# A sense of fair play

Lynne Woolley explains all you need to know about IFRS 13

Prior to the introduction of IFRS 13 Fair Value Measurement, many different standards each gave their own guidance on how to measure fair value (FV). This led to inconsistencies between entities. To improve comparability, FV measurement was added to the IASB's agenda in 2005 and IFRS 13 was issued in 2011 (effective from 1 January 2013).

FV is defined as: "**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".

- **The price**, often referred to as the 'exit price'.
- An **orderly transaction**, ie not a forced transaction.
- **Market participants** – buyers and sellers in the principal (or advantageous) market that are: independent; knowledgeable; able and willing.

FV measurement assumes transaction happen in the 'principal market' – for example, the market with the greatest volume/level of activity for that asset/liability.

In the absence of the principal market, use the 'most advantageous' market – for example, the market that produces the highest net receipt per unit after considering all costs to sell.

Note: FV is not adjusted for transaction costs.

**Example 1**

An asset is sold in two countries at two different prices:

| | Country A | Country B |
|---|---|---|
| Price per unit | £100 | £105 |
| Transaction costs | £5 | £3 |
| Delivery costs | £2 | £2 |

If Country A is the principal market, FV per unit, after deducting delivery but not transaction costs, would be £98.

If neither country is the principal market, look at the most advantageous market. Country B produces a higher net receipt, £100, than Country A, £93.

Country B would therefore be used to calculate FV of £103 (ignoring transaction costs).

**Example 2**

When calculating FV, alternative uses of the asset/liability should be considered:

– A factory site is acquired for £5m.
– Nearby sites, recently developed for residential purposes, have a value of £6m.
– Factory demolition costs – £0.2m

The FV would be £5.8m based on the highest and best use of the land:

- Current use, £5m; vs
- Alternative use, after demolition costs, £5.8m.

When calculating FV, an entity should use valuation techniques that are appropriate in the circumstances and for which sufficient data are available – maximising use of observable inputs and minimising use of unobservable inputs.

'Observable inputs' are developed using market data.

**Level 1 inputs:** quoted prices in active markets for identical assets/liabilities, eg equity shares in a listed company.

**Level 2 inputs:** are observable, directly or indirectly, eg quoted prices for similar assets/liabilities.

**Level 3 inputs:** are unobservable inputs, for example discounted future cash flows using the entities own financial information.

The standard gives highest priority to Level 1 inputs.

While Historic Cost is still deemed to be more reliable and less subjective, FV produces a more relevant value to users for decision making. PQ

• **Lynne Woolley, Reed Business School**