

CA



THE INSTITUTE OF
CHARTERED ACCOUNTANTS
OF SRI LANKA

**GUIDELINES ON VALUATION OF PROPERTY,
PLANT AND EQUIPMENT, INVESTMENT PROPERTY
AND BIOLOGICAL ASSETS FOR THE PURPOSE OF
FINANCIAL REPORTING**

**Guidelines on Valuation of Property, Plant and Equipment,
Investment Property and Biological Assets for the purpose of
Financial Reporting**

Disclaimer

The purpose of this document is to provide guidance to the preparers, practitioners and the valuers in arriving the fair value of Property, Plant and Equipment, Investment Property and Biological Assets for the purpose of Financial Reporting.

Where there is conflict between a recommendation contained in these Guidelines and the requirements of any applicable laws or regulations or accounting standards, the latter requirements shall take precedence. The Institute of Chartered Accountants of Sri Lanka can neither accept any responsibility or liability whatsoever (whether in respect of negligence or otherwise) to any party as a result of anything contained in or omitted from the Guidelines, nor for the consequences of reliance or otherwise on the provisions of these Guidelines.

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Introduction

Valuations are widely used for the purpose of financial reporting. The objective of this Guideline is to ensure the reliability and consistency in valuation of **Property, Plant and Equipment (PPE), Investment Property (IP) and Biological Assets (BA)** by providing a framework for financial reporting purposes. The requirements and implications of Sri Lanka Accounting Standards (SLFRSs) and International Valuation Standards (IVS) have been considered in the preparation of this Guideline. This is produced to clarify the aspects on such assets' valuation for the purpose of financial reporting in order to agree on a consistent application.

Application

This application guideline applies for the purpose of ascertaining, the value of such assets under Sri Lanka Accounting Standards. Valuations undertaken for inclusion in financial statements shall be required to meet the Sri Lanka Accounting Standards that are applicable and the principles contained in the General Valuation Standards, except as specifically modified by a requirement of the relevant accounting standard.

Qualifications

Every external valuation of PPE, IP and BA for the financial reporting purposes for the entities having public accountability, shall be undertaken by qualified valuers who meet the eligibility criteria of either A, B or C as given below;

- A. A corporate member of the Institute of Valuers of Sri Lanka (IVSL) who shall be:
 - i. A Fellow member; or
 - ii. A Graduate member with 5 years of experience in such grade of membership; or
 - iii. An Associate member with 20 years of experience in such grade of membership; or

- B. A corporate member of the Royal Institution of Chartered Surveyors of the United Kingdom (RICS) who shall be:
 - i. A Fellow member; or
 - ii. A member of RICS with 5 years of experience in such grade of membership.

- C. For assets of Technologically or otherwise of specialist nature, if the valuer deems necessary he shall seek expert advice in the fair value assessment.

Conflict of Interest

Professionals involved in the valuation of PPE, IP and BA for financial reporting purposes are expected to comply with the ethical requirements (eg: the members of the Institute of Chartered Accountants of Sri Lanka – Code of Ethics) Hence, he shall take reasonable steps to identify circumstances that could pose a conflict of interest. Upon evaluating the significance of threats,

if any he shall apply safeguards when necessary to eliminate the threats or reduce them to an acceptable level. Also, before accepting or continuing a client relationship or specific engagement, such professional shall evaluate the significance of any threats created by business interests or relationships with the client or a third party.

However, every external valuation of such assets for the entities having *public accountability* shall be undertaken by the valuers who are not within the scope of Related Parties. (as defined in Paragraph 9 of LKAS 24 *Related Party Disclosures*)

Effective Date of the Valuation Report

Valuation report shall state the effective date of the valuation and such value shall be recognized in the financial statements from that date.

Basis of Valuation

The basis of valuation for financial reporting shall be the **fair value** as set out in SLFRS 13 *Fair Value Measurement*.

Scope of Work

Management shall ensure that the report includes a description of the purpose of the valuation, extent of investigation, procedures adopted, assumptions and the limitations.

Report Contents

The list of items that shall be included in a valuation report are set out in Annexure 01.

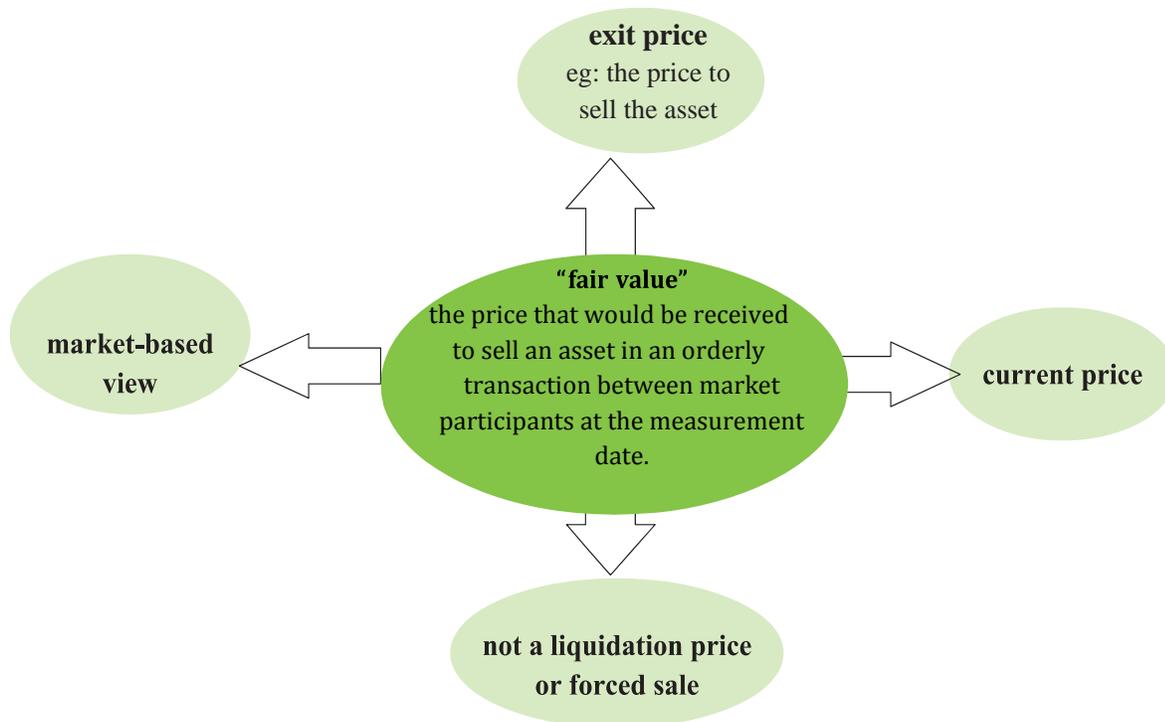
Guidance from SLFRS 13 in arriving at the fair value for the purpose of financial reporting

