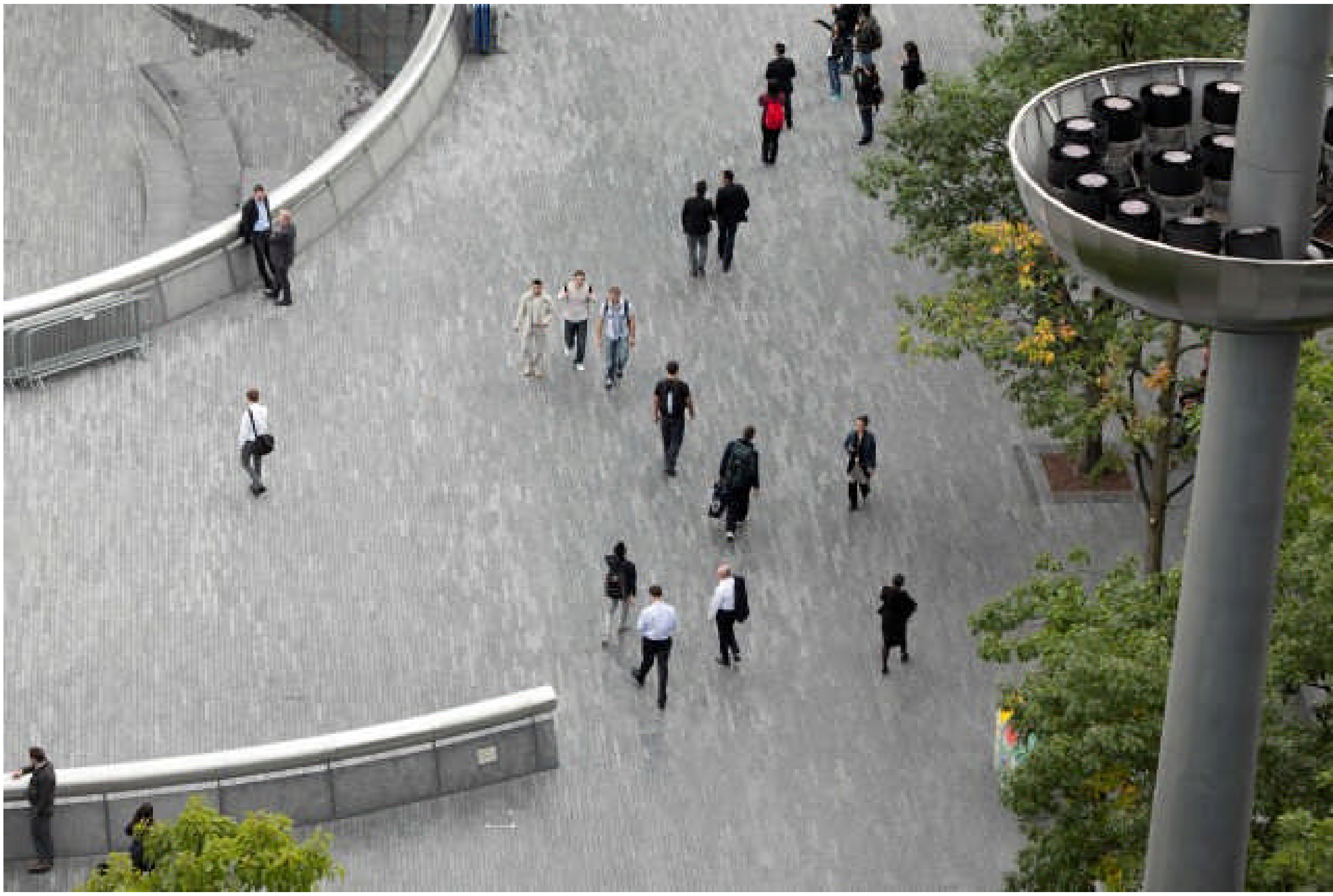
Disclosing the Fair Value of Financial Instruments in 2013 Interim Financial Statements



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To our Clients and Friends

Starting in 2013, Canadian public companies must disclose detailed information about the fair value of financial instruments in their IFRS interim financial statements that used to be provided only in their annual financial statements. This task has been made more difficult because there have been changes to the disclosure requirements as well. As a result, companies cannot simply update the financial instrument fair value disclosures they provided in their 2012 annual financial statements. Changes include:

- A "stand back" test to consider whether disclosure objectives are met.
- New criteria for grouping financial instruments into classes for fair value disclosure purposes.
- Expanded guidance on assigning measurements as Level 1, 2 or 3 in the fair value hierarchy.
- More focused and detailed disclosures of Level 3 measurements, including a description of a company's valuation processes.

