Fair Value Measurement Ind AS 113
When to measure fair value as per Ind AS 113?
When another Ind AS requires or permits Fair Value measurement (FMV) except

- a) Ind AS 102 : Share - based payment
- b) Ind AS 17 : Leases
- c) Ind AS 2 : Inventories
- d) Value in Use (VIU) in Ind AS 36 : Impairment of Asset

How to measure Fair Value?

- Ind AS 113 provides guidance on how to measure fair value of financial, and non financial assets and liabilities when required or permitted by another Ind AS.
- Ind AS 113 does not function in isolation but it acts as a companion standard to other Ind AS.
How to measure Fair Value?

Step I: Refer primary Ind AS for identifying account balance or transaction that should be measured or disclosed at fair value.

Step II: Refer Ind AS 113 for determination of fair value at initial recognition.

Step III: Refer primary Ind AS for subsequent measurement or disclosure at fair value.

Fair Value Defined

“The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participant at the measurement date”
Fair Value- Key Concepts

- Fair value represents exit price and not entry price
- Transaction price is the entry price
- Exit price of an asset or liability is different from entry price
- Fair value is market-based measurement, not an entity specific measurement
- Fair Value measurement is not adjusted for transaction costs
Exit price vs. Entry price

What asset would fetch in the market or what is to be paid on transfer of liability (exit or sale price)

Entity’s intention or ability is not considered

Ignore transaction cost – they are not attribute of assets or liabilities

Assumes HABU (the highest and Best use of Assets) from market participants perspective for non-financial assets

Use of non-financial asset is: Physically possible, Financially feasible, Legally permissible
Fair Value- Key Concepts

Transfer of liability vs. Settlement of liability

When liability is transferred to market participants then it continues & not settled

‘Transfer’ reflects market based measurement & excludes firm specific efficiencies or inefficiencies
Fair Value may not equal the Transaction Price

• Transaction is between related parties

• Transaction occurs under duress or force

• **Unit of account** represented by the transaction is different from that of the asset or liability

• Market in which the transaction occurs is different from the **principal or most advantageous market**
Fair value for Financial Reporting vs. Investment Value

Fair value is based on ‘market participants’ but investment value on specific buyer

Fair value includes market level synergy but excludes specific synergy
Fair Value- Key Concepts

Fair value for Financial Reporting vs. FMV

Fair value has a **hierarchy of inputs** for valuation but FMV does not have it.

Fair Value uses **HABU** for non-financial asset valuation resulting in maximising value against consensus value under FMV.

DOLM adjustments may require in certain cases under Fair value but DLOC is doubtful.

Fair value disregard blockage discount (decline in value due to size)
**Fair Value definition - Explained**

**Asset:** The price that would be received to sell an asset

**Fair value = Exit Price**

In an orderly Transaction

Between Market Participants

At Measurement date

**Liability:** The price that would be paid to transfer the liability

‘KAWI’ buyers and sellers in principal or most advantageous market

Valuation Date
Who are Market Participants?

Buyers and Sellers in the principal (or most advantageous) market for the asset or liability having the following characteristics.

- **K** - Knowledgeable and using all available information
- **A** - Able of entering into the transaction
- **W** - Willing to enter into the transaction
- **I** - Independent [Unrelated parties]

Fair Value Measurement Ind AS 113
The standard requires market participants view while excluding entity specific factors impacting the price.

How market participants would consider:

- Condition and location of asset
- Restriction on the sale or use of the asset
How to decide principal or most advantageous market?

Principal Market

- **Exists**
  - **Yes**
    - Use price as fair value
  - **No**
    - Consider both transaction costs & transportation cost while determining most advantageous market

Greatest volume and level of trading activity

- Exhaustive search is not required. Only consider all information reasonably available

Most Advantageous market

- Maximizes the amount for selling the asset or minimizes the amount for transferring the liability.
Principal or Most Advantageous Market (POMAM)

- In the absence of evidence to the contrary, use market that entity usually transacts in

- POMAM is considered from the perspective of the entity

- Entity must have access to POMAM at the measurement date

- Need to access to POMAM is sufficient. (Need to able to sell asset or transfer liability is not required)

- Transaction costs and transportation costs are considered while determining most advantageous market but treatment is different for fair value measurement.
What is orderly transaction?

“An orderly transaction is one that involves exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such as assets or liabilities; it is not a forced transaction (e.g. a forced liquidation or distress sale)”

Two key components

- Adequate market exposure
- Buyers and Sellers are not forced
Orderly transactions

- **Yes**
  - Transaction price is considered for fair value

- **No**
  - Little or no weight on the transaction price as compared to other indicators of fair value
  - No sufficient information to conclude orderly transaction
  - Consider transaction price for fair value but less weight placed on it compared to orderly transaction
When a transaction is not orderly

- Inadequate exposure to market to allow usual and customary marketing activities
- Asset/liability marketed to single market participant
- Seller is near bankruptcy or receivership
- Transaction price is outlier
Unit of account (What is being measured) or UOA?

