Survey on the application of IFRS 13 *Fair Value Measurement* by Irish Companies

November 2016

MISSION

To contribute to Ireland having a strong regulatory environment in which to do business by supervising and promoting high quality financial reporting, auditing and effective regulation of the accounting profession in the public interest

DISCLAIMER

Whilst every effort has been made to ensure the accuracy of the information contained in this document, IAASA accepts no responsibility or liability howsoever arising from any errors, inaccuracies, or omissions occurring. IAASA reserves the right to take action, or refrain from taking action, which may or may not be in accordance with this document.

CONTENTS

		Page
1.	Financial reporting examination remit of IAASA	1
2.	Introduction	1
3.	Fair value measurement requirements under IFRS	1 – 2
4.	Purpose of this thematic survey	3
5.	Summary of key messages to preparers, Boards and Audit Committees	3
6.	Intangible assets acquired in business combinations by issuers during 2015	4
7.	Types of intangible assets recognised by issuers' analysed by sector	5
8.	Ratio of intangible assets to the total purchase consideration, analysed by sector	6
9.	Fair value: findings	6 – 10
	9.1 Intangible assets – measurement basis used and fair value methodologies	6 – 7
	9.2 Highest and best use – application to non-financial assets	7 – 8
	9.3 Fair value of liabilities acquired	8
	9.4 Fair value of liabilities including non–performance risk and credit enhancements	8 – 9
	9.5 Fair value of deferred contingent consideration	9
	9.6 Fair value of financial assets and financial liabilities	9 – 10
10.	Fair value judgements: areas of focus in future IAASA examinations	10

Appendix I – Classification of Irish issuers, by sector 11

Appendix II – Irish issuers covered by this survey 12

1 Financial reporting examination remit of IAASA

IAASA, Ireland's accounting enforcer, is tasked with the examination and enforcement of certain listed entities' periodic financial reporting ('issuers'). As such, IAASA examines the annual and half-yearly financial reports (together 'periodic financial reports') of certain equity, debt and closed-ended fund issuers with securities admitted to trading on a regulated market within the European Union ('EU') for compliance with the relevant reporting framework. The relevant reporting framework for the purposes of this document is confined to those issuers preparing their financial statements under International Financial Reporting Standards ('IFRS') as that is accounting framework applicable to the 28 issuers forming the basis for this desk-top survey[1].

2 Introduction

IAASA's 2015 *Observations* document noted an increase in acquisition activity amongst Irish equity issuers. In some technology, service and knowledge-based businesses increasing fair value is being attributed to certain types of intangible assets. These entities are required to make fair value judgements based, in many cases, on unobservable inputs. ESMA's[2] *Common Enforcement Priorities for 2015 Financial Statements* included fair value measurement and related disclosures as an area of focus for national accounting enforcers when examining issuer's 2015 financial statements.

It is important for entities to inform users of the measurement bases used in their financial statements (i.e. fair values of both financial and non-financial assets and liabilities) because the bases on which an entity prepares the financial statements significantly affects users' analysis [IAS 1.118 refers].

Where substantial amounts of intangible (and other non-financial) assets are recognised, this will impact the amount of goodwill recognised at inception and, in instances where assets are definite life assets, the annual depreciation charge in subsequent years is also affected.

As a consequence, IAASA has undertaken a desk-top survey of the fair value judgements made by issuers' directors in measuring the amounts to be recognised on the Statement of Financial Position (balance sheet) in respect of:

(a) intangible assets acquired; and

(b) financial assets acquired and financial liabilities assumed.

The survey examined the 2015/16 annual financial reports published by Allied Irish Banks plc, a debt issuer, and all 27 equity issuers falling with IAASA's financial reporting remit. Appendix II to this document lists the individual annual financial statements covered by this survey. In undertaking this desk-top survey, additional information was not sought from the selected issuers.