Overview

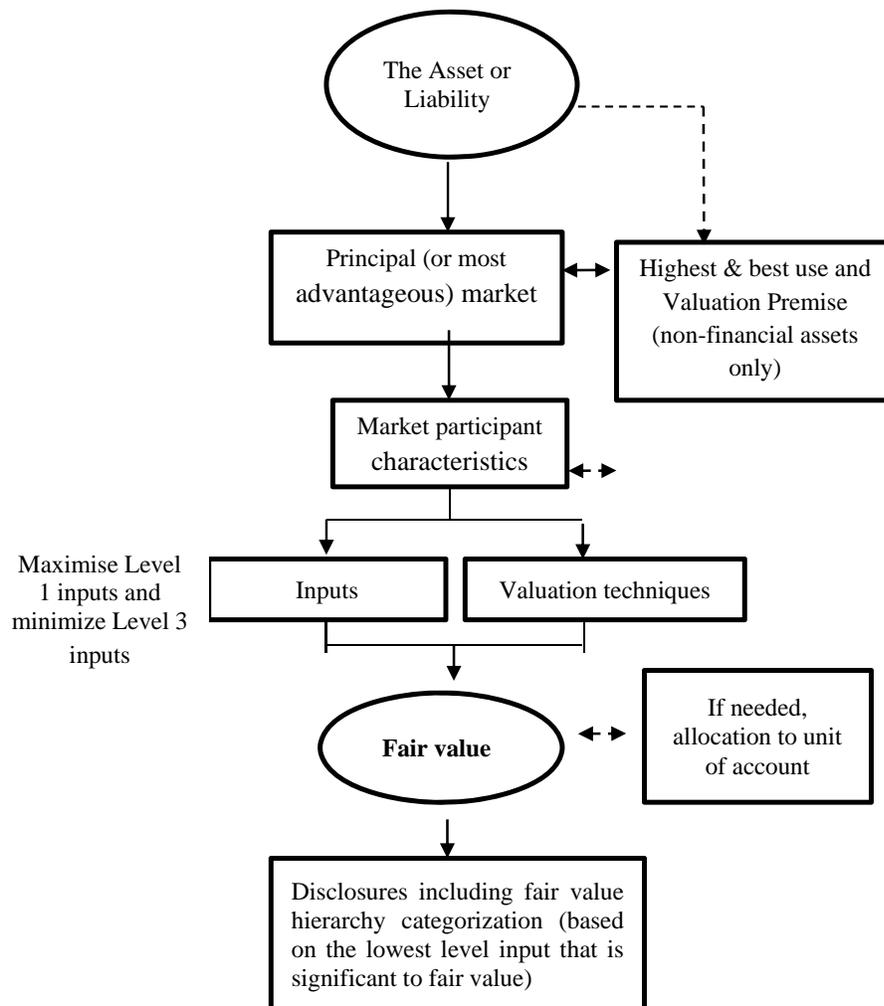
Sri Lanka Accounting Standard – SLFRS 13 provides a fair value measurement framework to apply to both initial and subsequent measurement, if fair value is required or permitted by other SLFRSs, based on an objective to estimate the price at which an orderly transaction to sell the asset would take place between market participants at the measurement date under current market conditions (ie an exit price from the perspective of a market participant that holds the asset at the measurement date) at the principal market (or in the absence of a principal market, in the most advantageous market) to measure such items at fair value.

Eg:

- Fixed assets which are subsequently measured in accordance with the revaluation model in LKAS 16 *Property, Plant and Equipment* are within the scope of SLFRS 13 in terms of both measurement and disclosure.
- Investment property, regardless of whether this is measured in accordance with the fair value model or the cost model under LKAS 40 *Investment Property*. Even when the cost model is followed, investment property is within the scope of SLFRS 13, as Paragraph 79(e) of LKAS 40 requires fair value to be disclosed (therefore requiring measurement).



Framework on the Fair Value Measurement



The Asset of Liability

A fair value measurement is for a particular asset or liability. Therefore, when measuring fair value an entity shall take into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Such characteristics include, for example, the following:

- the condition and location of the asset; and
- restrictions, if any, on the sale or use of the asset.

Example: Restrictions on the use of an asset

A donor of land specifies that the land must be used by a sporting association as a play contributes land in an otherwise developed residential area to a not-for-profit neighbourhood association. The land is currently used as a playground. Upon review of relevant documentation, the association determines that the donor's restriction would not transfer to market participants if the association sold the asset, being the donor restriction on the use of the land is specific to the association. Furthermore, the association is not restricted from

selling the land. Without the restriction on the use of the land by the association, the land could be used as a site for residential development. In addition, the land is subject to an easement (ie a legal right that enables a utility to run power lines across the land).

Hence, the effect on the fair value measurement of the land arising from the restriction and the easement is as follows:

- (a) Donor restriction on use of land. Because in this situation the donor restriction on the use of the land is specific to the association, the restriction would not be transferred to market participants. Therefore, the fair value of the land would be the higher of its fair value used as a playground (ie the fair value of the asset would be maximised through its use by market participants in combination with other assets or with other assets and liabilities) and its fair value as a site for residential development (ie the fair value of the asset would be maximised through its use by market participants on a stand-alone basis), regardless of the restriction on the use of the land by the association.
- (b) Easement for utility lines . Because the easement for utility lines is specific to (ie a characteristic of) the land, it would be transferred to market participants with the land. Therefore, the fair value measurement of the land would take into account the effect of the easement, regardless of whether the highest and best use is as a playground or as a site for residential development.

Principal or the most advantageous market

Fair value is the price obtained from selling an asset in transaction that takes place in either:

- The principal market, or
- The most advantageous market (where no principal market exists).

In order to establish the principal (or the most advantageous) market, an entity needs to evaluate potential markets. An entity does not have to undertake an exhaustive search to find the principal (or the most advantageous) market. Nevertheless, all information that is available must be considered. Where there is no information to the contrary, the market in which the entity usually transacts for the item is presumed to be the principal (or the most advantageous) market.

Once an entity identifies the principal market, the fair value must be measured in that market, even if another market (or markets) exist that are more advantageous. In addition, the potential market must be accessible as at measurement date.

Eg: An asset is sold in two different active markets at different prices.

