IFRS 13: Prospective Transition Adjustments

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IFRS 13 *Fair Value Measurement* is required to be applied prospectively for annual periods beginning on or after January 1, 2013. IFRS 13 explains how to measure fair value and applies to fair value measurements and disclosures that are required or permitted by other IFRSs. IFRS 13 may affect the measurement and disclosure of fair value for both financial and non-financial assets and liabilities as well as an entity's own equity instruments.

In some instances, the fair value measurement basis required by IFRS 13 could differ from the determination of fair value required prior to applying IFRS 13. Accordingly, in such instances, the initial application of IFRS 13 will result in the recognition of a measurement adjustment.

For example, an entity owns land and a small office building (which constitute investment property) in the core of a growing city for 25 years. The land and building is surrounded by high-rise condominiums that were built in the last 5 years. The entity uses the fair value model to measure its investment property in accordance with IAS 40 *Investment Property*. Prior to applying IFRS 13, the fair value of the investment property was determined based on current rental rates and projected cash flows in accordance with paragraph 40 of IAS 40. On initial application of IFRS 13, the entity needs to also consider the guidance in IFRS 13 relating to the highest and best use of non-financial assets. Specifically, paragraph 27 of IFRS 13 states:

> "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 or by selling it to another market participant that would use the asset in its highest and best use."

In this example, the highest and best use of the investment property to a market participant may not be to simply use it in its current condition but rather to sell the land to a property developer or convert the property into a high-rise condominium. As a result, a measurement adjustment could arise upon the initial application of IFRS 13.

The Group considered when the initial application of IFRS 13 might result in measurement adjustments and what accounting treatment is appropriate for such adjustments.

The Group's Discussion

Group members observed that it has been some time since a new standard required prospective application and emphasized that the prospective application of IFRS 13 results in the same accounting treatment as a change in estimate under IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors.* This approach requires that any measurement adjustments upon initial application of IFRS 13 be recognized in the period of adoption through profit or loss or other comprehensive income. The adjustment would not be recognized in retained earnings (as would be the case if the standard had required retrospective application).

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Group members noted that whether the adjustment is recognized through profit or loss or other comprehensive income is determined by the requisite IFRS that requires an item to be measured at fair value (noting that IFRS 13 stipulates how to measure fair value not when or where). In the investment property example, the change in fair value upon initial application of IFRS 13 should be recognized in profit or loss because IAS 40 requires subsequent measurement adjustments to be recognized in profit and loss. Similarly, an entity should recognize a fair value measurement change arising upon initial application of IFRS 13 in other comprehensive income, when another IFRS requires the subsequent fair value changes to be recognized through other comprehensive income.

Group members observed that fair value measurements can be triggered at different points in time and, as a result, measurement adjustments on initial application of IFRS 13 could occur at different times. For example, a measurement adjustment relating to an asset that is regularly measured at fair value at each reporting period would be recognized in the first quarter. Other assets that are periodically adjusted to fair value would have a transition adjustment when that remeasurement occurs. For example, an entity may have a policy to test for impairment in the third quarter. In this case, the initial application would not trigger a transition adjustment because the asset is not remeasured at that time. Instead, a transition adjustment could arise following the impairment test performed in the third quarter and any measurement adjustment would be recognized at that time.

Some Group members expressed concern that some might approach IFRS 13 quite broadly and at too high a level. Group members noted that the initial application of IFRS 13 represents a significant change not only to financial instruments but to non-financial assets as well. Group members encouraged preparers to give IFRS 13 sufficient attention because the analysis required to apply IFRS 13 generally needs to be at a fairly detailed level. Group members noted that in many cases, such as the investment property example, IFRS 13 provides guidance when there was previously no guidance and correct application will require some detailed thought.

Group members emphasized that preparers should consider what disclosures are required by paragraphs 28 and 30 in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* in the annual financial statements in the year before and the year of initial application including, but not limited to, disclosures about the amount of the adjustment.

Group members observed that the International Accounting Standards Board (IASB) did not make a consequential amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards* to provide prospective transition relief for IFRS 13. As a result, Group members noted that entities that have not transitioned to IFRSs yet will need to think through how IFRS 13 should be applied and consider the effect of the general exception in IFRS 1 to avoid the use of hindsight.