“The level at which an asset or liability is aggregated or disaggregated in an Ind AS recognition process.”

- Unit of account is determined as per primary Ind AS that permits or requires fair value

- Ind AS 113 does not provide any guidance on the determination of UOA

<table>
<thead>
<tr>
<th>Transaction</th>
<th>Unit of account</th>
</tr>
</thead>
<tbody>
<tr>
<td>Derivative</td>
<td>Contract</td>
</tr>
<tr>
<td>Goodwill impairment</td>
<td>CGU or group of CGU to which goodwill is allocated</td>
</tr>
<tr>
<td>Listed investment</td>
<td>P &amp; Q; ‘P’ should be of the measurement date</td>
</tr>
</tbody>
</table>
FVM Framework

Step I: Determine UOA as per primary Ind AS

Step II: Determine valuation premise

Classify assets & liabilities into

Financial
Valuation premise: standalone
Consider election of net position (group) based valuation

Non-Financial
Valuation premise: HABU standalone or in combination of other assets or liabilities
FVM Framework

Step III: Determine market

Step IV: Determine valuation approaches & methods

<table>
<thead>
<tr>
<th>Market</th>
<th>Income</th>
<th>Asset or cost</th>
</tr>
</thead>
</table>

Step V: Calculate value & carry out sanity test

Step VI: Determine fair value and if necessary allocate fair value to each account
Fair value Hierarchy- Why?

• To maximize the use of observable market data and minimize the use of unobservable inputs

• To establish classification of fair value measurement level 1, 2 or 3 for disclosure purpose

• Assessing the significance of a particular input to the FMV in its entirety require judgment, considering factors specific to the asset or liability
A hierarchy of inputs for fair value measurement from most to least reliable

<table>
<thead>
<tr>
<th>Level</th>
<th>Inputs</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Observable</td>
<td>Quoted (unadjusted) market price in active market for identical assets or liabilities</td>
</tr>
<tr>
<td>2</td>
<td>Observable</td>
<td>Other than Level1 inputs, that are observed either directly or indirectly for e.g. quoted price for similar assets and liabilities in active market, quoted price for identical or similar assets and liabilities in inactive market, other than observable inputs like yield curve, credit risk.</td>
</tr>
<tr>
<td>3</td>
<td>Unobservable</td>
<td>Everything else (internal model or estimate of management – entity’s own assumption about the assumptions that the market participants will use.</td>
</tr>
</tbody>
</table>
FVM – Unique Features

Level 1
- Price listed on the NSE, BSE prices for securities
- List futures contract prices on the NSE, BSE

Level 2
- A rate on a debt instrument that is tied to a market rate such as LIBOR
- A dealer quote for a security that may not be traded on a public market; however, the dealer is willing and able to transact

Level 3
- Inputs obtained from broker quotes that are indicative such as a quote for certain machinery and equipment
- Valuation models that are based on management assumptions such as cash flow forecasts that cannot be corroborated with observable market data
Unit of account

Example 1:
Infy Ltd. holds majority stake (55%) in Sify Ltd. total number of shares held as on measurement date is INR 2 million. Infy acquired stake 6 months before the measurement date at INR 40 million. The management has valuation report based on DCF for INR 50 million. The price of one share as on the measurement date was INR 30.

(i) What is the unit of account?
   (a) Investment as a whole
   (b) Standalone

(ii) What is the fair value at the measurement date?
   (a) INR 60 million
   (b) INR 40 million
   (c) INR 50 million
(i) What is the unit of account?
(a) Investment as a whole

(ii) What is the fair value at the measurement date?
(a) INR 60 million
Example 2:
Green company acquired red company in a business combination. Red has on its balances an investment in shares of blue company which is publicly traded on the NSE and BSE.

<table>
<thead>
<tr>
<th>Exchange</th>
<th>Price</th>
<th>Transaction cost</th>
<th>Net</th>
</tr>
</thead>
<tbody>
<tr>
<td>BSE</td>
<td>20</td>
<td>3</td>
<td>17</td>
</tr>
<tr>
<td>NSE</td>
<td>19</td>
<td>1</td>
<td>18</td>
</tr>
</tbody>
</table>

What is the fair value of shares at the measurement date?

(a) 20, if the principal market is BSE
(b) 19, if the principal market is NSE
(c) 19, if neither BSE nor NSE is the principal market. (It falls to most advantageous category)
(a) 20, if the principal market is BSE
(a) 19, if the principal market is NSE
(b) 19, if neither BSE nor NSE is the principal market. (It falls to most advantageous category)
Example 3:
Reporting entity acquires land in a business combination.

   Land is currently develop for industrial use as a manufacturing facility
   
   Nearby sites have been developed for high rise residential building
   
   Reporting entity determines that the site could be developed for residential use, although it intends to continue its use as a manufacturing facility.

What is the fair value of the land?
It Depends!

Highest and Best Use would be determined by comparing:

a) the fair value of the manufacturing operation, assuming in use premise or

b) the value of land vacant for residential use taking into consideration demolition costs. – *Fair value is the higher of those values*