Market	A	B
Annual Volume	30,000	20,000
Trades per month	30	12
Price received	2,600	2,500
Transaction costs	300	100
Transport cost	200	200
Net Amount received	2,100 (2,600-300-200)	2,200 (2,500-100-200)
Market Status	Principal Market (the market with greatest volume & level of activity)	Most Advantageous Market (if Market / information is not available for access)
Possible Fair Value	2,400 (2,600-200)	2,300 (2,500-200)

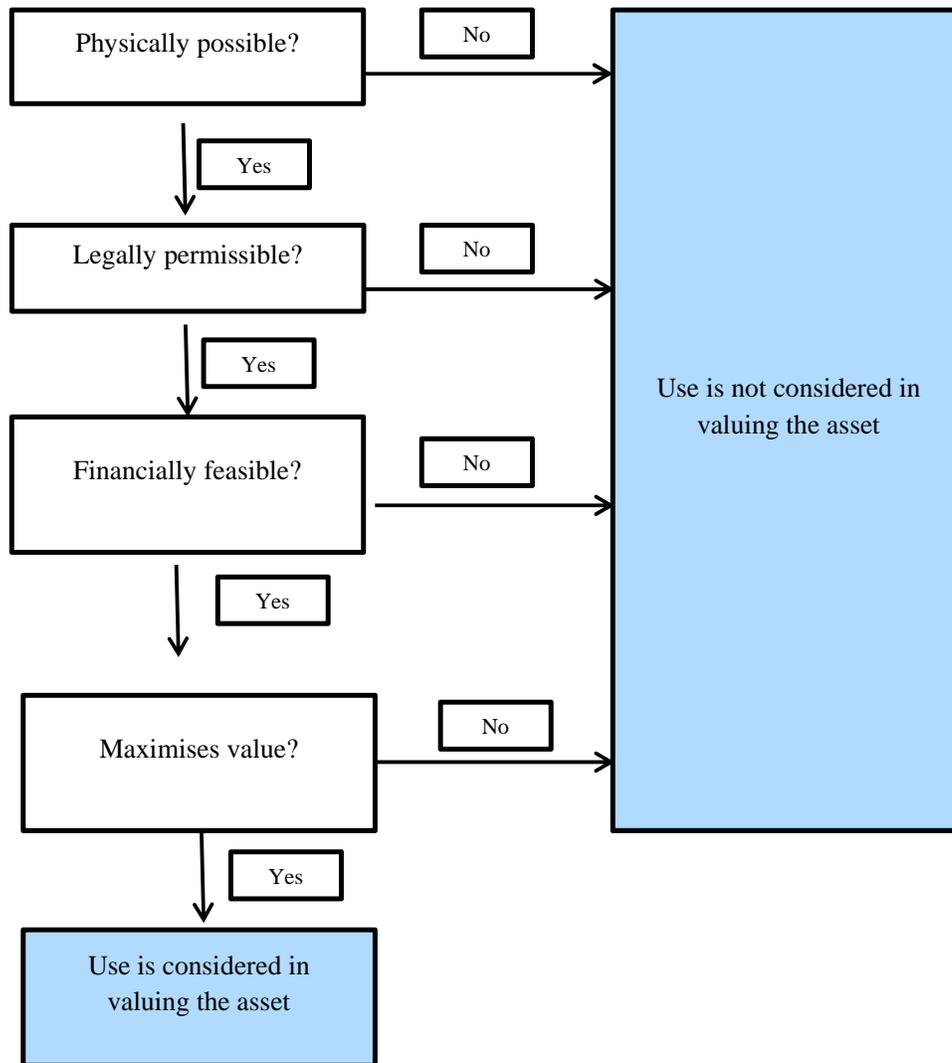
Highest and best use for non-financial assets

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 by taking into account the use of the asset that is:

- physically possible – physical characteristics of the asset that market participants would take into account when pricing the asset (eg the location or size of a property).
- legally permissible – consider legal restrictions on the use of the asset that market participants would take into account when pricing the asset (eg: the zoning regulations applicable to a property).
- financially feasible – consider whether that physically possible and legally permissible asset, generates adequate income or cash flows (taking into account the costs of converting the asset to that use) to produce an investment return that market participants would require from an investment in that asset put to that use.

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 maximize the value of the asset.

Even though, an entity does not intend to use the asset according to its highest and best use (eg: entity plans to use defensively by preventing others from using it, to protect its competitive position), the entity shall measure the fair value of a non-financial asset assuming its highest and best use by market participants.



Characteristics of the Market participants

When measuring fair value, an entity is required to use the assumptions the assumptions that market participants would use when pricing the asset or liability. Instead, of identifying specific market participants, an entity must identify characteristics of market participants that would generally transact for the asset or liability being measured. When determining these characteristics, an entity takes into consideration factors that are specific to the asset or liability; the principal (or most advantageous) market; and the market participants in that market and may require significant judgement. For example, a residential real estate development entity may be considered a market participant when measuring the fair value of land held by a manufacturing company if the highest and best use of the land is deemed to be residential real estate development.

SLFRS 13 assumes that market participants have all of the following characteristics:

- they are independent of each other, that is, they are not related parties;

- they are knowledgeable, having a reasonable understanding about the asset or liability using all available information, including information obtained through usual and customary due diligence efforts;
- they are able to enter into a transaction for the asset or liability; and
- they are willing to enter into a transaction for the asset or liability, that is, they are motivated but not forced or otherwise compelled to do so.

Valuation Techniques

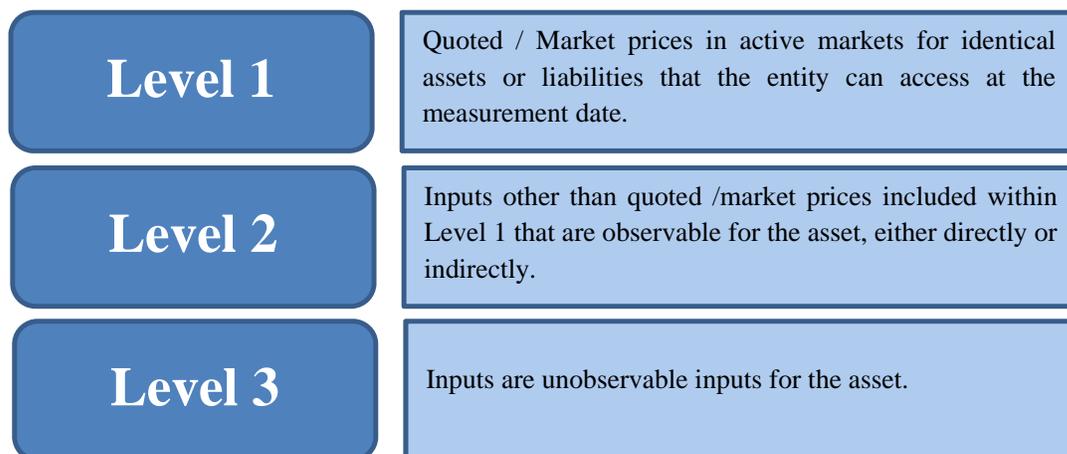
An entity shall use **valuation techniques** that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs. **Observable inputs** are those that are developed using market data, such as publicly available information about actual events or transactions, and that reflect the assumptions that market participants would use when pricing the asset or liability. **Unobservable inputs** are those for which market data are not available and that are developed using the best information available about the assumptions that market participants would use when pricing the asset or liability.

