PASSFR.EU

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

IFRS® Standard 13 Fair Value Measurement

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

Why is It Necessary Fair Value Measurement?

What is Main Definition?

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Principal market	refers to a market, in which the maximum volume and level of activity of an asset or liability exists.

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Market approach	refers to one of the fair value measurement methods that uses prices and other relevant information obtained from market transactions involving identical or comparable (similar) assets or liabilities.

Recognition on Fair Value

Example of Recognition on Fair Value

Situation
Broker-trader entity X purchase goods in order to buy them quickly and earn from price fluctuations, so such an entity values the goods at fair value. Entity X purchased an automobile for CU10,000 from an insolvent entity in March. The automobile will be resale in future. Under the normal business conditions, a similar automobile costs CU12,000 in the market. Entity X will recognize the inventories at fair value for CU12,000.

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Record	
Dr. Inventories	CU12,000
Cr. Cash	CU10,000
Cr. Revenue	CU2,000

Examples of Assets Characteristics Consideration

Condition and location of assets

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- Restrictions on the sale of assets

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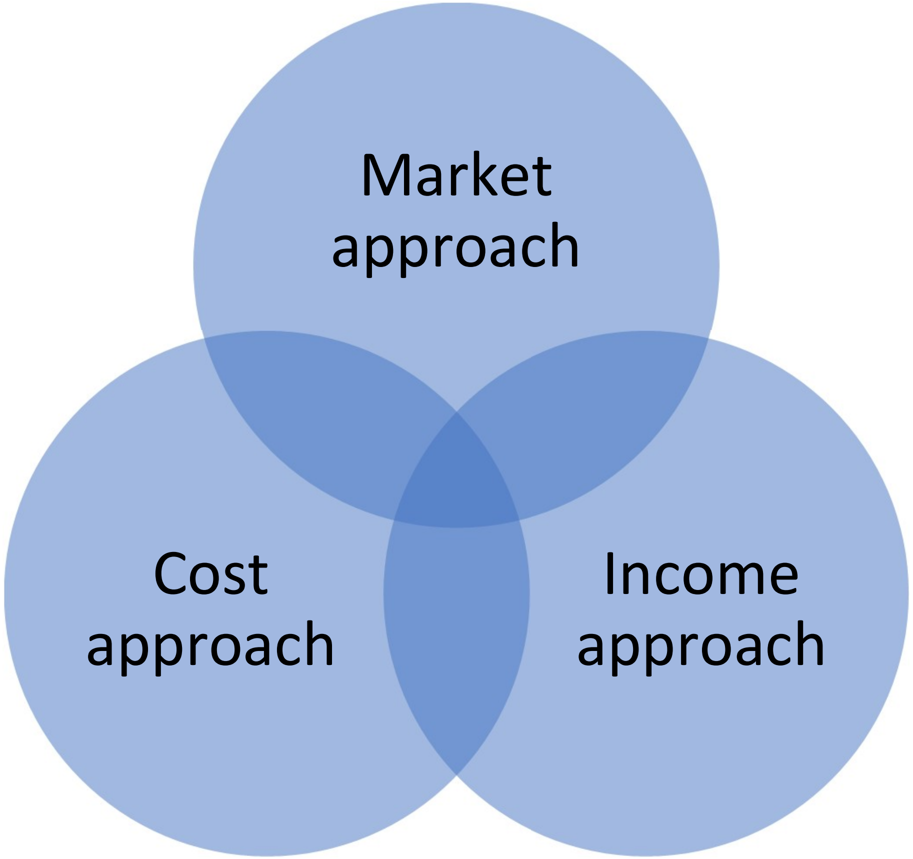
Condition and location of assets

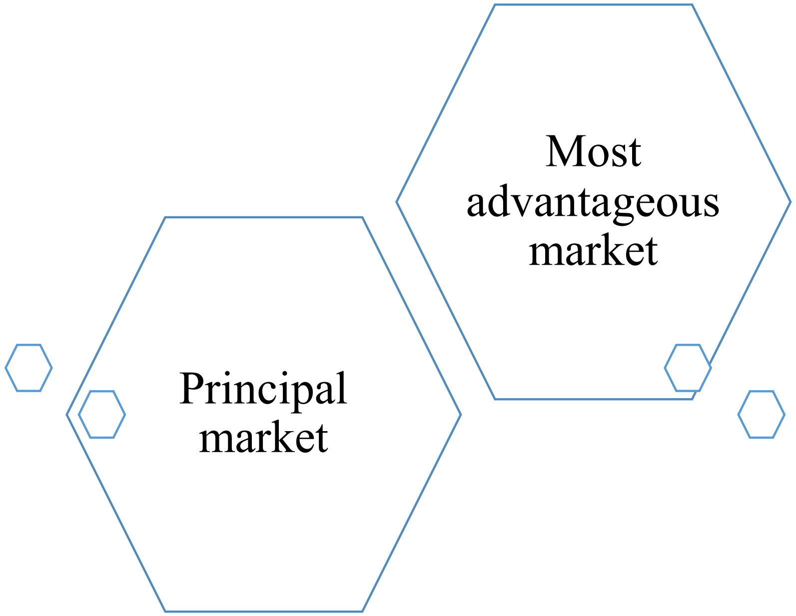
Restrictions on the sale of assets

Restrictions on the use of assets

Fair Value Valuation Techniques



Market Approach



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- Entities may have access to different markets even for the same assets or liabilities, because different entities have different activities.
- Therefore, the principal market is viewed from the perspective of an individual entity, considering the possibility in which it may sell specific assets or transfer specific liabilities.