While the changes will affect the reporting for all companies, they will have the greatest impact on the disclosures of companies that have instruments categorized as Level 3 in the hierarchy. Companies that have plain vanilla financial instruments that are categorized as Level 1 or Level 2 often will find that their interim disclosures have not been significantly affected.

In this Newsletter we illustrate the type of fair value of financial instruments disclosures that a hypothetical company, Sample Co., might provide in its 2013 first quarter interim financial statements. The illustrative disclosures are accompanied by explanatory notes that discuss the changes to the requirements and the new judgements and other determinations that Sample Co. made in applying them.

Sample Co. is a manufacturing company and, accordingly, this illustration does not consider the special circumstances of financial institutions.

We hope you will find this Newsletter helpful. If you have any questions, please do not hesitate getting in touch with your local pwc representative or office.

PricewaterhouseCoopers LLP

March 2013

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Illustrative note

Explanatory Notes (ENs)

Note X. Fair value of financial instruments

Commentary

EN 1
EN 2
EN 10
EN 11

This note illustrates the minimum disclosures required by IAS 34.16A(j) to be included in Sample Co's March 31, 2013 interim financial statements. Items highlighted in yellow represent the effect of new or amended requirements which are explained in the accompanying notes. There are significant additional disclosures that will be necessary in Sample Co.'s annual financial statements.

This example illustrates one possible format for the disclosures; there may be others.

EN 3
EN 4

The following table provides information about financial assets and liabilities measured at fair value in the statement of financial position and categorized by level according to the significance of the inputs used in making the measurements:

EN 5

	March 31, 2013	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Recurring measurements				
Financial assets				
Debt securities – Government bonds	$ 850	$ 348	$ 502	$ –
Equity securities (a):				
Financial services	1,244	1,244	–	–
Manufacturing	5,010	–	–	5,010
Total equity securities	6,254	1,244	–	5,010
Derivatives – Foreign exchange forwards	570	–	570	–
	$ 7,674	**$ 1,592**	**$ 1,072**	**$ 5,010**
Financial liabilities				
Derivatives – Interest rate swap	$ (386)	$ –	$ (386)	$ –
	$ (386)	**$ –**	**$ (386)**	**$ –**

(a) On the basis of its analysis of the nature, characteristics and risks of equity securities, the Company has determined that presenting them by industry is appropriate.

EN 7 The Company used the following techniques to value financial instruments categorized in Level 2:

- The fair value of bonds was determined by obtaining quoted market prices or executable dealer quotes for identical or similar instruments in inactive markets, or other inputs that are observable or can be corroborated by observable market data.
- The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows based on observable yield curves.
- The fair value of forward foreign exchange contracts is determined using the forward exchange rates at the measurement date, with the resulting value discounted back to present values.

EN 7 The Company uses the comparable company valuation multiples approach when measuring the fair value of its ten per cent equity investment in a private manufacturing company, categorized as Level 3 in the fair value hierarchy. The Company has selected five comparable public company peers that have similar risk, growth and cash-generating potential profiles and concluded that an Enterprise Value/EBITDA valuation multiple of 9.0x is a relevant performance measure for its investment. Valuation multiples are derived from the reported earnings and the period end stock price of companies in the peer group, or if a company in the group is sold, the transaction price. If an observed transaction price represents the sale of a controlling interest, the Company deducts the amount of the control premium from the indicated fair value obtained using transaction multiples. The Company assesses the control premiums from which to derive the non-controlling interest by referring to data on empirical control premium studies that considered industry, pricing, deal size and timing of the observed premiums. The Company also adjusts the indicated fair value to give the effect of the lack of liquidity compared to the publicly traded peer group when it determines that the market participants would take this into account when pricing the investment. Liquidity discount is quantified on the basis of relevant restricted stock studies.