Three widely used valuation techniques are: market approach, cost approach and income approach. Revisions resulting from a change in the valuation technique or its application shall be accounted for as a change in accounting estimate in accordance with LKAS 8. However, the disclosures in LKAS 8 for a change in accounting estimate are not required for revisions resulting from a change in a valuation technique or its application.

Inputs to Valuation Techniques

Inputs to Valuation Techniques are the assumptions that market participants would use in pricing the asset or liability.

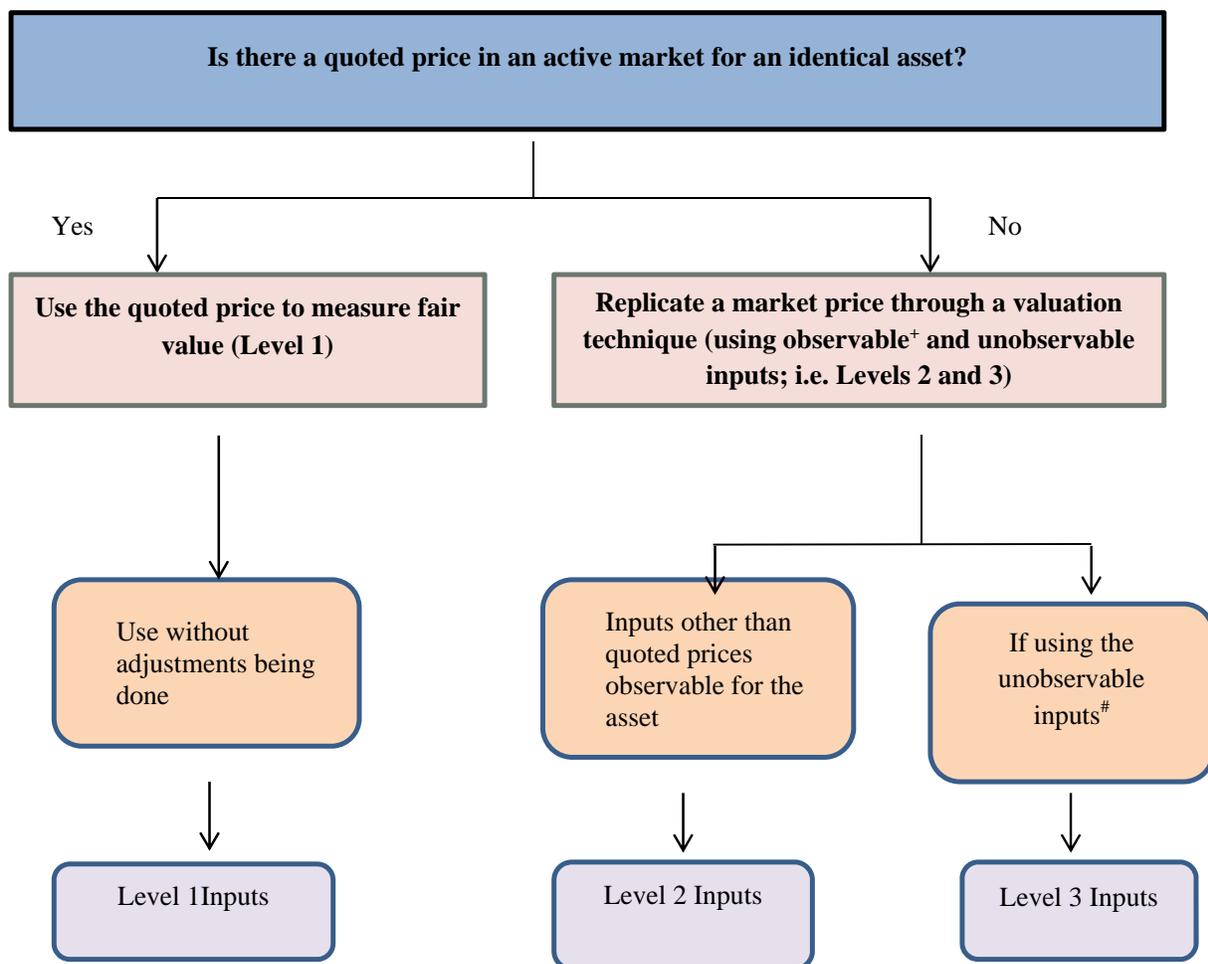
Fair value hierarchy categorises the inputs into three levels to measure the fair value;



Level two inputs: If the asset has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset.

Level three inputs, ie. unobservable inputs are used to measure fair value to the extent that relevant observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset at the measurement date. An entity develops unobservable inputs using the best information available in the circumstances, which might include the entity's own data, taking into account all information about market participant assumptions that is reasonably available.

The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1 inputs) and the lowest priority to unobservable inputs (Level 3 inputs). Therefore, estimating fair value using significant Level 3 inputs is frequently inherently challenging due to the absence of market data.

