Co-funded by the
Erasmus+ Programme
of the European Union

PASSFR.EU

A Digital Learning Platform for Generation Z:
Passport to IFRS®

A Digital Learning Platform for Generation Z: Passport to IFRS®

IFRS® Standard 13 Fair Value Measurement

Funded by the Erasmus+ Program of the European Union. However, European Commission and Turkish National Agency cannot be held responsible for any use which may be made of the information contained therein.

CASE STUDY - IFRS 13 FAIR VALUE MEASUREMENT

Introduction

There might be situations, in which users of financial statements would prefer information about accounting objects measured in fair value over acquisition price or production cost. According to IFRS 13, fair value refers to a value gained during the sale of an asset or paid when transferring liability in an orderly transaction between market participants at the measurement date. When measuring fair value of a particular asset or liability, their specific characteristics should be taken into account at the measurement date. Correct fair value measurement involves using appropriate valuation techniques and choosing the right type of the market when applicable.

Thus, in order to provide and deepen the knowledge and ability of students in applying fair value measurement, this case study has a twofold purpose:

- First, learn how to apply the market approach to evaluate the fair value of the goods when one trades the goods in several different markets, and to explain the results received based on the provisions of the standard;
- Second, to use the provisions of the standard applying fair value at the initial recognition of an asset and amend financial statements accordingly.

The Case Information

Novotex & Co is a group of economic entities that has been engaged in various economic activities for more than ten years. The individual activities of the group are concentrated in separate entities, it includes trade of wooden saunas, broker-trading, etc. However, all entities share the same accounting policy.

One of the group entities – Uno Tree (UT) – sells one type of wooden saunas. Entity UT submitted one sauna for sale at different prices in two different markets. At the valuation date (e.g. the date of the financial statements), the entity has information about the possible selling prices in both markets and the related costs. In the table below, there is information provided on sauna's selling price, transaction and transportation costs in markets P and R.

Markets	**P**	**R**
Price, CU	2,600	2,500
Transaction costs, CU	300	100
Transportation costs, CU	200	200

Another group entity Zoe Zoe (ZZ) acts as broker-trader entity that buys goods and sells it quickly, earning from price changes, so such goods are measured at fair value. ZZ bought a truck for CU45,000 t the auction in December. The truck is ready for sale in the future. Under usual business conditions, a purchase price of a similar truck would be CU68,000. Entity ZZ ignored fair value adjustment requirements and recognized the full amount paid for the truck as inventory, which is reported under current assets in financial statements.

Subtracted financial statements of entity ZZ are provided in the table below.

Statement of financial position, CU		
Item	**Prepared statement**	**Corrected statement**
Non-current assets	1,200,000	
Current assets	800,000	
Inventories	631,000	
Cash	451,000	
Total assets	**3,082,000**	
Non-current liabilities	1,100,000	
Equity	500,000	
Other non-current liabilities	600,000	
Current liabilities	1,982,000	
Total liabilities	**3,082,000**	

Statement of Profit & Loss, CU		
Item	**Prepared statement**	**Corrected statement**
Revenue	5,063,000	
Costs of goods sold	(3,100,000)	
Gross profit	1,963,000	
Operating expenses	(1540,000)	
Operating profit	423,000	
Non-operating revenue & expenses	(10,000)	
Profit before income tax expense	413,000	
Income tax expense (20%)	(82,600)	
Net profit	**330,400**	

Discussion Questions

1. Determine the fair value of the goods for sale by entity UT using the market approach when:

- the market P is the principal market;
- the market R is the principal market;
- neither P nor R are the principal markets; and explaining your answers.

2. Amend the Statement of Financial Position and Statement of Profit & Loss of entity ZZ taking into account that the truck has to be measured at fair value using journal entries to explain the changes.

SOLUTION OF CASE STUDY – IFRS 13 FAIR VALUE MEASUREMENT

Solution of question No.1

When it comes to using market approach for fair value measurement in accordance with IFRS 13, there are several assumptions are used. That is, if there is a principal market for an asset or a liability, the fair value determined corresponds to the price of the said asset or liability in that market, even if its price in another market could be more favourable on the valuation date. When the principal market is absent, then the fair value is measured in the most advantageous market.

<u>When market P is considered as the principal market</u>, the fair value of the sauna will be calculated as follows: price CU2,600 – transportation costs CU200 = CU2,400 fair value of the sauna.

<u>When the market R is considered as the principal market</u>, the fair value of the sauna will be calculated as follows: price CU2,500 – transportation costs CU200 = CU2,300 fair value of the sauna.

In a case where neither P nor R markets are principal markets, the most advantageous market is chosen. Then the net amount obtained for the sauna is considered in the market as follows:

Market P: price CU2,600 – transaction costs CU300 – transportation costs CU200 = CU2,100 net amount

Market R: price CU2,500 – transaction costs CU100 – transportation costs CU200 = CU2,200 net amount

<u>The most advantageous market for fair value determination will be market</u> R (CU2,200 > CU2,100). However, the fair value of the sauna in the most advantageous market R will be CU2,300, as the fair value is still determined by only deducting transportation costs from its price and not the transaction costs.

Solution for question No.2

When Zoe Zoe Co. bought a truck in an auction and did not apply fair value measurement at initial recognition, its journal records were as follows:

Dr. Inventories	45,000	
Cr. Cash		45,000

Taking into consideration the provisions of IFRS 13, fair value may be applied at the initial recognition, while the transaction price differences from the fair value the resulting gain or loss the entity should be recognized as profit (loss). The journal records applying fair value measurement at initial recognition looks as follows:

Dr. Inventories	68,000	
Cr. Cash		45,000
Cr. Revenue		23,000

Statement of financial position, CU		
Item	**Prepared statement**	**Corrected statement**
Non-current assets	1,200,000	1,200,000
Current assets	800,000	823,000
Inventories	631,000	654,000
Cash	169,000	169,000
Total assets	**2,000,000**	**2,023,000**
Non-current liabilities	1,100,000	1,118,400
Equity	500,000	518,400
Other non-current liabilities	600,000	600,000
Current liabilities	900,000	904,600
Total liabilities	**2,000,000**	**2,023,000**

Statement of Profit & Loss, CU		
Item	**Prepared statement**	**Corrected statement**
Revenue	5,063,000	5,086,000
Costs of goods sold	(3,100,000)	(3,100,000)
Gross profit	1,963,000	1,986,000
Operating expenses	(1,540,000)	(1,540,000)
Operating profit	423,000	446,000
Non-operating revenue & expenses	(10,000)	(10,000)
Profit before income tax expense	413,000	436,000
Income tax expense (20%)	(82,600)	(87,200)
Net profit	**330,400**	**348,800**

The fair value measurement applied at the initial recognition resulted in changes in ZZ entity's reports. Revenue increased by CU23,000 in the Statement of Profit & Loss, and thus resulted in bigger income tax expenses and bigger net profit of the entity as well. The changes in Statement of the financial position accrued in inventory value, which increased by CU23,000, equity by CU18,400 and current liabilities by CU4,600.