3 Fair value measurement requirements under IFRS

Paragraph 10 of IFRS 3 *Business Combinations* requires that, as of the acquisition date, an acquirer shall recognise, separately from goodwill, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree. IFRS 3.18 states that the acquirer shall measure the identifiable assets acquired and the liabilities assumed at their acquisition date fair values. IFRS 3.24 to 31 set out limited exceptions to these measurement principles.

IFRS 13 *Fair Value Measurements* describes how fair value is determined for financial and non-financial assets and liabilities and the application of the valuation premise for non-financial assets (including intangible assets) where assets are used alone or in combination with other assets.

[1] i.e. Allied Irish Banks plc, a debt issuer, and the 27 equity issuers falling with IAASA's financial reporting remit
[2] The European Securities and Markets Authority ('ESMA')

IFRS 13.2 requires that fair value is a market-based measurement and is not an entity-specific measurement. IFRS 13.3 requires that when a price for an identical asset or liability is not observable, the entity measures fair value using another valuation technique.

IFRS 13.27 requires that the fair value 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. Highest and best use of a non-financial asset establishes the valuation premise used to the fair value of the asset.

IFRS 13.42 requires the fair value of a liability reflects the effect of non-performance risk. Non-performance risk includes, but may not be limited to, an entity's own credit risk.

IFRS 13.61 requires an entity to use valuation techniques that are:

> '… *appropriate in the circumstances and for which sufficient data are available to measure fair value maximising the use of relevant observable inputs and minimising the use of unobservable inputs*.'

In some cases a single valuation technique will be appropriate and in other cases multiple valuation techniques will be appropriate [IFRS 13.63 refers].

Valuation techniques include the market approach, the cost approach and the income approach [IFRS 13.B5 to B11]. IFRS 13.B11 states that valuation techniques include, for example, the following:

(a) present value techniques;

(b) the multiple-period excess earnings method which is used to measure the fair value of some intangibles; and

(c) option pricing models.

As noted above, it is important for an entity to inform users of the measurement bases used in the financial statements [IAS 1[3].118 refers]. IAS 1.117(b) requires entities to disclose other accounting policies that are relevant to an understanding of the financial statements.

IAS 1.122 requires an entity to disclose, in the summary of significant accounting policies or other notes, the judgements, (apart from those involving estimations) that management has made that have the most significant effect on the amounts recognised in the financial statements.

Disclosure of the significant fair value judgements is important information for the users of financial statements and, in particular, where issuers' have material business combinations and/or acquire material amounts of financial assets and assume liabilities.

IFRS 13.91 to 97 require entities to disclose extensive fair value information depending on the fair value hierarchy into which its key inputs are categorised with additional information required for fair values that rely on Level 2 and Level 3 inputs.

For each class of assets and liabilities not measured at fair value in the Statement of Financial Position but for which the fair value is disclosed, an entity is required to disclose fair value information required by IFRS 13.93(b)(d) and (i) [IFRS 13.97 refers].

[3] IAS 1 *Presentation of Financial Statements*

4 Purpose of this thematic survey

The purpose of this document is to:

(a) quantify the amount and type of intangible assets acquired, arising from business combinations, at fair value during 2015, analysed by sector;

(b) provide an overview as to the fair value measurement policies applied by issuers to intangible assets acquired and financial liabilities assumed;

(c) assess the overall the quality of issuers' disclosure of the fair value of financial assets and financial liabilities; and

(d) encourage preparers, management and directors to reassess whether or not the fair value measurement policies are in full compliance with IFRS 13, IFRS 3 and IAS 1 and provide necessary and entity-specific information to users of the financial statements.

IAASA's observations as to how the results of this survey may inform future IAASA examination activities is set out at section 10 below.

Given the nature and scope of this desk-top survey, it is not possible to conclude as to the level of apparent compliance or otherwise with IFRS 13 fair value requirements by issuers. However, the findings provide indications as to aspects of IFRS 13 where closer examination by IAASA may be merited.

