

Fair value measurement (IFRS 13)

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1. Objective and big picture

IFRS 13 does not tell you **when** to use fair value—that comes from other standards (IFRS 9, IAS 40, IFRS 3, etc.). Its job is to tell you **how** to measure fair value and **what to disclose** when you do.

Objective of IFRS 13:

- **Define fair value** in a single, consistent way.
- **Provide a framework** for measuring fair value.
- **Require disclosures** that help users understand fair value measurements and their reliability.

Fair value is explicitly a **market-based** measurement, not an entity-specific “what it’s worth to us” number.

2. Scope of IFRS 13

2.1 What is covered

IFRS 13 applies when another IFRS requires or permits **fair value** or **fair value-based** measurements, including:

- **Fair value** (e.g. investment property under IAS 40, biological assets under IAS 41).
- **Fair value less costs of disposal** (e.g. impairment under IAS 16 or IAS 36).
- **Fair value through profit or loss / OCI** (e.g. financial instruments under IFRS 9).
- **Fair value of assets and liabilities acquired** in a business combination (IFRS 3).

2.2 What is not covered

IFRS 13 does **not** apply to:

- **Share-based payment** transactions (IFRS 2).
- **Leases** measured under IFRS 16 (except where another standard requires fair value).
- **Measurements similar to fair value but not fair value**, e.g.:
 - Net realisable value (IAS 2).
 - Value in use (IAS 16 and IAS 36).

It also does **not** introduce new fair value requirements; it only standardises how to measure fair value where it is already required or permitted.

3. Definition of fair value

3.1 Core definition

Fair value is defined 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.”

Key elements:

- **Price:** a single amount, not a range.
- **Orderly transaction:** not a forced sale or distress situation.
- **Between market participants:** knowledgeable, independent, willing parties.
- **At the measurement date:** current, not historical.

3.2 Exit price concept

Fair value is an **exit price**:

- **Asset:** price to **sell** the asset.
- **Liability:** price to **transfer** the liability to another party.

It is **not**:

- The price to buy the asset (entry price).
- The amount the entity would internally value the asset at (entity-specific value).

4. Key building blocks of fair value

4.1 The asset or liability (unit of account)

The **unit of account** is determined by the standard requiring fair value (e.g. IFRS 9, IAS 40). IFRS 13 then measures fair value for that unit:

- **Individual asset** (e.g. one machine).
- **Group of assets** (e.g. cash-generating unit in a business combination).
- **Liability or group of liabilities** (e.g. decommissioning obligation).

Example: If IFRS 9 requires fair value of a **bond**, the unit of account is the bond itself, not the issuer's entire capital structure.

4.2 The transaction

Fair value assumes:

- **Orderly transaction** in the **principal market** (or most advantageous market if no principal market).
- Transaction occurs under **current market conditions** at the measurement date.

Principal market: the market with the **greatest volume and level of activity** for the asset or liability. **Most advantageous market:** the market that maximises the amount received (for assets) or minimises the amount paid (for liabilities), after transaction costs.

Transaction costs are **not** included in fair value, but they are considered when identifying the most advantageous market.

4.3 Market participants

Market participants are:

- **Independent** of the reporting entity (no related party influence).
- **Knowledgeable** and able to access information.
- **Able and willing** to transact.
- Acting in their **economic best interest**.

Assumptions about market participants drive:

- Expected cash flows.
- Risk adjustments.
- Discount rates.

4.4 The price

Fair value is the **price in the principal (or most advantageous) market:**

- **Excludes transaction costs.**
- **Includes transport costs** if location is a characteristic of the asset (e.g. commodity stored in a specific location).

5. Highest and best use (non-financial assets)

5.1 Concept

For **non-financial assets**, fair value reflects the asset's **highest and best use** from the perspective of market participants.

Highest and best use must be:

- **Physically possible** (e.g. land can physically support a building).
- **Legally permissible** (e.g. zoning laws allow commercial use).
- **Financially feasible** (e.g. expected cash flows justify the investment).

The asset's current use is presumed to be highest and best use unless evidence suggests otherwise.

5.2 Valuation premise

Two valuation premises:

- **In-use:** asset provides maximum value when used in combination with other assets (e.g. machine in a production line).
- **In-exchange:** asset provides maximum value on a stand-alone basis (e.g. parcel of land sold separately).

Fair value reflects the **valuation premise** that market participants would adopt.

5.3 Example — Land

An entity owns land currently used as a warehouse site. Zoning allows high-density residential development.