EN 16 The Company's finance department is responsible for performing the valuation of financial instruments, including Level 3 fair values. The valuation processes and results are reviewed and approved by the Controller and the CFO at least once every quarter, in line with the Company's quarterly reporting dates. Valuation results are discussed with the Audit Committee as part of its quarterly review of the Company's financial statements.

EN 14 The significant unobservable inputs used in the fair value measurement of the investment as at March 31, 2013 are as follows:

Indicated fair value of the 10% interest based on EV/EBITDA of 9.0x	$	6,030
Non-controlling interest discount of 11%		(663)
Discount for the lack of liquidity of 6%		(357)
Fair value as at March 30, 2013	**$**	**5,010**

EN 15 If the valuation multiple would be changed to 8.5x or 9.5x, the fair value of the investment and other comprehensive income would decrease or increase by $279, respectively. Generally, a change in the input used for the valuation multiple assumption is accompanied by a directionally similar change in the non-controlling interest and liquidity assumptions. Management believes that reasonably possible changes to other unobservable inputs would not result in a significant change in the estimated fair value.

EN 12 The following table presents the changes in the Level 3 investments for the three months ended March 31, 2013:

		Equity securities		High-yield debt securities (a)
Opening balance	$	4,873	$	–
EN 6 Transfer into Level 3		–		623
Transfers out of Level 3		–		–
Total gains or losses for the period				
Included in net income – investment gains (losses)		–		(41)
Included in other comprehensive income – available for sale investments		137		–
Purchases, sales, issues and settlements				
Sales		–		(582)
Closing balance	**$**	**5,010**	**$**	**–**
EN 13 **Change in unrealized gains and losses for the period included in net income (investment gains (losses)) for assets held at March 31, 2013**	**$**	**–**	**$**	**–**

(a) Transferred to Level 3 from Level 2 due to the deterioration of the credit standing of the issuer of the debentures that resulted in a significant increase in the credit risk adjustment, which is not based on observable inputs. The debentures have been sold in the secondary market during the reporting period.

EN 6 The Company's policy is to recognize transfers into and transfers out of fair value hierarchy levels as of the date of the event or change in circumstances that caused the transfer.

During the three months period ended March 31, 2013, the Company transferred government bonds with a carrying value of $943 at the date of transfer (and $956 at March 31 2013) from Level 1 into Level 2 due to the market for the identical bonds becoming inactive. There were no transfers out of Level 2 to Level 1 in the period.

EN 9 Financial instruments that are not measured at fair value on the balance sheet are represented by cash and cash equivalents, accounts receivable, accounts payable and long-term debt. The fair values of cash equivalents, accounts receivable and accounts payable approximate their carrying values due to their
EN 1 short term nature. The long-term debt had a carrying value of $608 (December 31, 2012 – $604) and a fair value of $615 (December 31, 2012 – $613).

Explanatory Notes

Change	Discussion
1. Overview	Effective for years beginning on or after January 1, 2013, IAS 34, *Interim Financial Reporting*, paragraph 16A(j) requires companies to make the disclosures in interim financial statements about the fair value of financial instruments required by IFRS 7, paragraphs 25, 26, and 28-30, and IFRS 13, paragraphs 91-93(h), 94-96, 98 and 99. In broad terms, paragraphs 25, 26 and 28-30 of IFRS 7 require companies to disclose the fair value of each class of financial instrument (whether recognized or unrecognized) in a way that permits it to be compared with the carrying amount. The paragraphs also limit offsetting of classes to those offset on the statement of financial position, establish disclosure requirements when, despite the transaction price differing from fair value, an entity does not recognize a gain or loss on initial recognition of a financial asset or liability, and provide exceptions when fair value disclosure is not necessary. Paragraphs 91-93(h), 94-96, 98 and 99 of IFRS 13 establish an overarching disclosure objective for fair value disclosures, require companies to report a fair value hierarchy table in which measurements are classified as Level 1, 2 or 3, provide guidance on grouping of assets and liabilities into classes in the table, and set disclosure requirements for each level in the hierarchy. IFRS 7 previously included requirements addressing most of these matters but these were deleted upon the introduction of IFRS 13. In general, disclosures required by paragraphs 25, 26 and 28-30 of IFRS 7 have not changed significantly compared to 2012. The requirements that used to be in IFRS 7 and are now in IFRS 13 paragraphs 91-93(h), 94-96, 98 and 99 have changed, in some cases significantly. ***The new IFRS 13 requirements mean that Sample Co. is not able to simply update the financial instrument fair value disclosures it made in its 2012 annual financial statements in preparing its 2013 interim financial statements.*** ***We summarize the major changes from the 2012 annual requirements and their effect of Sample Co.'s interim financial statement disclosures below.***
2. Stand back assessment of the adequacy of disclosures (IFRS 13.91 and .92)	In 2012, companies had to provide only the minimum disclosures specified by IFRS 7. In 2013, the disclosure must be sufficient to help users of its financial statements assess the following: (a) The valuation techniques and inputs used to develop recurring fair value measurements; and, (b) For measurements involving the use of significant unobservable inputs, the effect of those measurements on profit or loss or other comprehensive income.