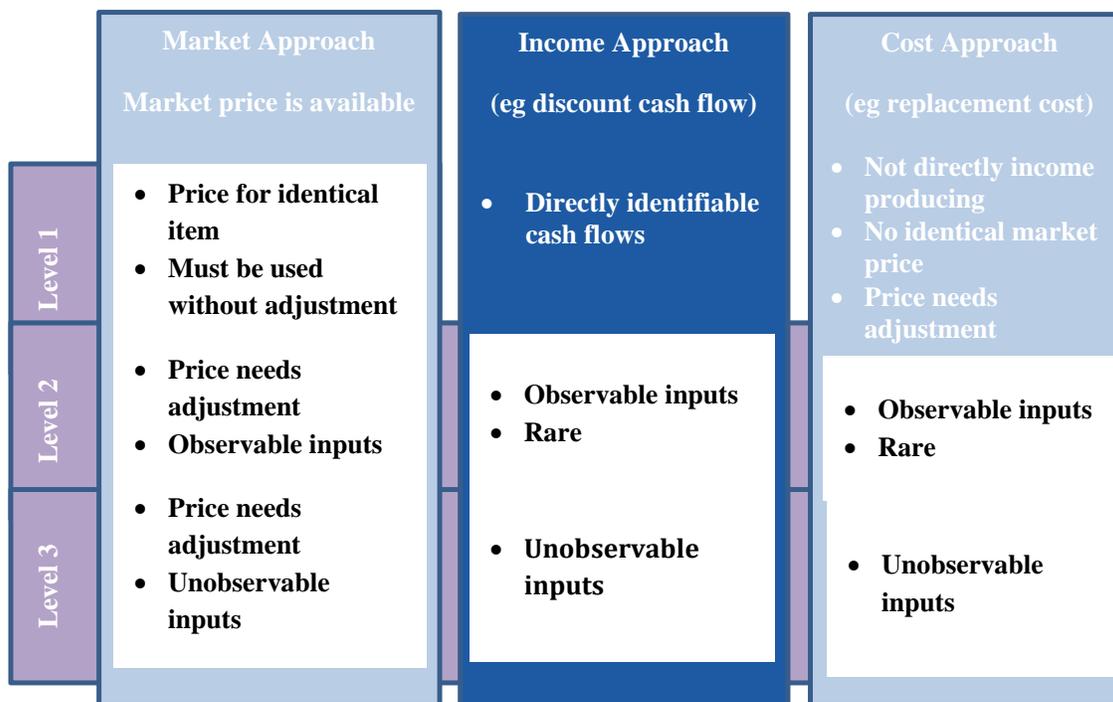


Maximise the use of relevant observable inputs. Observable inputs include market data (prices and other information that is publicly available).

Unobservable inputs include the entity's own data (budget, forecasts) which must be adjusted if market participants would use different assumptions.

Valuation techniques

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 minimizing the use of unobservable inputs



The **market approach** uses prices and other relevant information generated by market transactions involving identical or comparable (i.e. similar) assets, liabilities or a group of assets and liabilities, such as a business.

Eg: market multiples derived from a set of comparables.

The **cost approach** reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost). From the perspective of a market participant seller, the price that would be received for the asset is based on the cost to a market participant buyer to acquire or construct a substitute asset of comparable utility, adjusted for obsolescence. Obsolescence encompasses physical deterioration, functional (technological) obsolescence and economic (external) obsolescence and is broader than depreciation for financial reporting purposes (an allocation of historical cost) or tax purposes (using specified service lives).

Eg: Current Replacement Cost method / Depreciated Replacement Cost

The **income approach** converts future amounts (eg cash flows or income and expenses) to a single current (ie discounted) amount. When the income approach is used, the fair value measurement reflects current market expectations about those future amounts. Those valuation techniques include, for example, the following:

- (a) present value techniques;

A fair value measurement of an asset using a present value technique captures all the following elements from the perspective of market participants at the measurement date:

- (i) an estimate of future cash flows for the asset being measured.
 - (ii) expectations about possible variations in the amount and timing of the cash flows (i.e. minimum explicit time period of five years) representing the uncertainty inherent in the cash flows.
 - (iii) the time value of money, represented by the risk-free interest rate.
 - (iv) a risk premium.
 - (v) other factors that market participants would take into account in the circumstances.
- (b) the multi-period excess earnings method, which is used to measure the fair value of some intangible assets.

An entity might need to make valuation adjustments, when using a valuation technique because market participants would make those adjustments when pricing a financial asset under the market conditions at the measurement date, including adjustments for measurement uncertainty.

An entity shall apply a consistent valuation technique and a change is allowed only in limited & justifiable circumstances.

Calibration of Valuation Techniques that uses unobservable inputs

If the transaction price is fair value at initial recognition and a valuation technique that uses unobservable inputs will be used to measure fair value in subsequent periods, the valuation technique shall be calibrated so that at initial recognition the result of the valuation technique equals the transaction price.

Calibration ensures that the valuation technique reflects current market conditions, and it helps an entity to determine whether an adjustment to the valuation technique is necessary (eg there might be a characteristic of the asset that is not captured by the valuation technique). After initial recognition, when measuring fair value using a valuation technique or techniques that use unobservable inputs, an entity shall ensure that those valuation techniques reflect observable market data (eg the price for a similar asset) at the measurement date.

Componentisation and Depreciation

The main objective of this approach is to reflect more precisely the pattern in which the asset's future economic benefits are expected to be consumed by the entity.

Recognition and depreciation:

Where the carrying amount is based on historic cost, the cost of those components that both have a significant cost in relation to the total and that have a materially different useful life shall be readily identifiable. (G16 of IVS 300)

Where the carrying amount is based on the fair value / revaluation of the item, an allocation will need to be made of the fair value of the item between the components.

Although it may be possible to determine the value attributable to a component of an item of plant or equipment if there is an active market for those components, in other cases the components will not be actively traded. The latter is normally the case with components of a building, eg buildings are rarely sold without the mechanical and electrical services needed for heating, lighting and ventilation, and the installed plant could not be sold without the building. (G17 of IVS 300)

Where the value of the individual components cannot be reliably determined, the value attributable to the whole lot is apportioned to the components. The ratio of the cost of the item to the cost of the whole lot may be an appropriate basis for such an apportionment. Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item and may be having different useful life times shall be depreciated separately. (Paragraph 43 of LKAS 16)

A condition of continuing to operate an item of property, plant and equipment (for example, an aircraft) may be performing regular major inspections for faults regardless of whether parts of the item are replaced. When each major inspection is performed, its cost is recognised in the carrying amount of the item of property, plant and equipment as a replacement if the recognition criteria are satisfied. Any remaining carrying amount of the cost of the previous inspection (as distinct from physical parts) is derecognised. This occurs regardless of whether the cost of the previous inspection was identified in the transaction in which the item was acquired or constructed. If necessary, the estimated cost of a future similar inspection may be used as an indication of what the cost of the existing inspection component was when the item was acquired or constructed.

Derecognition (Paragraph 70 of LKAS 16):

If under the recognition principle (in paragraph 7 of LKAS 16), an entity recognizes in the carrying amount of an item of property, plant and equipment the cost of a replacement for part of the item, then it derecognises the carrying amount of the replaced part, regardless of whether the replaced part had been depreciated separately. If it is not practicable for an entity to determine the carrying amount of the replaced part, it may use the cost of the replacement as an indication of what the cost of the replaced part was at the time it was acquired or constructed.