- **Current use:** warehouse (industrial).
- **Alternative use:** residential development.

If market evidence shows that residential development yields higher value and is legally and financially feasible, the **highest and best use** is residential. Fair value is based on the **residential development potential**, even if the entity intends to keep using it as a warehouse.

6. Application to liabilities and own equity instruments

6.1 General principle

Fair value of a **liability** or an **entity's own equity instrument** reflects:

- The **price to transfer** the liability or instrument to a market participant.
- The effect of **non-performance risk**, including the entity's own credit risk.

6.2 When there is a quoted price

If the liability or equity instrument is traded in an active market:

- Use the **quoted price** (e.g. quoted bond or share price).

6.3 When there is no quoted price

If there is no active market for the liability itself:

- Use the **quoted price of the corresponding asset** held by another party (e.g. a loan asset held by a bank).
- If that is not available, use valuation techniques (e.g. present value of cash flows).

6.4 Non-performance risk

Non-performance risk includes:

- **Own credit risk** (probability of default).
- Other factors affecting the likelihood that the entity will fulfil the obligation.

Fair value must **consistently reflect** non-performance risk, whether the liability is:

- Financial (e.g. bond).
- Non-financial (e.g. decommissioning obligation).

6.5 Example — Decommissioning liability

An entity has a legal obligation to dismantle an oil platform in 20 years.

- Expected cash outflows: future dismantling costs.
- Discount rate: reflects time value of money and non-performance risk.

Fair value is the **present value of expected cash flows**, adjusted for risk and market participant assumptions (e.g. contractor margins, risk premiums).

7. Financial assets and liabilities with offsetting positions

IFRS 13 allows a **portfolio** (or “group”) measurement when:

- The entity manages a group of financial assets and liabilities on a **net risk** basis (e.g. interest rate risk, credit risk).
- The portfolio is measured at fair value in the statement of financial position.

In such cases, fair value may reflect:

- **Net exposure** to market risks.
- **Credit risk** of the counterparty on a net basis.

Example: A bank has a portfolio of interest rate swaps with the same counterparty, some in asset positions and some in liability positions. Fair value can be measured on a **net basis** if risk management and reporting are aligned with that approach.

8. Fair value at initial recognition

8.1 Transaction price vs fair value

At initial recognition, the **transaction price** is often equal to fair value, but not always.

Situations where they may differ:

- **Related party transactions.**
- **Distressed sales.**
- **Transactions with significant marketing incentives** (e.g. bundled deals).
- **Long-term contracts** with off-market terms.

If fair value differs from the transaction price, the difference is usually recognised as a **gain or loss** at initial recognition, unless another standard requires deferral.

8.2 Example — Interest rate swap

An entity enters into an interest rate swap at market terms:

- No initial cash exchange.
- The present value of expected cash flows is zero at inception.

Fair value at initial recognition is **zero**, equal to the transaction price (no day 1 gain or loss).

If the swap is off-market (e.g. fixed rate below market), fair value at initial recognition is **not zero**, and a day 1 gain or loss may arise.

9. Valuation techniques

9.1 Overview

IFRS 13 requires the use of **valuation techniques** that are:

- **Appropriate** in the circumstances.
- **Consistent** with how market participants would price the asset or liability.
- **Maximising observable inputs** and minimising unobservable inputs.

Three broad approaches exist:

1. **Market approach**
2. **Cost approach**
3. **Income approach**

9.2 Market approach

Uses prices and other relevant information from **market transactions** involving identical or comparable assets or liabilities.

Examples:

- Quoted share prices on an active exchange.
- Recent sales of similar properties.
- Multiples (e.g. EBITDA multiples) from comparable companies.

9.3 Cost approach

Reflects the amount that would be required currently to **replace** the service capacity of an asset (current replacement cost).

Examples:

- Replacement cost of a machine, adjusted for physical deterioration and obsolescence.
- Cost to reproduce a specialised asset.

9.4 Income approach

Converts future amounts (cash flows or income and expenses) into a single present value.

Common techniques:

- **Discounted cash flow (DCF).**
- **Option pricing models** (e.g. Black–Scholes).
- **Multi-period excess earnings** for intangible assets.

Key elements:

- Forecast cash flows.
- Discount rate reflecting time value of money and risk.
- Terminal value assumptions.

9.5 Example — Machine held and used

An entity owns a specialised machine used in production:

- No active market for identical machines.
- Market approach is limited.
- Cost approach: replacement cost of a similar machine, adjusted for age and condition.
- Income approach: present value of cash flows generated by the machine.