Change	Discussion
	Assessments of the sufficiency of disclosures involve considering the level of detail necessary, how much emphasis to place on each requirement, how much aggregation or disaggregation to undertake and whether the users of financial statements need additional information beyond the minimum required by IFRS. ***After considering its compliance with the minimum requirements, Sample Co. concluded that additional disclosures were not necessary.***
3. Identifying classes of assets and liabilities (IFRS 13.93 and .94)	For 2012, companies grouped financial assets and financial liabilities into classes for fair value reporting purposes according to the nature of the information to be disclosed and the characteristics of instruments, in accordance with IFRS 7.6. For 2013, this requirement remains unchanged for financial assets and financial liabilities that are not measured at fair value on the statement of financial position. For those that are, companies also have to consider the risks of the asset or liability and where its measurement is categorized in the fair value hierarchy table in establishing its classes. IFRS 13 states that for assets and liabilities included in Level 3, the number of classes may need to be greater because fair value measurements have a greater degree of uncertainty and subjectivity. ***After reviewing the new criteria, Sample Co. determined that no changes to determination of classes were necessary except for its investments in equity securities. In 2012, Sample Co. grouped these investments together as a single class. For 2013, the Company decided to disaggregate these investments based on their different industries, because the industries present significantly different risks. Had Sample Co. had more than one investment classified in Level 3, a further disaggregation of these investments into separate classes might have been warranted.***
4. Classifying items in the fair value hierarchy (IFRS 13.72-.90)	IFRS 13 significantly expands and clarifies the discussion of the factors to take into account in assigning measurements as Level 1, 2 or 3 in the fair value hierarchy. For instance, IFRS 13 now includes examples of Level 2 and Level 3 inputs for particular assets and liabilities. This additional guidance may cause some companies to reconsider classifications. ***After considering the expanded discussion in IFRS 13, Sample Co. determined that no changes to its classifications were necessary.***
5. Separating recurring from non-recurring measurements in the fair value hierarchy (IFRS 13.93(a))	Starting in 2013, certain of the disclosure requirements depend on whether fair value measurements included in the fair value hierarchy table are recurring or non-recurring. A recurring fair value measurement is one that IFRS requires or permits in the statement of financial position at the end of each reporting period. A non-recurring measurement is one that IFRS requires or permits in the statement of financial position in particular circumstances. For non-recurring measurements, companies must also disclose the reason for the measurement. This requirement may have a bigger impact on fair value disclosures in annual financial statements because under IFRS 13 or consequential amendments to the disclosure requirements in other standards, such as IAS 36, companies may have to include any non-financial assets or liabilities measured at fair value (or whose