5 Summary of key messages to preparers, Boards and Audit Committees

Intangibles assets
IAASA's assessment of issuers' fair value measurement of intangible assets in issuers' reports is that there is room for improvement in the disclosures related to issuers' judgements and assumptions related fair value measurement of intangible assets. This is consistent with similar comments from ESMA (section 2 above refers).

In applying fair value judgements, IAASA encourages issuers to:

(a) provide more entity-specific disclosure that informs users of the measurement bases used in the fair value measurement of intangible assets;

(b) provide clearer disclosure of the key fair value judgements and assumptions that management has made and that have the most significant effect on the amounts of intangible assets recognised in the financial statements;

(c) provide more disclosure as to how material liabilities acquired are fair valued; and

(d) provide fair value disclosures, by class, of assets and liabilities where appropriate.

Financial assets and financial liabilities

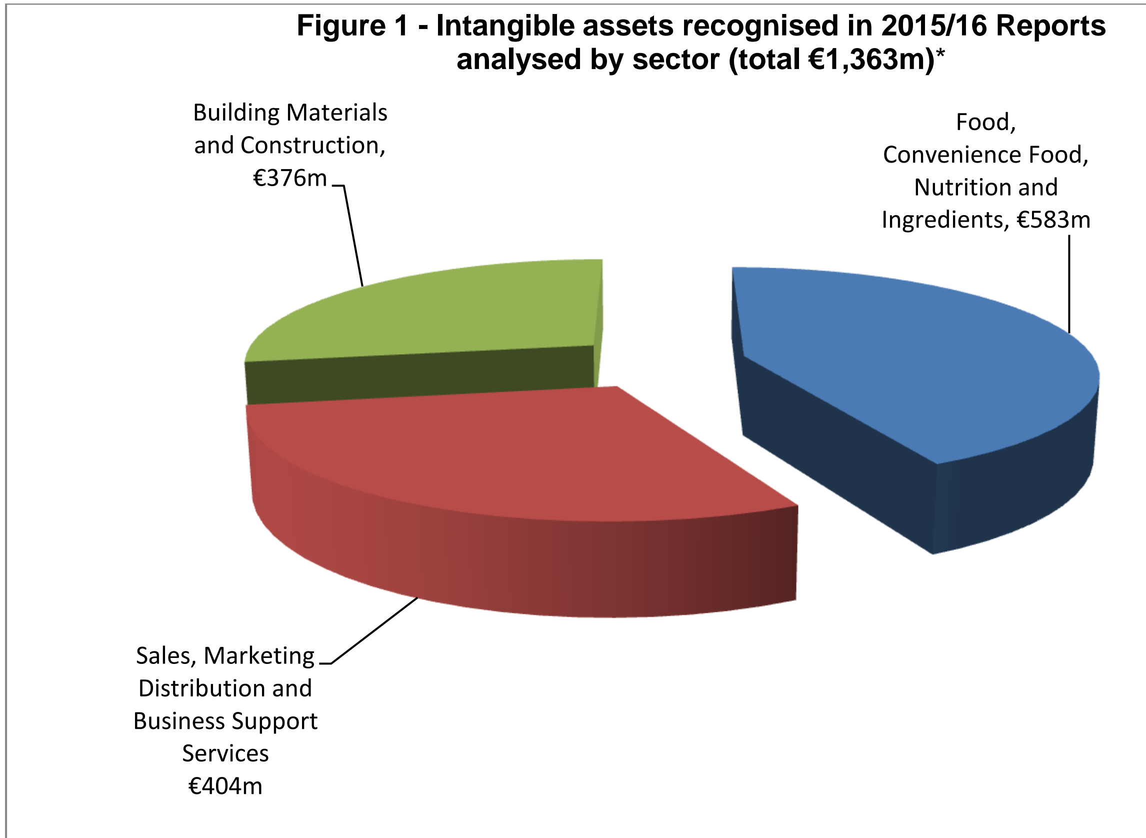
In applying fair value judgements, IAASA encourages issuers to:

(a) provide improved disclosure of collateral pledged and held; and

(b) for Level 3 prices, provide improved disclose as to whether or not reasonably possible alternative assumptions would change fair value significantly.

