraphs B15 and B16] 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, [Refer: paragraphs B23–B30]

taking into account all available market data about credit and other non-performance risk for the asset or liability.

(f) There is a wide or significant increase in the bid-ask spread. [Refer: paragraphs 70 and 71]

(g) There is a significant decline in the activity of, or there is an absence of, a market for new issues (ie a primary market) for the asset or liability or similar assets or liabilities.

(h) Little information is publicly available (eg for transactions that take place in a principal-to-principal market)."

Paragraph B38 of IFRS 13 (Guidance) states that,

*"**If an entity concludes that there has been a significant decrease in the volume or level of activity for the asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities), <u>further analysis of the transactions or quoted prices is needed</u>. A decrease in the volume or level of activity <u>on its own</u> may not indicate that a transaction price or quoted price does not represent fair value or that a transaction in that market is not orderly.** However, **if an entity determines that a transaction or quoted price does not represent fair value <u>(eg there may be transactions that are not orderly)</u>, an adjustment to the transactions or quoted prices <u>will</u> be necessary if the entity uses those prices as a basis for measuring fair value and that adjustment may be significant to the fair value measurement in its entirety**. [Refer: paragraphs 72, 73 and 75] Adjustments also may be necessary in other circumstances (e.g. when a price for a similar asset requires significant adjustment to make it comparable to the asset being measured [Refer: paragraph 83(b) o]r when the price is stale [Refer: paragraph 83(c)])."*

Paragraph B39 of IFRS 13 states that,

"<u>This IFRS does not prescribe a methodology for making significant adjustments to transactions or quoted prices</u>. See paragraphs 61–66 and B5–B11 for a discussion of the use of valuation techniques when measuring fair value. Regardless of the valuation technique used, an entity shall include appropriate risk adjustments, [Refer: paragraphs 64, 88, B15, B16 and Basis for Conclusions paragraphs BC143–BC146, BC149 and BC150] including a risk premium reflecting the amount that market participants would demand as compensation for the uncertainty inherent in the cash flows of an asset or a liability (see paragraph B17). Otherwise, the measurement does not faithfully represent fair value. In some cases determining the appropriate risk adjustment might be difficult. [Refer: Basis for Conclusions paragraph BC150] However, the degree of difficulty alone is not a sufficient basis on which to exclude a risk adjustment. The risk adjustment shall be reflective of an orderly transaction between market participants at the measurement date under current market conditions. [Refer: Basis for Conclusions paragraphs BC143–BC146]"

Paragraph B40 of IFRS 13 (Guidance) states that:

*"B40. If there has been a significant decrease in the volume or level of activity for the asset or liability, **<u>a change in valuation technique</u>** [Refer: paragraph 65] **<u>or the use of multiple valuation techniques may be appropriate</u>** (e.g. 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 shall*

consider the reasonableness of the range of fair value measurements. 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 measurements may be an indication that further analysis is needed. [Refer: Basis for Conclusions paragraphs BC147 and BC148]"

The Board highlighted that if above paragraphs are read in their sequence, it transpires that:

a) *The fair value of an asset or a liability might be affected when there has been a significant decrease in the volume or level of activity for that asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities [Paragraph B37 of IFRS 13 (Guidance));*

b) ***To determine whether**, on the basis of the evidence available, **there has been a significant decrease in the volume or level of activity for the asset or liability, an entity shall evaluate the significance and relevance of factors such as those listed in paragraph B37 of IFRS 13 (Guidance);***

c) ***If an entity concludes that there has been a significant decrease in the volume or level of activity for the asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities), further analysis of the transactions or quoted prices is needed. A decrease in the volume or level of activity on its own may not indicate that a transaction price or quoted price does not represent fair value or that a transaction in that market is not orderly.** [Paragraph B38 of IFRS 13 (Guidance)]*

d) ***if an entity determines that a transaction or quoted price does not represent fair value (eg there may be transactions that are not orderly), an adjustment to the transactions or quoted prices will be necessary if the entity uses those prices as a basis for measuring fair value and that adjustment may be significant to the fair value measurement in its entirety** [Paragraph B38 of IFRS 13 (Guidance)]*

e) ***This IFRS does not prescribe a methodology for making significant adjustments to transactions or quoted prices. See paragraphs 61–66 and B5–B11 for a discussion of the use of valuation techniques when measuring fair value.** [Paragraph B39 of IFRS 13 (Guidance)]*

f) *If there has been a significant decrease in the volume or level of activity for the asset or liability, **a change in valuation technique** [Refer: paragraph 65] **or the use of multiple valuation techniques may be appropriate** (e.g. the use of a market approach and a present value technique).*

g) ***Paragraphs 61-66 of IFRS 13 and paragraphs B5-B11 of IFRS 13 (Guidance) provide guidance on use of valuation techniques (such as market approach and income approach) for valuation***

Based on above, the Board concluded that IFRS 13 Fair value measurement **does allow** use of an alternative technique to estimate fair market value of an asset (which is a scrip of associate in this case) in circumstances and conditions mentioned in paragraphs B37 to B38 of IFRS 13.

The Board highlighted that some of the key points relevant in this respect are as follows:

- To conclude whether there has been a significant decrease in volume *or level of activity for the scrip of associate (on PSX) in relation to normal market activity for that Scrip (or similar Scrips on PSX), is a matter of judgement; and*

- To determine that ***quoted price of Scrip (in this case) does not represent fair value, requires an in-depth analysis of PSX market which if performed would have revealed information such as (i)*** **any change in characteristics of market participants or (ii) whether or not the underlying scrip could be sold in an orderly transaction or (iii) the quoted price of scrip existing at reporting dates is an outlier.**

The Board noted that, in the present case, the use of an estimated fair value, requires an assessment and documentation from entity's end (covering the aspects as mentioned above) which should later on be examined and documented as audit evidence by statutory audit team in their 'audit engagement file'.

The Board noted that, as regards second question that whether it is necessary to use the same method/technique for fair value determination in a year (which is to be used for determining recoverable amount of investee company under IAS 36) which was used in the preceding year, it is not necessary to use same method / technique to determine / estimate fair value under IAS 36 / IFRS 13 but it would depend on the facts and circumstances of the case.

The Board concluded that at reporting date if there are circumstances / indicators such as those stated in paragraph B37 of IFRS 13 (Guidance), an entity is required to perform assessment at such reporting date covering requirements of paragraphs B37 and B38 of IFRS 13 (Guidance) and if such assessment determines that quoted price does not represent fair market value, then, it may estimate fair value of the scrip as allowed under paragraph B40 of IFRS 13 (Guidance). However, in order to perform a complete assessment of impairment, it is also necessary to consider "Value in use" of the investment in addition to its fair value.

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