The entity may use **multiple techniques** and reconcile them, giving more weight to the technique that best reflects market participant assumptions.

10. Inputs to valuation techniques and the fair value hierarchy

10.1 Inputs

Inputs are the assumptions that market participants would use when pricing the asset or liability, such as:

- **Observable market data** (prices, rates, indices).
- **Unobservable inputs** (entity's own assumptions, adjusted to reflect market participants).

IFRS 13 requires maximising **observable** inputs.

10.2 Fair value hierarchy

The hierarchy categorises inputs into **three levels**:

- **Level 1:** quoted prices (unadjusted) in active markets for **identical** assets or liabilities.
- **Level 2:** inputs other than Level 1 that are **observable**, directly or indirectly.
- **Level 3:** **unobservable** inputs (significant to the measurement).

Level 1 inputs

- Quoted share prices on a stock exchange.
- Quoted prices for traded bonds in an active market.

Measurement: Fair value = **quoted price × quantity**, usually without adjustment (except for block discounts not allowed under IFRS 13).

Level 2 inputs

- Quoted prices for **similar** assets or liabilities.
- Interest rates, yield curves, credit spreads.
- Market-corroborated inputs (e.g. implied volatilities).

Example: A corporate bond not traded frequently, but with observable yield curves and credit spreads. Fair value is derived from these observable inputs.

Level 3 inputs

- Unobservable inputs, such as:
 - Forecast cash flows for a private company.
 - Internal estimates of volatility for an unlisted option.
 - Long-term growth rates not directly observable.

Level 3 measurements require **significant judgement** and are subject to enhanced disclosure.

10.3 Example — Unquoted equity investment (Level 3)

An entity holds shares in a private company:

- No active market.
- Limited observable data.

Valuation:

- Income approach (DCF) using:
 - Forecast cash flows (unobservable).
 - Discount rate derived partly from observable market data (risk-free rate, market risk premium) and partly from unobservable inputs (company-specific risk).
- Result: Level 3 fair value measurement.

11. Special topics — decreased market activity and adjustments

11.1 Decreased volume or level of activity

When market activity for an asset or liability has **significantly decreased**, quoted prices may not represent fair value. IFRS 13 requires:

- Assess whether transactions are **orderly**.
- Adjust or disregard prices from distressed sales.
- Use valuation techniques that reflect **current market conditions**.

Indicators of decreased activity:

- Wide bid–ask spreads.
- Few recent transactions.
- Significant price volatility.

11.2 Day 1 gains and losses

If fair value at initial recognition differs from the transaction price:

- Recognise a **day 1 gain or loss** unless another standard requires deferral (e.g. some financial instruments when inputs are not fully observable).

12. Disclosure requirements

IFRS 13 requires extensive disclosures to help users understand:

- **Valuation techniques** used.
- **Inputs** to those techniques.
- **Level of the fair value hierarchy**.
- **Transfers** between levels.
- **Sensitivity** of Level 3 measurements to changes in unobservable inputs.

12.1 General disclosures

For each class of assets and liabilities measured at fair value:

- **Fair value at the reporting date**.
- **Level (1, 2, or 3)** in the hierarchy.
- **Valuation techniques** and **inputs** used.
- Whether there were **transfers between levels**, and reasons.

12.2 Level 3 disclosures

For Level 3 measurements:

- **Reconciliation** of opening and closing balances (including gains/losses, purchases, sales, transfers).
- **Gains or losses** recognised in profit or loss and OCI.
- **Description of valuation processes**.
- **Quantitative information** about significant unobservable inputs.
- **Sensitivity analysis** showing how changes in inputs would affect fair value.

Example: For a Level 3 private equity investment, the entity discloses:

- Key unobservable inputs (e.g. EBITDA multiple, discount rate).
- Range and weighted average of those inputs.
- Effect on fair value of reasonably possible changes (e.g. $\pm 1\%$ discount rate).

13. Integrated examples

13.1 Quoted equity investment (Level 1)

An entity holds 10,000 shares of a listed company:

- Closing price at year-end: R25 per share.
- Active market, no restrictions.

Fair value: $10,000 \times R25 = R250,000$ (Level 1).

No adjustments for transaction costs; those are recognised separately when the shares are sold.

13.2 Corporate bond (Level 2)

An entity holds a corporate bond:

- Not traded frequently, but:
 - Observable yield curve for similar credit quality.
 - Observable credit spreads.