6 Intangible assets acquired in business combinations by issuers during 2015

The amount of intangible assets (excluding goodwill) acquired by issuers during fiscal 2015 was as follows:



** Where amounts are denominated in a non-euro currency, amounts are restated to euro at a 31 December 2015 foreign exchange rate*

7 Types of intangible assets recognised by issuers' analysed by sector

The nature and variety of intangible assets (including Goodwill), analysed by sector, is outlined below:

Sector	Class of Intangible assets (including goodwill)
Airline and Transportation	Computer software; and Landing rights.
Beverages	Brands; Distribution rights; Goodwill; and Trade relationships.
Biotech and Pharmaceutical	Customer relationships; Contract based and technology; Goodwill; Software; and Trade names.
Building Materials and Construction	Brands; Customer relationships (Customer related and contract based); Goodwill; Marketing related; Patents; (including Technological know how and order backlogs); Software; and Trade names.
Casino and Gaming	Brands; Computer software; Goodwill; and Licences.
Containers, Paper and Packaging	Customer related; Goodwill; Marketing related; and Software.
Financial Institution and Financial Services	Brands; Core deposit intangible assets; Computer software; Customer relationships; Goodwill; Other purchased intangible assets; and Purchased client books.
Food, Convenience Foods, Nutrition and Ingredients	Brands; Computer related; Customer relationships; Enterprise Resource Planning related intangibles; Goodwill; Patents; and Software.
Publishing and Broadcasting	Goodwill; Mastheads; and Software.
Sales, Marketing, Distribution and Business Support Services	Brand related intangibles: Customer and Supplier related intangibles; and Goodwill.
Technology: E-business infrastructure	Software.

8 Ratio of intangible assets to the total purchase consideration, analysed by sector

Sector	Total consideration for business combinations (€m)	Goodwill (€m)	Intangible assets (€m)	Intangibles as % of total net assets acquired %	Intangibles as % of Total Net Assets Hi%/Low %
Building Material and Construction	8,507	3,587	376	8%	54%/6%
Casino and Gaming	7	6	-	N/A*	N/A*
Containers, Paper and Packaging	153	112	-	N/A*	N/A*
Food, Convenience Food Nutrition and Ingredients	1,278	582	583	84%	139%/54%
Sales, Marketing, Distribution and Business Support Services	640	290	404	116%	116%/116%
Totals	**10,585**	**4,577**	**1,363**		

** N/A indicates that there were business combinations in which no intangible assets were acquired*

In technology/science based entities, the percentage of intangible assets and goodwill to total purchased consideration is at the highest relative to construction-related entities where intangible assets are a lower percentage of the total purchase consideration.

9 Fair value: findings

9.1 Intangible assets – measurement basis used and fair value methodologies

IFRS 13.61 states that an entity shall use valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

IFRS 13.63 states that in some cases a single valuation technique will be appropriate. In other cases, multiple valuation techniques will be appropriate. Valuation techniques may include, depending on the issuer's circumstances: the market approach [IFRS 13.B5 – B7], the cost approach [IFRS 13.B8 – B9] or the income approach [IFRS 13.B10 – B11].

Survey findings – fair value measurement basis (and disclosure) of intangible assets

The desk-top survey revealed the following:

(a) 19 out of 28 issuers recognised intangible assets;

(b) 11 out of 28 issuers reported business combinations during the year. Of these; 7 out of 11 issuers' recognised intangible assets;

(c) in 4 out 11 cases the auditors' report disclosed the fair value of intangibles as a area of audit focus;

(d) the average percentage of intangible assets acquired to total net assets acquired amounted to 23% (Range:139% - 6%); and

(e) a majority of issuers assessed that recognised intangible assets have finite lives.