Exchange of Assets

All items of property, plant and equipment acquired in exchange for non-monetary assets or a combination of monetary and non-monetary assets should be measured at fair value, except that, if the exchange transaction lacks commercial substance (i.e. transaction did not have a discernible effect on an entity's economics) or the fair value of neither of the assets exchanged can be determined reliably, then the cost of the asset acquired in the exchange should be measured at the carrying amount of the asset given up.

In evaluating whether a transaction has commercial substance, an entity should calculate the present value of the post-tax cash flows that it can reasonably expect to derive from the portion of its operations affected by the transaction. The discount rate should reflect the entity's current assessment of the time value of money and the risks specific to those operations rather than those that marketplace participants would make.

Impairment of Assets

An entity shall assess at the end of each reporting period whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset.

In assessing whether there is any indication that an asset may be impaired, an entity shall consider, as a minimum, the following indications:

External sources of information

- (a) there are observable indications that the asset's value has declined during the period significantly more than would be expected as a result of the passage of time or normal use.
- (b) significant changes with an adverse effect on the entity have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the entity operates or in the market to which an asset is dedicated.
- (c) market interest rates or other market rates of return on investments have increased during the period, and those increases are likely to affect the discount rate used in calculating an asset's value in use and decrease the asset's recoverable amount materially.
- (d) the carrying amount of the net assets of the entity is more than its market capitalisation.

Internal sources of information

- (e) evidence is available of obsolescence or physical damage of an asset.
- (f) significant changes with an adverse effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, an asset is used or is expected to be used. These changes include the asset

Paragraph 9 of the Sri Lanka Auditing Standard 500 *Audit Evidence* states that if information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes:

- (a) Evaluate the competence, capabilities and objectivity of that expert;
- (b) Obtain an understanding of the work of that expert; and
- (c) Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.

Application guidance is stated in paragraphs A34 to A48 of the said SLAuS.

When the auditor intends to use the work of an auditor's expert, his responsibilities are set out in the Sri Lanka Auditing Standard SLAuS 620 *Using the Work of an Auditor's Expert*. According to the paragraph 9 of such standard, the auditor shall evaluate whether his expert has the necessary competence, capabilities and objectivity for the Auditor's purposes. Further, in order to determine the nature, scope and objectives of such expert's work and to evaluate the adequacy of the expert's work for the auditor's purposes, he shall obtain sufficient understanding of the field of expert's expertise (paragraph 10). In addition, paragraph 11 requires the following matters to be agreed with the expert;

- (a) The nature, scope and objectives of that expert's work;
- (b) The respective roles and responsibilities of the auditor and that expert;
- (c) The nature, timing and extent of communication between the auditor and that expert, including the form of any report to be provided by that expert; and
- (d) The need for the auditor's expert to observe confidentiality requirements.

The auditor shall obtain sufficient appropriate audit evidence to provide reasonable assurance that fair value measurements and disclosures are in conformity with SLFRSs.

Annexure 01 – Report Contents

For the purpose of communicating the information that is necessary for proper understanding of the valuation, it is recommended to include the below information in the valuation report that is prepared for the purpose of financial reporting;

- (a) Identification and status of the valuer
- (b) Identification of the client and any other intended users
- (c) Purpose of the valuation
- (d) Identification of the asset to be valued
- (e) Basis of value
- (f) Highest and best use considered for the valuation
- (g) Extent of investigation
- (h) Encumbrances attached to the asset and the impact on the valuation
- (i) Nature and source of the information relied upon
- (j) Assumptions and special assumptions
- (k) Confirmation that the valuation complies with these guidelines.
- (l) Valuation approach and reasoning
- (m) Amount of the valuation or range of values
- (n) Date of the valuation report and effective date of valuation

Annexure 02 – Fair value disclosures required under SLFRS 13

Reference	Disclosures	Y/N/NA
SLFRS13 p91	<p>1. Disclose information that helps users of its financial statements assess both of the following:</p> <ul style="list-style-type: none"> (a) for assets and liabilities that are measured at fair value on a recurring or non-recurring basis in the statement of financial position after initial recognition, the valuation techniques and inputs used to develop those measurements; and (b) for recurring fair value measurements using significant unobservable inputs (Level 3), the effect of the measurements on profit or loss or other comprehensive income for the period. 	
SLFRS13 p92 (a)-(d)	<p>To meet the objective in SLFRS 13 para 91, consider all the following:</p> <ul style="list-style-type: none"> (a) the level of detail necessary to satisfy the disclosure requirements; (b) how much emphasis to place on each of the various requirements; (c) how much aggregation or disaggregation to undertake; and (d) whether users of financial statements need additional information to evaluate the quantitative information disclosed. 	
	<p>2. If the disclosures provided in accordance with this SLFRS and other SLFRSs are insufficient to meet the objectives in SLFRS 13 para 91, disclose additional information necessary to meet those objectives.</p>	
SLFRS13 p 93(a)- (i)	<p>3. To meet the objectives in SLFRS 13 para 91, disclose, at a minimum, the following information for each class of asset (see SLFRS 13 para 94 for information on determining appropriate classes of assets and liabilities) measured at fair value (including measurements based on fair value within the scope of this SLFRS) in the statement of financial position after initial recognition:</p> <ul style="list-style-type: none"> (a) for recurring and non-recurring fair value measurements, the fair value measurement at the end of the reporting period, and for non-recurring fair value measurements, the reasons for the measurement; (b) for recurring and non-recurring fair value measurements, the level of the fair value hierarchy within which the fair value measurements are categorised in their entirety (Level 1, 2 or 3); (c) 	

for assets and liabilities held at the end of the reporting period that are measured at fair value on a recurring basis, the amounts of any transfers between Level 1 and Level 2 of the fair value hierarchy, the reasons for those transfers and the entity's policy for determining when transfers between levels are deemed to have occurred. Transfers into each level are disclosed and discussed separately from transfers out of each level;

- (d) for recurring and non-recurring fair value measurements categorised within Level 2 and Level 3 of the fair value hierarchy, a description of the valuation technique(s) and inputs used in the fair value measurement. If there has been a change in valuation technique, disclose that change and the reason(s) for making it. For fair value measurements categorised within Level 3 of the fair value hierarchy, provide quantitative information about the significant unobservable inputs used in the fair value measurement;

An entity is not required to create quantitative information to comply with this disclosure requirement if quantitative unobservable inputs are not developed by the entity when measuring fair value. However, when providing this disclosure, an entity cannot ignore quantitative unobservable inputs that are significant to the fair value measurement and are reasonably available to the entity.