Valuation:

- Discount contractual cash flows using observable yield curve and spreads.
- Result is a Level 2 fair value.

13.3 Investment property (highest and best use)

An entity owns an office building:

- Current use: office rental.
- Market evidence suggests conversion to residential yields higher value and is legally and financially feasible.

Fair value:

- Based on residential development potential (highest and best use).
- Valuation may use an income approach (DCF of expected residential cash flows) or market approach (comparable residential properties).

13.4 Decommissioning liability (Level 3)

An entity has a legal obligation to dismantle a plant in 15 years:

- Expected future cash outflows: R5 million.
- Discount rate: 5% including non-performance risk.

Fair value:

$$\text{Fair value} \approx \frac{5,000,000}{(1 + 0.05)^{15}}$$

This is a Level 3 measurement because key inputs (future costs, risk adjustments) are unobservable.

14. Summary and exam focus points

Core ideas to remember:

- **Fair value** is a **market-based exit price**, not entity-specific value.
- **Principal or most advantageous market** and **market participants** are central.
- For **non-financial assets**, fair value reflects **highest and best use**.
- For **liabilities and own equity**, fair value includes **non-performance risk**.
- **Valuation techniques**: market, cost, income—always maximise observable inputs.
- **Fair value hierarchy**: Level 1 (quoted prices), Level 2 (observable inputs), Level 3 (unobservable inputs).
- **Disclosures** are especially detailed for **Level 3** measurements.

15. Comprehensive Question Bank

SECTION A — Multiple-Choice Questions (MCQs)

1. Fair value under IFRS 13 is defined as:

- A. The value the entity believes the asset is worth
- B. The price to acquire an asset in a forced transaction
- C. The price to sell an asset or transfer a liability in an orderly transaction between market participants
- D. The value in use of an asset

➤ Answer: C

2. Fair value is based on:

- A. Entity-specific assumptions
- B. Market-participant assumptions
- C. Historical cost
- D. Net realisable value

➤ Answer: B

3. The principal market is:

- A. The market with the highest price
- B. The market with the lowest transaction costs
- C. The market with the greatest volume and level of activity
- D. Any market the entity prefers

➤ **Answer: C**

4. Transaction costs:

- A. Are included in fair value
- B. Are excluded from fair value
- C. Are included only for financial instruments
- D. Are included only for non-financial assets

➤ **Answer: B**

5. Highest and best use applies to:

- A. Financial assets only
- B. Non-financial assets only
- C. Liabilities only
- D. All assets and liabilities

➤ **Answer: B**

6. A Level 1 input is:

- A. Unobservable input
- B. Observable input other than quoted prices
- C. Quoted price in an active market for an identical asset
- D. Quoted price for a similar asset

➤ **Answer: C**

7. Level 3 inputs are:

- A. Always observable
- B. Always unobservable
- C. Observable but adjusted
- D. Used only for financial instruments

➤ **Answer: B**

8. Which valuation technique uses discounted future cash flows?

- A. Market approach
- B. Cost approach
- C. Income approach
- D. Replacement approach

➤ **Answer: C**

9. Non-performance risk includes:

- A. Only market risk
- B. Only liquidity risk
- C. The entity's own credit risk
- D. Only interest rate risk

➤ **Answer: C**

10. When market activity decreases significantly:

- A. Quoted prices must always be used
- B. Quoted prices may require adjustment
- C. Fair value cannot be measured
- D. The entity uses historical cost

➤ **Answer: B**

11. A Level 2 input example is:

- A. Quoted share price on the JSE
- B. Internal cash flow forecast for a private company
- C. Observable yield curve
- D. Management's estimate of future growth

➤ **Answer: C**

12. Fair value of a liability reflects:

- A. The cost to settle the liability with the creditor
- B. The price to transfer the liability to a market participant
- C. The entity's own estimate of settlement cost
- D. The value in use of the liability

➤ **Answer: B**

13. Highest and best use must be:

- A. Physically possible
- B. Legally permissible
- C. Financially feasible
- D. All of the above

➤ **Answer: D**

14. Day-1 gains or losses arise when:

- A. Transaction price equals fair value
- B. Transaction price differs from fair value
- C. Historical cost differs from fair value
- D. Value in use differs from fair value

➤ **Answer: B**

15. Portfolio fair value measurement applies when:

- A. Assets are held for trading
- B. The entity manages exposures on a net basis
- C. The entity has more than one financial instrument
- D. The entity chooses to apply it