An analysis of the 11 issuers (in (b) above) who reported business combinations during the year,

revealed the following:

(a) As regards the measurement basis applied to the fair value of intangible assets:

- 4 issuers disclosed that the income approach was applied to fair value intangible assets. For 3 out of 4 issuers the fair valuation method of intangibles was described as employing a '*discounted cash flow analysis using the present value of the estimated after-tax cash flows*';

- 2 issuers provided boilerplate references to intangible assets initial fair value being based on '*the fair value at acquisition date*' or reference to engaging '*independent experts*' to assist with the valuation of intangible assets;

- 3 issuers provided a description as to how the fair value of certain classes of intangible assets was determined; however, they were silent on the valuation approach applied to determine the fair value of other classes of intangible assets acquired; and

- the 2 remaining issuers did not acquire intangible assets as part of the business combination.

(b) Issuers use of independent valuation experts to determine the fair value of intangible assets

- only 2 out of 7 issuers having acquired material amounts of intangible assets in business combinations refer to the use of independent experts to assist with the valuation of intangible assets.

(c) Valuation methodologies applied for intangible assets: Entity-specific disclosures:

- it was not apparent from the financial statements which specific valuation methodologies had been applied by issuers to each class of intangible assets (e.g. multiple-period excess earnings, relief from royalty method, Greenfield method);

- 3 out of 9 issuers' disclosed the unobservable inputs used in the valuation of intangible assets included:

  - risk adjusted discount rates;
  - revenue forecasts;
  - estimated customer attrition;
  - royalty savings; and
  - the expected useful life of the intangible asset acquired.

  The remaining 6 of 9 issuers were silent on the key assumptions used.

9.2 Highest and best use – application to non-financial assets

IFRS 13.27 states that 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.

IFRS 13.29 states that highest and best use is determined from the perspective of market participants, even if the entity intends a different use. However, an entity's current use of a non-financial asset is presumed to be its highest and best use unless market or other factors suggest that a different use by market participants would maximise the value of the asset.

The valuation premise for non-financial assets in IFRS 13.31 to 33 and IFRS 13.B3 is relevant. IFRS 13.31 states that highest and best use of a non-financial asset might provide maximum value to market participants through its use:

(a) in combination with other assets as a group; or

(b) in combination with other assets and liabilities (e.g. a business); or

(c) on a stand-alone basis.

Survey findings – highest and best use

- 19 of 28 issuers made no reference as to whether or not the fair value of non-financial assets (including but not limited to intangible assets) was its highest and best use;
- 4 issuers disclosed selected non-financial assets were carried at highest and best use; and
- for 5 issuers, the highest and best use was not applicable because there was not a significant amount of non-financial assets recognised by those issuers.

An entity's current use of a non-financial asset (including intangible assets) is presumed to be its highest and best use unless market or other factors suggest that a different use by market participants would maximise the value of the asset. There is no evidence to suggest that issuers' judgements of highest and best use is inconsistent with a market participant's perspective as required by IFRS 13.93(h)(i). IAASA will monitor issuers' assessment of highest and best use and whether market factors or other information suggest a different use may maximise the value of an asset.

9.3 Fair value of liabilities acquired

Survey findings – fair value of liabilities

- the carrying value of liabilities acquired in business combinations was stated to be an approximation to fair value in most cases, or, the fair value adjustment during the measurement period post acquisition was not material;
- in a small number of acquisitions it was noted that there was a *material adjustment* to the carrying value of liabilities in order to bring the liabilities carrying value at date of acquisition to fair value. In these instances preliminary observations indicate the adjustment may have related to adjustment to provisions;
- in 23 out of 28 cases the fair value of borrowing was clearly disclosed. In 3 cases the fair value of borrowings was not disclosed and in 2 cases the amounts were not material; and
- in most cases the fair value of borrowings was described as calculated as '*based on the expected future principal and interest cash flows, discounted at appropriate current market interest rates*' or similar text.