- (e) for recurring fair value measurements categorised within Level 3 of the fair value hierarchy, a reconciliation from the opening to the closing balances, disclosing separately changes during the period attributable to the following:
- (i) total gains or losses for the period recognised in profit or loss, and the line item(s) in profit or loss in which those gains or losses are recognised;
 - (ii) total gains or losses for the period recognised in other comprehensive income, and the line item(s) in other comprehensive income in which those gains or losses are recognised;
 - (iii) purchases, sales, issues and settlements (each of those types of changes disclosed separately); and
 - (iv) the amounts of any transfers into or out of Level 3 of the fair value hierarchy, the reasons for those transfers and the entity's policy for determining when transfers between levels are deemed to have occurred (see SLFRS 13 para 95). Transfers into Level 3 are

	disclosed and discussed separately from transfers out of Level 3;	
	<p>(f) for recurring fair value measurements categorised within Level 3 of the fair value hierarchy, the amount of the total gains or losses for the period in (e)(i) included in profit or loss that is attributable to the change in unrealised gains or losses relating to those assets and liabilities held at the end of the reporting period, and the line item(s) in profit or loss in which those unrealised gains or losses are recognised;</p> <p>(g) for recurring and non-recurring fair value measurements categorised within Level 3 of the fair value hierarchy, a description of the valuation processes used by the entity. If income approach is used, frequency and methods of calibration, back testing and other testing procedures of pricing models. [IFRS IE65(b)];</p> <p>(h) for recurring fair value measurements categorised within Level 3 of the fair value hierarchy:</p> <p>(i) for all such measurements, a narrative description of the sensitivity of the fair value measurement to changes in unobservable inputs if a change in those inputs to a different amount might result in a significantly higher or lower fair value measurement. If there are interrelationships between those inputs and other observable inputs used in the fair value measurement, provide a description of those interrelationships and of how they might magnify or mitigate the effect of changes in the unobservable inputs on the fair value measurement. To comply with that disclosure requirement, the narrative description of the sensitivity to changes in unobservable inputs includes, at a minimum, the unobservable inputs disclosed when complying with (d); and</p> <p>(ii) for financial assets and financial liabilities, if changing one or more of the unobservable inputs to reflect reasonably possible alternative assumptions would change fair value significantly, state that fact and disclose the effect of those changes. Disclose how the effect of a change to reflect a reasonably possible alternative assumption was calculated. For that purpose, significance is judged with respect to profit or loss, and total assets or total liabilities – or, when changes in fair value are recognised in other comprehensive income, total equity; and</p>	

	(i) for recurring and non-recurring fair value measurements, if the highest and best use of a non-financial asset differs from its current use, disclose that fact and why the non-financial asset is being used in a manner that differs from its highest and best use.	
SLFRS13 p 94(a),(b)	<p>4. Determine appropriate classes of assets and liabilities on the basis of the following:</p> <p>(a) the nature, characteristics and risks of the asset; and</p> <p>(b) the level of the fair value hierarchy within which the fair value measurement is categorised.</p> <ul style="list-style-type: none"> ▪ The number of classes may need to be greater for fair value measurements categorised within Level 3 of the fair value hierarchy because those measurements have a greater degree of uncertainty and subjectivity. ▪ Determining the appropriate classes of assets and liabilities for which disclosures about fair value measurements shall be provided requires judgement. A class of assets and liabilities will often require greater disaggregation than the line items presented in the statement of financial position. ▪ Provide information sufficient to permit reconciliation to the line items presented in the statement of financial position. If another SLFRS specifies the class for an asset, an entity may use that class in providing the disclosures required in SLFRS 13 if that class meets the requirements in SLFRS 13 para 94. 	
SLFRS13 p95 (a)-(c)	<p>5. Disclose and consistently follow the entity's policy for determining when transfers between levels of the fair value hierarchy are deemed to have occurred in accordance with SLFRS 13 para 93(c) and (e)(iv). The policy about the timing of recognising transfers is the same for transfers into the levels as for transfers out of the levels. Examples of policies for determining the timing of transfers include the following:</p> <p>(a) the date of the event or change in circumstances that caused the transfer;</p> <p>(b) the beginning of the reporting period; and</p> <p>(c) the end of the reporting period.</p>	
SLFRS13 p96	<p>6. If an entity makes an accounting policy decision to use the exception in SLFRS 13 para 48 (exemption where an entity manages a group of financial assets and liabilities on the basis of its net exposure to market or credit risk), disclose that fact.</p>	
SLFRS13 p97	<p>7. For each class of asset not measured at fair value in the statement of financial position but for which fair value is disclosed, disclose the information required by SLFRS 13 para 93(b)-(d) and (i).</p>	

	However, an entity is not required to provide the quantitative disclosures about significant unobservable inputs used in fair value measurements categorised within Level 3 of the fair value hierarchy required by SLFRS 13 para 93(d). For such assets and liabilities, an entity does not need to provide the other disclosures required by this SLFRS.	
SLFRS13 p99	8. Present the quantitative disclosures required by this SLFRS in a tabular format unless another format is more appropriate.	

Note:

Additional information that helps users of its financial statements also needs to be disclosed.

The reference in the first column to the left in the above table indicates the paragraphs of the Sri Lanka Accounting Standard - SLFRS 13. For example, "SLFRS13p40" indicates SLFRS 13 and paragraph 40.

Preparers are encouraged to enter either Y- Yes, N – No or N/A – Not Applicable, as appropriate, for each disclosure item.

