Ihre Ansprechpartner

Sehr geehrte Damen und Herren,

für Rückfragen zu der beigefügten Publikation „In depth“ zur Thematik
“IFRS 13 European real estate survey”
stehen Ihnen folgende Ansprechpartner gerne zur Verfügung:

Andreas Bödecker
Tel.: +49 511 5357-3230
E-Mail: andreas.boedecker@de.pwc.com

Guido Fladt
Tel.: +49 69 9585-1455
E-Mail: g.fladt@de.pwc.com

Karsten Ganssauge
Tel.: +49 40 6378-8164
E-Mail: karsten.ganssauge@de.pwc.com

Wolfgang Weigel
Tel.: +49 69 9585-2574
E-Mail: wolfgang.weigel@de.pwc.com

In depth
A look at current financial reporting issues

December 2014
No. INT2014-12

What's inside:
Fair value hierarchy
Significant unobservable inputs
Income approach
Asset classes
Sensitivities

IFRS 13 European real estate survey

At a glance

IFRS 13 'Fair value measurement' applies prospectively for annual periods beginning on or after 1 January 2013 with earlier application permitted. This new standard significantly expands disclosure requirements to provide users of financial statements with detailed quantitative and qualitative information about assumptions made and processes used when measuring assets or liabilities at fair value.

In this publication we look at how a sample of European real estate companies have responded to IFRS 13 disclosure requirements in relation to investment properties, specifically, the quantitative information disclosed about significant unobservable inputs used in fair value measurement and the sensitivity of the fair value measurement to significant changes in those unobservable inputs.

The sample of European real estate companies used within this publication consists of 37 companies listed within the United Kingdom, France, Germany, The Netherlands, Switzerland and Italy.

Fair value hierarchy – Level 2 or level 3?

In IFRS 13, fair value measurements are categorised into a three-level hierarchy based on the type of inputs and no longer based on the valuation method. The IFRS 13 hierarchy is defined as follows:

- **Level 1** inputs are unadjusted quoted prices in active markets for items identical to the asset being measured. Consistent with existing guidance, if there is a quoted price in an active market (that is, a Level 1 input), an entity uses that price without adjustment when measuring fair value;
- **Level 2** inputs are inputs other than quoted prices in active markets included within Level 1 that are directly or indirectly observable; and
- **Level 3** inputs are unobservable inputs that are usually determined based on management's assumptions. However, Level 3 inputs have to reflect the assumptions that market participants would use when determining an appropriate price for the asset.

Due to the nature of real estate assets – Which are often unique and not traded on a regular basis – And the subsequent lack of observable input data for identical assets, fair value measurements of real estate will be categorised as Level 2 or Level 3 valuations. Further, certain IFRS 13 disclosures are only required for fair value measurements classified as Level 3. Based on the 37 companies reviewed 36 identify investment properties as falling within Level 3 of the fair value hierarchy, with the remaining one company not disclosing this information.

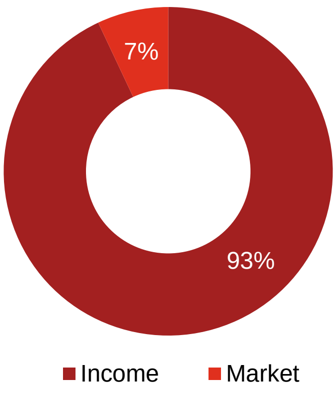
Significant unobservable inputs

Paragraph 93(d) IFRS 13 requires '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 the inputs used in the fair value measurements... for fair value measurements categorised within Level 3 of the fair value hierarchy, an entity shall provide quantitative information about the significant unobservable inputs used in the fair value measurement.

IFRS 13 does not indicate a preferred valuation technique and states that the three widely used valuation techniques are the market approach, the cost approach and the income approach. The main aspects of those approaches are summarised in paragraphs B5-B11 of the standard.

IFRS 13 requires an entity to choose valuation techniques that are appropriate to the specific circumstances and maximise the use of observable inputs. As market participants would usually estimate the price of an investment property based on their expectations about future income, an income approach or a market approach will often be more suitable to measure fair value in this case. IFRS 13 encourages an entity to apply multiple valuation techniques if appropriate and the respective indications of fair value should be evaluated considering the reasonableness of the range of values indicated by those results.