In the event that liabilities assumed are material in future reports, IAASA may examine in more depth the fair value adjustments applied to liabilities assumed and the methodologies applied therein.

9.4 Fair value of liabilities including non–performance risk and credit enhancements

IFRS 13.43 states that when measuring the fair value of a liability, an entity shall take into account the effect of its credit risk and any other factors that might influence the likelihood that the obligation will or will not be fulfilled. That effect may differ depending on the liability, for example:

(a) whether the liability is an obligation to deliver cash (a financial liability) or an obligation to deliver goods or services (a non-financial liability); and

(b) the terms of credit enhancements related to the liability, if any.

Survey findings – fair value of liabilities including non–performance risk

Based on the desktop nature of the survey and in the absence of further explanations from issuers it was not possible to determine to what extent liabilities reflect the effect of non-performance risk and credit enhancements.

- 1 issuer disclosed that the fair value of loans is discounted at interest rates effective at the balance sheet date and adjusted for credit spreads;

- 1 issuer stated that the discount rate used reflected the Group's own credit risk; and
- in general, it was not possible to determine whether or not the fair value of liabilities reflected third party credit enhancements.

As deemed appropriate IAASA may examine in more depth the fair value measurement of liabilities including non–performance risk in future reports.

9.5 Fair value of deferred contingent consideration

Survey findings – fair value measurement of deferred contingent consideration

- 11 out of 28 issuers reported recognising contingent consideration;
- the determination of the fair value of contingent consideration was described in issues financial statements as follows:
  - discounting the estimated amounts payable to their present value at the acquisition date;
  - through discounting the expected payment based on scenario modelling to present value;
  - by applying a risk adjusted discount rate to the future payments which are based on forecasted operating profits of the acquired entity over the relevant period;
  - estimated using an income approach. Contingent consideration that has been recognised is adjusted by the application of a range of outcomes and associated probabilities in order to determine the carrying amount; and
  - in some instances the issuers policy on the valuation of contingent consideration was not disclosed in the financial statements.

In some cases, the absence of a valuation policy for contingent consideration is mitigated by the amounts currently recognised being not material.

Some issuers did not disclose a valuation policy for contingent consideration despite having recognised contingent consideration in the current or prior periods.

9.6 Fair value of financial assets and financial liabilities

Survey findings – Fair value measurement of financial assets and financial liabilities

The survey reveals that there is a high level of compliance with the fair value disclosure requirements for financial assets and financial liabilities in some areas, with room for improvement in other areas as following:

- 27 out of 28 issuers clearly disclosed the fair value of financial assets and financial liabilities as at the end of the period;
- 27 out of 28 issuers clearly disclosed the fair value hierarchy (Level 1, 2, and 3);
- 24 out of 28 issuers provided narrative description of the sensitivity of level 3 fair values to changes in unobservable inputs or the amounts in level 3 were not material; and
- 24 out of 28 issuers provided a description of the valuation techniques and the inputs.

However, the following indicates that there is still room for improvements in issuers' financial asset/liabilities fair value disclosures:

- In 9 out of 28 cases it was not clear:
    - whether or not collateral was pledged and whether or not collateral was held;
    - what collateral was pledged and what collateral was held; or
    - what was the fair value of collateral pledged/held in accordance with IFRS 7.14(a) and 15(a); and
- 13 out of 28 issuers did not appear to disclose for Level 3 fair value measurements whether or not reasonably possible alternative assumptions would change fair value significantly.