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- Transaction costs are not an indication of an asset or a liability, as these costs may vary for a specific of transaction.

Market Approach

<u>Example in the principal market:</u>

Market	A	B
Price, CU	12,000	15,000
Transport costs, CU	2,000	3,000
Transaction costs, CU	1,000	1,200

Market Approach

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Market	A	B
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The fair value of assets is CU12,000 – CU2,000 = CU10,000

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Example in the most advantageous market

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Net amount obtained in market B is CU15,000 – CU3,000 - CU1,200 = CU10,800

Market Approach

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Net amount obtained on market A is CU12,000 – CU2,000 - CU1,000 = CU9,000

Net amount obtained in market B is CU15,000 – CU3,000 - CU1,200 = ***<u>CU10,800</u>***

Therefore, the most advantageous market is market B.

The fair value of assets is CU12,000 *(not taking into account transport costs CU15,000 - CU3,000), as obtained in the most advantageous market (B).*

Cost Approach

Fair Value Setting by Cost Approach

Situation	Entity X had purchased specific production equipment for CU50,000 two years ago. Today, the entity has a need to determine the fair value of the production equipment. The entity considers it appropriate to apply the cost approach as there is no analogue or similar product on the market and, therefore, the market approach cannot be applied.

Fair Value Setting by Cost Approach

Situation	Entity X had purchased specific production equipment for CU50,000 two years ago. Today, the entity has a need to determine the fair value of the production equipment. The entity considers it appropriate to apply the cost approach as there is no analogue or similar product on the market and, therefore, the market approach cannot be applied.
Fair value measurement	Upon request, Entity Z provided an estimate of how much it would cost to produce a similar equipment. The cost of producing such equipment would be CU60,000. However, this value cannot be considered as fair value as the value needs to be adjusted for obsolescence. Experts at Entity X have determined that the equipment must be valued at 65% of the new equivalent. Therefore, the fair value is CU39,000 (CU60,000 x 65%).

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- Assumptions about cash flows and discount rates should be internal and consistent;
- **Discount rates should be in line with key economic factors in the currency.**

Fair Value Setting by Income Approach

Situation	**Entity X purchased production equipment for CU50,000 in installments over 2 years. Payments are made once time a year at CU25,000, including interest. Annual interest rate 3%.**
Fair value of assets	$NPV = 25{,}000/(1+0.03)^1 + 25{,}000/(1+0.03)^2$ $=CU47{,}836.74$
Fair value of the current part of non-current liabilities	$NPV = 25{,}000/(1+0.03)^1$ $=CU24{,}271.84$

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Fair value of the current part of non-current liabilities	$NPV = 25,000/[(1+0.03)]^1$ $=CU24,271.84$
Entries in the general journal at the time of acquisition	Record Dr. Tangible assets (equipment) CU47,836.74 Cr. Long-term liabilities CU23,564.90 Cr. Short-term liabilities CU24,271.84

Fair Value Hierarchy

Level 1

- Price in the active market

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Level 3

- Price based on assumptions after assessing user risks

Fair Value Hierarchy

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Level	Explanation
Level 1	On this level, the focus is on the identification: · the principal market for the asset or liability, if there is no principal market, the most advantageous market; · whether an entity can enter into a transaction for an asset or liability at a price in that market at the measurement date.

Fair Value Hierarchy

Level	Explanation
Level 2	When assets or liabilities have a specified (contractual) maturity at this level, the observation period and level 2 include: · quoted prices in the active markets for similar assets or liabilities; · quoted prices in identical markets for identical or similar assets or liabilities; · data other than the prices quoted that are observable for the asset or liability.

Fair Value Hierarchy

Level	Explanation
Level 3	Unobservable inputs on this level shall be used to estimate fair value to the extent that no relevant observable inputs are available. This applies if, on the measuring date, the market for an asset or liability is low (or non-existent). The unobservable inputs must then reflect the assumptions that market participants would use in setting the price of the asset or liability, including risk assumptions. Risk assumptions include the risks inherent to the particular valuation technique used to determine fair value (for example, the pricing model) and the risks inherent in the valuation method inputs.

What Information is Disclosed for a User of Financial Statements?

- **First, an entity shall disclose information for assets and liabilities that are measured at fair value on a recurring or non-recurring basis after initial recognition, the valuation techniques and inputs used to develop those measurements.**
- Second, an entity shall disclose information for the recurring fair value measurements of assets and liabilities, significant unobservable inputs (Level 3) were used to determine the effect of the measurements on profit or loss or other comprehensive income for the period.

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Practical Example

Market	A	B	C	D
Price, CU	100,000	110,000	90,000	98,000
Transaction cost, CU	12,000	12,000	11,500	11,000
Transport cost, CU	3,000	2,000	4,500	5,000

Practical Example

Cost structure	Raw materials, CU	Labour, CU	Testing, CU	Total, CU
Supplier Z	60,000	15,000	12,000	87,000
Supplier X	70,000	20,000	8,000	98,000

Practical Example

Market	A	B	C	D
Calculation the Value of equipment, CU	100,000 - 12,000 – 3,000 = 85,000	110,000 - 12,000 – 2,000 = 96,000	90,000 - 11,500 – 4,500 = 74,000	98,000 - 11,000 -5,000 = 82,000

On market B, the fair value of the equipment is CU108,000 (CU110,000 - CU2,000), not accounting for the transaction costs.

Practical Example

- Depending on the cost approach, the value of the equipment is found to range from CU87,000 to CU98,000. Knowing that the equipment has been practically unused, obsolescence is not assessed.

	Cost approach	Market approach (Market B)
Value of equipment, CU	CU87,000 – CU98,000	CU108,000

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