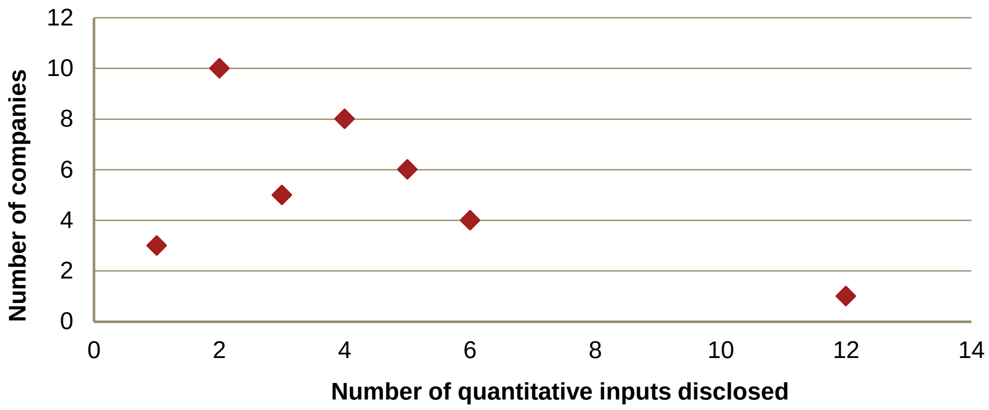
Based on the 37 companies reviewed, all used either an income based or a market based approach to determine fair value, with 2 companies using both an income and a market approach for different types of investment properties.



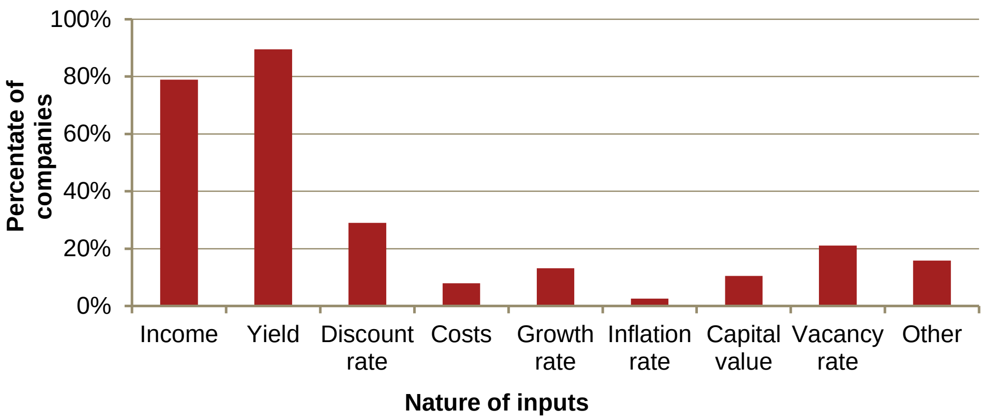
For the income based approach used by the companies in our sample we have analysed the quantitative information disclosed about the significant unobservable inputs used in the fair value measurement.

Income approach

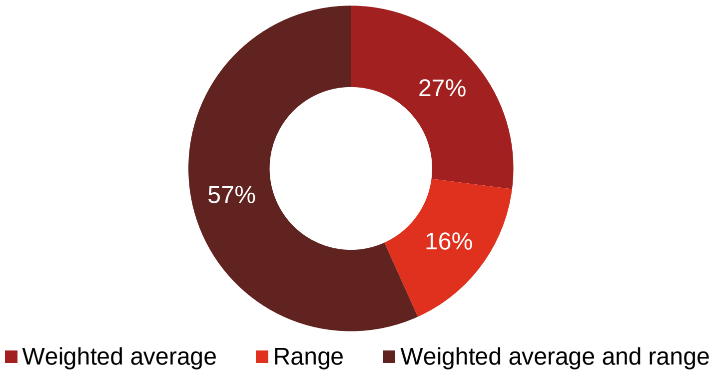
The most commonly used valuation techniques falling within the income approach categorisation are the direct capitalisation method and the discounted cash flow method. These methods are types of present value techniques where fair value is determined on the basis of future income to be earned from the asset. Where companies have used these valuation methodologies we have noted a wide range in the number of quantitative inputs disclosed, ranging from one input to twelve inputs.



Although there is a wide range of inputs these can generally be grouped into categories. The chart below sets out the nature of inputs disclosed by companies using the income approach. Given the nature of this approach, the two most popular inputs disclosed related to income or yield:



As well as a range of inputs being disclosed we have also noted that the way in which such quantitative data is presented also varies, with some companies disclosing an average, others a range and some both an average and a range:



Asset classes

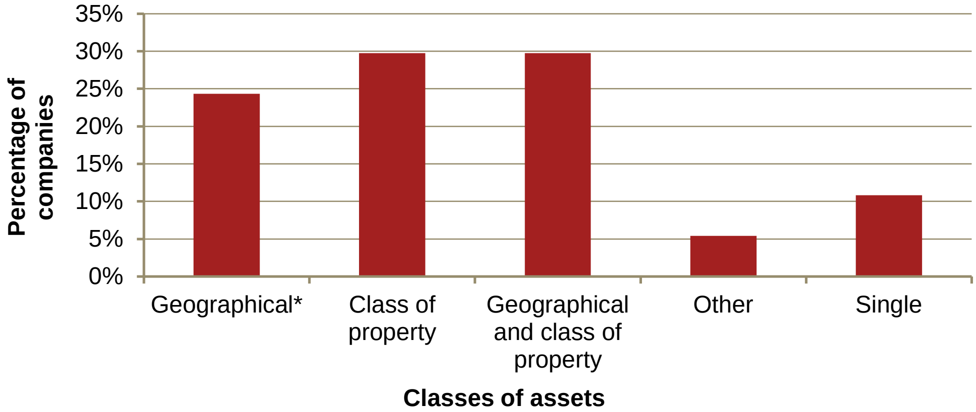
Paragraph 94 of IFRS 13 requires that 'an entity shall determine appropriate classes of assets and liabilities on the basis of the following:

1. The nature, characteristics and risks of the asset or liability; and
2. The level of the fair value hierarchy within which the fair value measurement is categorised'

The number and 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 appropriate classes of assets and liabilities for which disclosures about fair value measurements should 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.'

For each of the companies within our survey we compared the classes of properties used for the purposes of the IFRS 13 disclosures to the identified operating segments as reported in their segments note. 43 per cent of companies have disaggregated the classes of properties in accordance with their disclosed operating segments. Where companies have not disaggregated properties based on the identified operating segments, 75 per cent of such companies have provided a greater level of disaggregation in their investment property note.

The following chart summarises the categories used by the 37 companies within our sample to disclose their classes of assets for the purposes of IFRS 13:



**Geographical categorisation includes categorisation by country, region and individual property location.*

Sensitivities

For investment properties measured at fair value that are categorised within Level 3 of the fair value hierarchy, paragraph 93(h) of IFRS 13 requires the following disclosures to be provided:

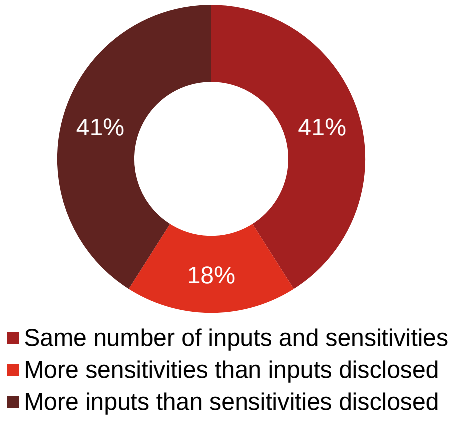
'…a narrative description of the sensitivity of the fair value measurement to changes in unobservable inputs if a change in those inputs to a different amount might result in a significantly higher or lower fair value measurement. If there are interrelationships between those inputs and other unobservable inputs used in the fair value measurement, an entity shall also 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 shall include at a minimum, the unobservable inputs disclosed when complying with (d)'.

Although the above does not explicitly require a quantitative sensitivity analysis; such a sensitivity analysis may be necessary in order to satisfy the requirements of IAS 1.

Paragraph 125 of IAS 1 requires that '*an entity shall disclose information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. In respect of those assets and liabilities, the notes shall include details of: (a) their nature; and (b) their carrying amount as at the end of the reporting period*'. Where assumptions made in determining the fair value of investment property fall to be significant assumptions in the context of IAS 1 then further information must be provided within the financial statements so that users understand the effect of estimation uncertainty. Paragraph 129 of IAS 1 notes disclosure of the sensitivity of carrying amounts to significant assumptions as an example of information to be provided.

Of the 37 companies reviewed, 23 provide quantitative disclosure of sensitivities and 14 provide qualitative disclosure of sensitivities. The format of the disclosure varies significantly between companies, with some choosing to present the analysis in a tabular format and others providing a summary narrative.

For each of the companies in the sample we have compared the number of significant unobservable inputs disclosed to the number of sensitivities presented. As outlined above, paragraph 93 (h) of IFRS 13 requires companies to include a narrative description of the sensitivity to changes in unobservable inputs; at a minimum, such a description should be provided for significant unobservable inputs used in the fair value measurement. 41 per cent of companies disclosed less sensitivities than inputs perhaps suggesting that not all unobservable inputs disclosed were considered 'significant' in the context of IFRS 13. Nevertheless, a further 41 per cent of companies disclosed the same number of sensitivities and inputs suggesting all inputs disclosed were considered significant. The remaining 18 per cent disclosed more sensitivities than inputs; these additional sensitivities are qualitative and provided as a narrative summary. The rationale for disclosing these additional sensitivities is unclear in all cases:



Where companies have provided quantitative sensitivities, the most commonly used sensitivities are a variation of 25 basis points for yield/discount rate (42% of companies disclosing this measure) and a 5 per cent variation for income (54%).