COURSE NOTES

IFRS 13 Fair Value Measurement

These notes accompany the interactive video on the topic. The video contains questions and exercises that illustrate how the knowledge covered in the video lecture is applied. Please engage with the video and pause and respond as appropriate.

The SBR Exam Focus

In SBR, standards are often examined together. Your knowledge of fair values can pop up in the exam in lots of different contexts, e.g. Group accounts, Financial Instruments, PPE & Investment Property and even in accounting for Government Grants!

So, the standard on fair values is important to be able to understand and apply. Marks will be for words and not number-crunching.

Nowadays, people know the price of everything and the value of nothing - Oscar Wilde

The objective of the standard is to provide a single source of guidance for fair value measurement where it is required by a reporting standard.

IFRS 13 does not extend the use of fair value, rather it provides guidance on how it should be determined when an initial or subsequent fair value measurement is required by a reporting standard.

It creates a uniform framework for measurement of fair value for entities around the world who apply either US GAAP or this standard. It enhances consistency.

Note that the standard does not apply IFRS 2 Share based Payments IFRS 16 Leases IAS 2 Inventories IAS 36 Impairment.

Definition

Fair value is the price that would be received to sell an asset (or paid to transfer a liability) in an orderly transaction between market participants at the measurement date.

Fair value is therefore an exit value. It is not entity specific but is what the market determines.

That it is an orderly transaction means that the price is not a forced sale.

That it is between market participants means that it is a price between strangers, not one a family or friend (related party) would be prepared to pay.

Guidance

The fair value of a non-financial asset is based upon highest and best use that is physically possible, and legally permissible.

The measurement should reflect the characteristics of the asset, e.g. its condition and location and the restrictions on its use.

Fair value is not adjusted for transaction costs.

Observe the fair value in the market where the asset is normally sold (the principal market), or in its absence, the most advantageous market.

Fair Value Hierarchy - the levels

1. Level 1 inputs are quoted prices in active markets for identical assets or liabilities that the entity can access at the measurement date.

   A quoted market price in an active market provides the most reliable evidence of fair value and is used without adjustment to measure fair value.

2. Level 2 inputs are observable market prices for similar assets. They will require adjusting.

3. Level 3 inputs are unobservable inputs because no market exists. They will require estimating. An entity develops unobservable inputs using the best information available in the circumstances. e.g. present value of the future cash flow.

The Key Takeaways

You must be able to apply the definition of fair values – which is why the video contains those examples.

Fair value is both an exit value and not entity specific.

Fair value can apply to liabilities as well.

The determination of fair value often requires judgment.

WHAT'S NEXT?

- Make sure you do the quizzes.
- Read the article.
- Do the homework questions Q1 Fair Value and Q2 Rhys – **see below.**

And keep moving.

QUESTIONS OVER THE PAGE

QUESTION 1

Fair Value

Parent acquired 75% of Subsidiary's 40,000 equity shares in a share exchange of three shares in Parent for every two shares in Subsidiary. The market price of Parent's shares at the date of acquisition were $3·20.

In addition to this Parent agreed to pay a further amount on four years later that was dependent upon the post-acquisition performance of Subsidiary. At the date of acquisition Parent assessed the fair value of this contingent consideration at $50,000, but at the current year-end, three years after the combination, it was clear that the actual amount to be paid would be only $30,000. (ignore discounting)

The policy of the group is to measure the non-controlling interest at acquisition at fair value. The market price Subsidiary's shares at the date of acquisition were $4·50.

The fair value of the net assets of the subsidiary at acquisition was $20,000.

Required:

Calculate the goodwill arising at acquisition.

QUESTION 2

Rhys has trees that need to be measured at fair value

IAS 41 Agriculture uses a fair value model for the accounting for agricultural activity – the management of the biological transformation of biological assets (living plants and animals) into agricultural produce (harvested product of the entity's biological assets). Changes in the fair value are recognised in the statement of profit or loss.

At the reporting date, Rhys has a plantation of 200 trees that are grown for their timber. They are currently two years old. There is no market for trees that are two years old. The trees reach maturity when they are five years old. The current market price of a five-year-old tree is $10. The discount rate is 10%. Last year it was determined that the trees had a fair value of $1,203.

Required:

Calculate the fair value of the plantation of the 200 trees at the reporting date.