Change	Discussion
	measurement is based on fair value) in the fair value hierarchy provided in these statements, not just financial instruments (e.g., long-lived assets that have been written down to fair value because of an impairment). See EN 11 below. ***In its 2013 fair value hierarchy table included in its interim statements, Sample Co. has added a sub-heading to indicate that all of its fair value measurements were recurring.***
6. Transfers between levels in the fair value hierarchy and policies for transfers (IFRS 13.93(c) and (e)(iv))	In 2012, companies had to disclose and discuss separately the amount and reasons for transfers in and out of the Level 3 category in the fair value hierarchy and any significant transfers between Level 1 and Level 2. In 2013, disclosure and discussion is necessary for all transfers among classes regardless of their significance but, in the case of transfers between Level 1 and Level 2, only if the asset or liability is measured at fair value on recurring basis and is on hand at the end of the period. Further, it is now necessary for companies to disclose and consistently follow the same policy for determining when transfers between levels are deemed to have occurred (e.g., the date of the event or change in circumstance that caused the transfer, the beginning of the period or the end of the period). ***In 2013, Sample Co. disclosed its policy for transfers among levels and transfers occurring during the period in accordance with the revised requirements. As a result, it did not disclose significant transfers occurring between Levels 1 and 2 in respect of assets or liabilities not on hand at March 31, 2013 but disclosed all transfers affecting Level 3 balances. Its disclosure that no transfers occurred in a period is optional.***
7. Valuation techniques and inputs (IFRS 13.93(d))	In 2012, companies had to disclose the methods used in determining the fair value of each class of financial assets and liability, and if valuation technique was used, the related assumptions, including quantitative information such as interest rates or discount rates, and any changes in the valuation techniques in the period. In 2013, disclosure is necessary only for the valuation techniques used for measurements classified as Level 2 or Level 3 in the fair value hierarchy and the "inputs" used in those measurements; (e.g., the fact that a company discounted cash flows in estimating fair value). Disclosure of the quantitative information about inputs (e.g., the actual discount rate used) is required only for Level 3 measurements (see "Quantitative information about unobservable inputs" below). ***Consistent with the new requirements, Sample Co. disclosures about quantitative information are limited to Level 3 measurements. There were no changes in the valuation techniques during the period.***
8. Level 3 measurements	Refer to the following section starting with EN 12 for a summary of changes in disclosure requirements applicable to Level 3 measurements only.
9. Comparative period disclosures (IFRS 13.C3)	In financial statements for interim reporting periods during the year of adoption of IFRS 13, comparative information is required for the IFRS 7 disclosures only. This is because the transitional provisions of IFRS 13 require prospective application.

Change	Discussion
10. Other changes not illustrated in this Newsletter	The following disclosures are not illustrated as not applicable to Sample Co.: (1) The existence of inseparable third-party credit enhancements (IFRS 13.98). (2) The accounting policy, unrecognized aggregated difference and the reason for not recognizing a gain or loss when, despite the transaction price differing from fair value, an entity does not recognize a gain or loss on initial recognition of a financial asset or liability (IFRS 7.28). (3) The information about the extent of possible differences between the carrying value and fair value of a contract containing discretionary participation feature or an investment in equity instruments carried at cost because the fair value cannot be measured reliably (IFRS 7.30).
11. Additional requirements for 2013 annual financial statements	In 2012, IFRS 7 required fair value disclosures only for financial instruments in annual financial statements. In 2013, IFRS 13 will require disclosures about all assets and liabilities in scope that are measured at fair value in the statement of financial position or whose fair value is disclosed in the financial statements. In addition, IAS 36 incorporates certain of these requirements, including the fair value hierarchy disclosure in certain cases. Examples of where the annual fair value hierarchy disclosure is necessary in 2013 include long-term debt measured at amortized cost but whose fair value is disclosed in the notes to the financial statements, and cash generating units with goodwill or assets held for sale written down to fair value less costs of sale. The IASB has recently proposed changes to IAS 36 effective for years beginning on or after January 1, 2014 that, if approved, will expand this disclosure to individual long-lived assets or cash generating units for which the company has recognized or reversed an impairment loss during the reporting period. Disclosure requirements for items whose fair value is disclosed in the notes are less extensive than those measured at fair value on the statement of financial position.