➤ **Answer: B**

16. Transport costs are included in fair value when:

- A. Transaction costs are high
- B. Location is a characteristic of the asset
- C. The entity chooses to include them
- D. The market is inactive

➤ **Answer: B**

17. Which is NOT a valuation technique under IFRS 13?

- A. Market approach
- B. Income approach
- C. Cost approach
- D. Historical cost approach

➤ **Answer: D**

18. Level 3 disclosures require:

- A. Only fair value amount
- B. Only valuation technique
- C. Sensitivity analysis of unobservable inputs
- D. No additional disclosures

➤ **Answer: C**

19. Fair value hierarchy prioritises:

- A. Unobservable inputs
- B. Observable inputs
- C. Management judgement
- D. Historical cost

➤ **Answer: B**

20. Fair value of an unquoted equity investment is typically:

- A. Level 1
- B. Level 2
- C. Level 3
- D. Not measurable

➤ **Answer: C**

SECTION B — Short-Answer Questions

1. Define “exit price” in the context of IFRS 13.

Answer: The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants.

2. Explain the difference between principal market and most advantageous market.

Answer: Principal market has the highest volume/activity; most advantageous market maximises net proceeds after transaction costs.

3. Why are transaction costs excluded from fair value?

Answer: Because fair value reflects the price in the market, not the entity’s specific transaction costs.

4. Provide two examples of Level 2 inputs.

Answer: Yield curves, credit spreads, quoted prices for similar assets.

5. What is non-performance risk?

Answer: The risk that the entity will not fulfil its obligation, including own credit risk.

SECTION C — Long-Form Questions

1. Discuss the concept of highest and best use for non-financial assets and provide an example.

(Expected answer: 1 page) Include physical possibility, legal permissibility, financial feasibility, and example such as land with alternative development potential.

2. Explain the fair value hierarchy and provide examples of Level 1, Level 2, and Level 3 measurements.

(Expected answer: 1 page)

3. Describe the three valuation techniques under IFRS 13 and explain when each is appropriate.

(Expected answer: 1 page)

4. Discuss the disclosure requirements for Level 3 fair value measurements.

(Expected answer: half a page)

SECTION D — Calculation & Scenario Questions

1. Level 1 — Quoted Equity

An entity holds 12,000 listed shares. Year-end price: R18.50.

Required: Calculate fair value.

Answer:

$$12,000 \times R18.50 = R222,000$$

2. Level 2 — Corporate Bond

Bond cash flows: R50,000 annually for 5 years. Discount rate (observable): 6%.

Required: Calculate fair value.

Answer:

$$FV = \sum_{t=1}^5 \frac{50,000}{(1.06)^t}$$

(You compute the present value of R50,000.)

3. Level 3 — Private Equity Valuation (DCF)

Forecast cash flows: R80,000; R100,000; R120,000. Discount rate: 10%. Terminal value at end of Year 3: R1,000,000.

Required: Calculate fair value.

Answer:

$$PV = \frac{80,000}{1.10} + \frac{100,000}{1.10^2} + \frac{120,000}{1.10^3} + \frac{1,000,000}{1.10^3}$$

4. Highest and Best Use — Land

Current use: warehouse. Alternative use: residential development. Residential yields R12m; warehouse yields R7m. Legally permissible and financially feasible.

Required: Determine fair value basis.

Answer: Highest and best use = residential; fair value based on R12m.

5. Liability — Decommissioning Obligation

Future cost: R6m in 20 years. Discount rate: 4%.

Required: Calculate fair value.

Answer:

$$FV = \frac{6,000,000}{(1.04)^{20}}$$

6. Portfolio Measurement

Entity has derivatives with same counterparty:

- Asset positions: R900,000
- Liability positions: R700,000

→ Net exposure: R200,000

Required: Explain whether net fair value measurement is permitted.

Answer: Yes, if the entity manages exposures on a net basis and reports them at fair value.

SECTION E — Case Study Questions

Case 1 — Inactive Market

A bond previously traded actively now has very few transactions, wide bid-ask spreads, and volatile pricing.

Required:

1. Assess whether quoted prices represent fair value
2. Explain adjustments required
3. Identify hierarchy level

Case 2 — Investment Property

Office building with potential for conversion to residential. Residential yields higher value and is legally permissible.

Required:

1. Determine highest and best use
2. Identify valuation techniques
3. Discuss disclosure requirements

Case 3 — Unquoted Equity Investment

Entity holds 30% in a private company. Cash flows uncertain; discount rate includes company-specific risk.