Annexure 03: Practical Application of SLFRS 13 to Specific items

	PPE	Investment Property	Biological Assets
Applicability	For items of PPE subsequently measured in accordance with the revaluation model	Regardless of whether this is measured in accordance with the fair value model or the cost model (as disclosure of FV is required).	From the point of initial recognition to be measured at fair value less costs to sell.
Unit of account	Generally, an item that is separately identifiable and individually significant will constitute a unit of account. If a market exist only for a group of assets as a whole (eg: land and buildings), even though the two components are separate units of account), measure fair value of the group as a whole and then to allocate the valuation to the individual components.	Eg: a unit of account could comprise land, a building or part of a building or both and if leased on a furnished basis, the related movable furniture as well.	<p>Could be either a single asset or a group of assets. Eg: trees in the forest LKAS 41 allows assets to be grouped according to their significant attributes.</p> <ul style="list-style-type: none"> ▪ Eg: livestock according to age or weight ▪ Crops according to quality <p>Until harvest, the future agricultural produce that is attached to the biological assets is not recognized separately and fair value is determined based on the asset as a whole.</p> <p>When an active market exists only for the combined package of the biological assets, land and land improvements; in order to arrive the fair value of the biological assets, it</p>

			may be necessary to deduct the fair value of the land and improvements from the combined package.
Valuation approaches and techniques	<ul style="list-style-type: none"> ▪ Typically through the market approach ▪ Cost approach if purchased recently ▪ Cost approach for specialized plant 	<p>Typically through market approach (eg: as a product of metrics – price per square foot/metre and the area of IP); Income approach [eg: yield method – current or market rental of property / property’s value) and DCF technique – discounting the expected cash inflows and outflows arising from the property at the rate of return investors would require. The valuation technique needs to be calibrated to ensure that the result reflects observable market data.]; Cost approach [cost of construction, financing costs and a reasonable profit margin.]</p> <p>The fair value of IP under construction could be measured using the cost approach.</p>	<p>Living animals using market approach. Plants during initial growth using cost approach, thereafter income approach (the valuation technique needs to be calibrated).</p>

Note 01:

The fair value of a biological asset includes not only the asset’s present harvest value, but also potential additional biological transformation that a market participant would consider in the valuation. Hence the factors such as the risks attached with the asset (eg: weather), estimated yields and estimated costs of bringing the asset to its intended condition needs to be considered. These risks address the uncertainty related to future cash flows and are reflected in either the discount rate and or the estimate of expected cash flows.

In DCF method of valuation, the present value of expected net cash flows from the asset discounted at a current market-determined rate is used to determine fair value in its present

location and condition. Determination of an appropriate discount rate is essential to ensure that the valuation is reliable.

When little biological transformation has taken place since initial cost incurrence, cost may approximate fair value (paragraph 24 of LKAS 24). In these situations, the International Financial Reporting Interpretations Committee (IFRIC) noted that the discount rate selected would be expected to result in a value that approximates that cost.

The best evidence of the fair value of an asset at initial recognition is the transaction price, unless the fair value of the asset is evidenced by comparison with other observable current market transactions in the same asset (without modification or repackaging) or based on a valuation technique whose variables include data from observable markets. The application of the said requirement may result in no gain or loss being recognised on the initial recognition of an asset. In such a case, gain or loss shall be recognised after initial recognition only to the extent that it arises from a change in a factor (including time) that market participants would consider in setting a price. Periodically, an entity calibrates the valuation technique and tests it for validity using prices from observable current market transactions in the same asset. An entity obtains market data from the same market where the asset was originated

Where an active market does not exist, for the asset in its current form, entities might use prices for similar assets for which observable prices do exist as an input into the fair value measurement. Then, it is needed to make appropriate adjustments for any differences between the asset being measured at fair value and similar asset, for which observable market prices are available.

Practically, a cash flow is prepared for the complete life of the plant, at current cost and prices. Based on the IFRIC agenda decision, the discount rate is determined so that the net present value approximates initial cost at the time of planting. This would also satisfy the need for calibration and the avoidance of 'day one profit.' A recalculation is done in subsequent years, based on the new current cost and prices. The fair value calculated at different points of time, would reflect prices prevailing at that time.

Annexure 04: Defined Terms

Active market	A market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.
Biological asset	A <i>biological asset</i> is a living animal or plant.
Costs of disposal	Incremental costs directly attributable to the disposal of an asset or cash-generating unit, excluding finance costs and income tax expense.
Costs to sell	The incremental costs directly attributable to the disposal of an asset, excluding finance costs and income taxes.
Entry price	The price paid to acquire an asset or received to assume a liability in an exchange transaction.
Exit price	The price that would be received to sell an asset or paid to transfer a liability.
Highest and best use	The use of a non-financial asset by market participants that would maximise the value of the asset or the group of assets and liabilities (eg a business) within which the asset would be used.
Impairment loss	The amount by which the carrying amount of an asset or a cash-generating unit exceeds its recoverable amount.
Most advantageous market	Most <i>advantageous market</i> for the asset is the market that maximises the amount that would be received to sell the asset, after taking into account transaction costs and transport costs.
Observable inputs	Inputs that are developed using market data, such as publicly available information about actual events or transactions, and that reflect the assumptions that market participants would use when pricing the asset or liability.
Principal market	<i>Principal market</i> for the asset is the market with the greatest volume and level of activity for the asset.
<i>Public accountability</i>	<p>An entity has <i>public accountability</i> if:</p> <ul style="list-style-type: none"> (a) its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets), or (b) it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. This is typically the case for banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks. <p>Following are the examples for entities which will be considered having the public accountability for this purpose;</p> <ul style="list-style-type: none"> - Companies licensed under the Banking Act, No. 30 of 1988 - Companies authorised under the Control of Insurance Act, No. 25 of 1962, to carry on insurance business

	<ul style="list-style-type: none"> - Companies carrying on leasing business - Factoring companies - Companies registered under the Finance Companies Act, No. 78 of 1988 - Companies licensed, under the Securities and Exchange Commission Act, No 36 of 1987, to operate unit trust - Fund Management Companies - Companies licensed under the Securities and Exchange Commission Act, No 36 of 1987, to carry on business as stock brokers or stock dealers - Companies licensed under the Securities and Exchange Commission Act, No. 36 of 1987 to operate a Stock Exchange - Companies listed in a Stock Exchange licensed under the Securities and Exchange Commission Act, No 36 of 19870 - Public corporation engaged in the sale of goods or the provision of services.
Recoverable amount	The <i>recoverable amount</i> of an asset or a cash-generating unit is the higher of its fair value less costs of disposal and its value in use.
Unobservable input	Inputs for which market data are not available and that are developed using the best information available about the assumptions that market participants would use when pricing the asset or liability.

Sources:

Code of Ethics for Professional Accountants (2014)

International Valuation Standards (2011). The bound volume including the IVS Framework, the IVS General Standards, IVS Asset Standards and IVS Applications

Sri Lanka Accounting Standards (2015). The bound volume of the SLFRSs including all the revised Accounting Standards that have been adopted as per 2015 'Consolidated without early adoption version of the IFRS bound volume'

Ratnayake, A. (2010, September), Valuing biological assets. Financial Management CIMA (UK)

The KPMG International Standards Group (2014/15), Insights into IFRS

The International Financial Reporting Group of EY (2014), International GAAP 2014