Disclosure requirements applicable to Level 3 measurements only

Change	Discussion
12. Reconciliations (IFRS 13.93(e))	In 2012, companies had to reconcile the opening balances reported for Level 3 classifications in the fair value hierarchy to the closing balances, disclosing separately changes attributable to: (i) Gains and losses recognized in profit or loss, and a description of where they are presented in the statement of comprehensive income or separate income statement. (ii) Total gains or losses recognized in other comprehensive income. (iii) Purchases, sales, issues and settlements, with each movement disclosed separately. (iv) Transfers into or out of Level 3 and the reasons for the transfers. Requirements in this area for 2013 remain the same except that the reconciliation is necessary only for recurring fair value measurements, and companies must identify the specific line items in profit or loss or comprehensive income in which gains and losses are recognized. ***In 2013, Sample Co. included in the reconciliation the description of the specific line item in the income statement where loss on sale of the Level 3 investment is recorded and the category of other comprehensive income for fair value gains and losses on financial assets designated as available for sale.***
13. Unrealized gains and losses for Level 3 estimates (IFRS 13.93(f))	In 2012, companies had to disclose the amount of gains and losses included in the statement of profit and loss for the period that relate to financial instruments held at the end of the reporting period and where those gains and losses are presented in the statement. Requirements in this area for 2013 remain the same except that disclosure is only for unrealized gains and losses relating to recurring fair value measurements and the specific lines items on the statement where the gain and losses are recognized must be identified. ***Sample Co. has elected to disclose that no unrealized gains and losses on Level 3 measurements were recognized in profit and loss during the period. This disclosure is optional.***
14. Quantitative information about unobservable inputs (IFRS 13.93(d))	In 2012, companies had to disclose significant assumptions about Level 3 investments, including information about rates and other quantitative data used in measurements. Starting in 2013, companies must provide quantitative information about the significant unobservable inputs used in its fair value measurements when the inputs were not developed by the entity (e.g., disclosure is unnecessary when an entity uses prices from prior transactions or third party pricing information without adjustment) but an entity cannot ignore information that is reasonably available to it. IFRS 13 does not provide specific guidance on what quantitative information is necessary but requires entities to provide, at a minimum, fair value disclosure for each class of assets and liabilities. Disclosure should contain sufficient detail to allow users to understand the unobservable inputs used and how those inputs vary over time. To be in accordance with IFRS 13.99, information generally should be provided in a tabular format.

Disclosure requirements applicable to Level 3 measurements only

Change	Discussion
	In 2013, Sample Co. expanded the disclosure to provide quantitative information about unobservable inputs used in fair value measurement of its Level 3 private equity investment. (Note: The quantitative amounts in the accompanying note are arbitrary and have been used for illustrative purposes only. The applicable discounts will depend on the specific facts and circumstances.)
15. Sensitivity analysis (IFRS 13.93 (h)(i) and (ii))	In 2012, if changing one or more of the assumptions to reasonably possible alternative assumptions would change the fair value significantly, companies had to state that fact, disclose the effect of those changes and how the effect of the change was calculated. This requirement remains the same in 2013 except that it applies only for unobservable inputs in recurring valuations. Furthermore, starting in 2013, entities also must provide: (a) A narrative description of the sensitivity of fair value measurements to changes in unobservable inputs that might result in a significantly higher or lower fair value; and (b) If there are inter-relationships with other unobservable inputs, a description of the inter-relationships and how they might magnify or mitigate the effects. ***In 2013, Sample Co. added a description of significant unobservable inputs inter-relationships. It concluded that its quantitative disclosure about Level 3 sensitivities was also sufficient to satisfy criterion (a) above.***
16. Valuation processes estimates (IFRS 13.93(g))	Beginning in 2013, companies are required to include a description of its valuation processes for items that are measured at fair value in the statement of financial position and classified as Level 3 in the fair value hierarchy. This includes, for example, how it decides its valuation policies and procedures and analyses changes in fair value measurements from period to period. A company might disclose the following to comply with this requirement: • Who decides the company's valuation policies and procedures, to whom that individual or group reports, and the internal reporting procedures in place (e.g., whether and, if so, how audit and other relevant Board committees discuss and assess the fair value measurements); • How the entity determined that third-party information, such as appraisers, broker quotes or pricing services, used in the fair value measurement was developed in accordance with IFRS; • The methods used to develop and substantiate the unobservable inputs used in a fair value measurement; and • The process for analyzing changes in fair value measurements from period to period. Depending on a company's circumstances, and the nature of its Level 3 measurements, other disclosures might be appropriate as well; e.g., the frequency and methods for calibration, back testing and other testing procedures for pricing models. ***In 2013, Sample Co. provided an explanation of the valuation processes it followed in making Level 3 estimates.***