10 Fair value judgements: areas of focus in future IAASA examinations

IAASA will continue to examine the determination of fair values in issuers' periodic financial reports including, but not limited to, the following:

(a) examination of the types of intangible assets recognised (or not recognised) by issuers;

(b) the measurement basis and valuation techniques used by class of intangible asset;

(c) evaluation as to whether or not the valuation techniques employed in measuring intangible assets maximise the use of observable inputs and minimise the use of unobservable inputs;

(d) examination of fair value adjustments within the measurement period after initial measurement and the reasons for same;

(e) the consistency of the key assumptions with other elements of the financial statements (e.g. discount rates in fair value measurement as compared to discount rates used elsewhere in the financials statements):

(f) the use of independent valuation experts in fair value measurements;

(g) fair value measurement of liabilities including whether or not and, if so, how they reflect non-performance risk and credit enhancements and the use of discount rates;

(h) the quality of the disclosure of collateral pledged or held; and

(i) for Level 3 prices issuers' disclosure of reasonably possible alternative assumptions that would change fair value significantly.

Appendix I – Classification of Irish issuers, by sector

Sector	Issuer	Reporting date
Airline and Transportation	Irish Continental Group plc Ryanair Holdings plc	31 December 2015 31 March 2016
Beverages	C&C Group plc	29 February 2016
Biotech and Pharmaceutical	Mainstay Medical International plc UDG Healthcare plc	31 December 2015 30 September 2015
Building Material and Construction	CRH plc Grafton Group plc Kingspan Group plc	31 December 2015 31 December 2015 31 December 2015
Casino and Gaming	Paddy Power Betfair plc	31 December 2015
Containers, Paper and Packaging	Smurfit Kappa Group plc	31 December 2015
Financial Institution and Financial Services	Allied Irish Banks plc Bank of Ireland IFG Group plc Permanent TSB Group Holdings plc	31 December 2015 31 December 2015 31 December 2015 31 December 2015
Food, Convenience Foods, Nutrition and Ingredients	Aryzta plc Glanbia plc Greencore Group plc Kerry Group plc	31 July 2015 2 January 2016 25 September 2015 31 December 2015
Homebuilders	Cairn Homes plc	31 December 2015
Insurance	FBD Holdings plc	31 December 2015
Oil, Gas and Mining Companies	Aminex plc Kenmare Resources plc	31 December 2015 31 December 2015
Publishing and Broadcasting	Independent News and Media plc	31 December 2015
Real Estate Investment Trust	Green REIT plc Hibernia REIT plc Irish Residential Property REIT plc	30 June 2015 31 March 2016 31 December 2015
Sales, Marketing, distribution and Business Support Services	DCC plc	31 March 2016
Technology: E-business infrastructure	Datalex plc	31 December 2015

Appendix II – Irish issuers covered by this survey

	Issuer	Reporting date	Business combinations occurred during the year
1	Allied Irish Banks plc[4]	31 December 2015	No
2	Aminex plc	31 December 2015	No
3	Aryzta AG	31 July 2015	Yes
4	Bank of Ireland	31 December 2015	No
5	Cairn Homes plc	31 December 2015	Yes
6	C&C Group plc	29 February 2016	No
7	CRH plc	31 December 2015	Yes
8	Datalex plc	31 December 2015	No
9	DCC plc	31 March 2016	Yes
10	FBD Holdings plc	31 December 2015	No
11	Glanbia plc	2 January 2016	Yes
12	Grafton Group plc	31 December 2015	Yes
13	Greencore Group plc	25 September 2015	No
14	Green REIT plc	30 June 2015	No
15	Hibernia REIT plc	31 March 2016	Yes
16	Irish Continental Group plc	31 December 2015	No
17	IFG Group plc	31 December 2015	No
18	Independent News and Media plc	31 December 2015	No
19	Irish Residential Properties REIT plc	31 December 2015	No
20	Kerry Group plc	31 December 2015	Yes
21	Kenmare Resources plc	31 December 2015	No
22	Kingspan Group plc	31 December 2015	Yes
23	Mainstay Medical International plc	31 December 2015	No
24	Paddy Power Betfair plc	31 December 2015	Yes
25	Permanent TSB Group Holdings plc	31 December 2015	No
26	Ryanair Holdings plc	31 March 2016	No
27	Smurfit Kappa Group plc	31 December 2015	Yes
28	UDG Healthcare plc	30 September 2015	No

[4] Debt issuer