Chapter 7

Fair Value Measurement-Ind AS 113 : Definition

Fair value is the mantra of today in financial reporting across borders. In India also, the Institute of Chartered Accountants of India (ICAI) converged its accounting standards with IFRSs and accordingly, corporate financial statements beginning accounting year 2016-17 started disclosing financial figures based on fair value measurement. One of the purposes of fair value measurement is to narrow the gap between the balance sheet value and market value of a company. Fair value measurement aims at fair recording of a business transaction so that the financial statements are able to show a true and fair view of the profitability and financial position.

Indian Accounting Standard (Ind AS) 113 is a dedicated standard which provides guidance on Fair Value Measurement (FVM). In this Chapter we will discuss about the objective, scope, key concepts and definitions, as prescribed in Ind AS 113 on Fair Value Measurement.

A. Objective of Ind AS 113

This Ind AS:

- Defines Fair Value
- Sets out a Framework for measuring Fair Value
- Requires Disclosures about fair value measurements

B. Scope

This Ind AS applies when another Ind AS requires or permits fair value measurements or disclosures about fair value measurements

The *measurement and disclosure* requirements of this Ind AS do not apply to the following:

- Share based payment transactions within the scope of *Ind AS 102, Share based Payment*
- Leasing transactions within the scope of *Ind AS 17, Leases*

- Measurements that have some similarities to fair value but are not fair value, such as net realisable value in *Ind AS 2, Inventories*, or value in use in *Ind AS 36, Impairment of Assets*

The *disclosure* requirements by this Ind AS do not apply to the following:

- Plan assets measured at fair value in accordance with *Ind AS 19, Employee Benefits*
- Assets for which recoverable amount is fair value less costs of disposal in accordance with *Ind AS 36, Impairment of Assets.*

C. Definitions

1. Fair Value (FV)

"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.*

1	FV is Exit Price	Fair Value is the price to sell an asset or transfer a liability, and therefore represents an exit price, not an entry price
2	FV is *Not* Transaction Price	The transaction price is NOT presumed to represent the fair value of an asset or liability on its initial recognition
3	FV in *Principal Market*	Fair value is an exit price in the principal market (or in absence of a principal market, the most advantageous market) in which reporting entity would transact
4	FV is *Market based measurement*	Fair Value is a market based measurement, not an entity specific measurement
5	FV *excludes* Transaction Costs	Fair Value measurements should not be adjusted for transactions costs

Note: *The definition of fair value focuses on assets and liabilities because they are a primary subject of accounting measurement. In addition, this Ind AS shall be applied to an entity's own equity instruments measured at fair value.*

2. Active Market

A market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

3. The Asset or Liability

A fair value measurement is for a particular asset or liability. An entity shall take into account the characteristics of the asset or liability at the time of measurement of fair value as if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Such characteristics include, for example, the following:

- the condition and location of the asset; and
- restrictions, if any, on the sale or use of the asset

4. Entry Price

When an asset is acquired or a liability is assumed in an exchange transaction for that asset or liability, the transaction price is the price paid to acquire the asset or received to assume the liability.

5. Exit Price

The fair value of the asset or liability is the price that would be received to sell the asset or paid to transfer the liability.

D. Key Concepts

Transfer of Liability versus. Settlement of Liability

1. When liability is transferred to market participants then it *continues and not settled.*
2. "Transfer" reflects market-based measurement & excludes firm specific efficiencies or inefficiencies

Fair Value may not be equal to Transaction Price

1. When transaction is between related parties
2. Where transaction occurs under duress or force
3. Unit of account represented by the transaction is different from that of the asset or liability

4. Market in which the transaction occurs is different from the principal or most advantageous market

Fair value for Financial Reporting vs. Fair Market Value (FMV)

1. Fair value has a hierarchy of inputs for Valuation but FMV does not have it
2. Fair Value uses HABU for non – financial assets Valuation resulting in maximising value against consensus value under FMV
3. DLOM adjustments may be required in certain cases under Fair Value but DLOC is doubtful
4. Fair value disregards blockage discount (decline in value due to size)