Required:

1. Identify hierarchy level
2. Explain valuation technique
3. Discuss sensitivity analysis

Model Answers:

CASE STUDY 1 — Inactive Market (Corporate Bond)

1. Do quoted prices represent fair value?

Not necessarily. IFRS 13 requires an entity to evaluate whether quoted prices in a market with **significantly decreased activity** still represent fair value.

Indicators such as:

- Few transactions
- Wide bid–ask spreads
- High volatility

suggest that the market may be **inactive** and that quoted prices may reflect **distressed or forced transactions**, not orderly ones.

Therefore, quoted prices **cannot automatically be accepted** as fair value.

2. Adjustments required

IFRS 13 requires the entity to:

- **Assess whether transactions are orderly**
 - If evidence suggests distress (e.g., forced liquidation), those prices must be **excluded**.
- **Use valuation techniques** that reflect current market conditions, such as:
 - **Income approach** (discounted cash flows using observable market inputs like yield curves)
 - **Market approach** using adjusted prices from similar instruments
- **Adjust observable inputs** to reflect:
 - Current credit spreads
 - Liquidity premiums

- Default risk
- Market participant assumptions

The valuation must maximise **observable inputs** (Level 2) and minimise unobservable ones.

3. Fair value hierarchy level

The measurement will typically fall under **Level 2** because:

- The bond itself is not actively traded (so Level 1 is not appropriate)
- Observable inputs (yield curves, credit spreads, benchmark rates) are still available
- Adjustments are made to reflect current market conditions

If significant unobservable inputs are required (e.g., entity-specific credit assumptions), the measurement may move to **Level 3**, but normally this scenario remains **Level 2**.

CASE STUDY 2 — Investment Property (Highest and Best Use)

1. Highest and best use

IFRS 13 requires fair value of non-financial assets to reflect **highest and best use**, considering:

- **Physical possibility**
- **Legal permissibility**
- **Financial feasibility**

In this case:

- Conversion to residential is physically possible
- Zoning laws permit residential use
- Market evidence shows residential yields higher value

Therefore, the **highest and best use is residential**, even if the entity currently uses the building as offices.

Fair value must reflect **residential development potential**, not current office use.

2. Appropriate valuation techniques

Depending on available data, the entity may use:

Market Approach

- Comparable sales of residential buildings

- Residential price per square metre
- Adjustments for location, condition, and development stage

Income Approach

- Discounted cash flows from expected residential rentals or sales
- Terminal value based on market exit prices
- Discount rate reflecting residential market risk

Often, both approaches are used and reconciled.

3. Disclosure requirements

IFRS 13 requires:

- **Valuation technique(s)** used
- **Inputs** (e.g., discount rate, rental yields, comparable price data)
- **Fair value hierarchy level**
 - Usually **Level 3**, because residential development assumptions are unobservable
- **Highest and best use justification**
 - Explanation that residential use maximises value
- **Sensitivity analysis** for Level 3 inputs
 - E.g., effect of $\pm 1\%$ change in discount rate
- **Reconciliation** of opening and closing balances if Level 3

These disclosures allow users to understand the judgement and uncertainty involved.

CASE STUDY 3 — Unquoted Equity Investment (Private Company)

1. Fair value hierarchy level

This is a **Level 3** measurement because:

- There is **no active market** for the shares
- Inputs such as cash flow forecasts and company-specific risk adjustments are **unobservable**
- Observable market data (risk-free rate, market risk premium) may be used, but unobservable inputs are significant to the valuation

Therefore, Level 3 classification is required.

2. Valuation technique

The appropriate technique is the **Income Approach**, typically a **Discounted Cash Flow (DCF)** model:

- Forecast future cash flows
- Adjust for uncertainty and company-specific risk
- Apply a discount rate reflecting:
 - Risk-free rate (observable)
 - Market risk premium (observable)
 - Company-specific risk (unobservable)
- Include terminal value
- Present value of all future cash flows = fair value

If market multiples for comparable companies exist, a **market approach** may supplement the DCF, but private company data is usually limited.

3. Sensitivity analysis

IFRS 13 requires quantitative sensitivity disclosures for Level 3 measurements.

The entity must show how fair value changes when **key unobservable inputs** change, such as:

- **Discount rate**
 - E.g., +1% decreases fair value by X Rand
- **Long-term growth rate**
 - E.g., -0.5% reduces terminal value by Y Rand
- **Cash flow forecasts**
 - E.g., ±10% change in EBITDA affects fair value by Z Rand

This helps users understand the uncertainty and risk inherent in the valuation.