Particular asset or liability that is the subject of measurement

A fair value measurement is for a particular asset or liability. The characteristics of the asset or liability that market participants would take into account when pricing the asset or liability at the measurement date shall be taken into account. Such characteristics include:

- the condition and location of the asset
- restrictions, if any, on the sale or use of the asset

The asset or liability measured at fair value might be either of the following:

- a stand-alone asset or liability (e.g. a financial instrument or a non-financial asset); or
- a group of assets, a group of liabilities or a group of assets and liabilities (e.g. a cash-generating unit or a business).

Principal (or most advantageous) market

The transaction to sell the asset or transfer the liability takes place either:

- in the principal market or
- in the absence of a principal market, in the most advantageous market.

Highest and best use for a non-financial asset

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use. The highest and best use of a non-financial asset takes into account the use of the asset that is

a. Physically Possible

b. Legally Permissible

c. Financially feasible

Highest or best use is usually (but not always) the current use – if for competitive reasons an entity does not intend to use the asset at its highest and best use, the fair value of asset still reflects its highest and best use by market participants (defensive value).

Fair Value Hierarchy

To increase the consistency and comparability in fair value assignments and related disclosures, fair value hierarchy categorises inputs into three levels as defined below.

- ***Input Level 3 (Unobservable)***

  Inputs that reflect management's own assumptions about the assumptions that a market participant would make (E.g. Projected cash flows used to value a business or non-controlling interest in an unlisted entity)

- ***Input Level 2 (Indirectly Observable)***

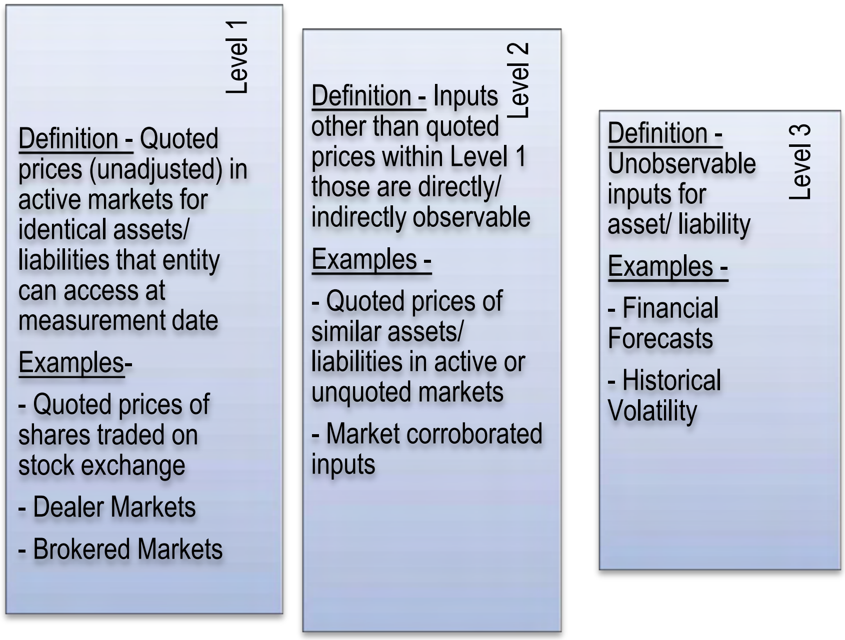
  a. Prices in active markets for similar assets / liabilities

  b. Quoted prices for identical / similar items in markets that are not active.

  c. Inputs other than quoted prices (E.g. Interest Rates and yield curves, implied volatilities etc.)

- ***Input Level 1 (Directly Observable)***

  Quoted prices in active markets for identical assets / liabilities (E.g. Quoted prices for an equity security on the BSE/ NSE).



**Quoted prices are given the highest priority and unobservable inputs the least*