"Hear Ye! Hear Ye!" FRS 102 is a coming... and so is fair value!!

Michael Donnelly outlines the areas of FRS 102 affected by Fair Value.

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The town crier of old has hung up his bell but he may need to return in order to get the message to some preparers of financial statements.

No doubt at this stage everybody has heard of FRS 102 and the imminent arrival of the new framework that is mandatory for accounting periods beginning on or after January 1st 2015. Current Irish GAAP will be withdrawn at this date and will no longer apply. Early adoption is permitted.

FRS 102, a document which comprises of 35 sections, will form the basis of financial reporting for the vast majority of Irish entities and has been referred to as the "New Irish GAAP". All existing FRSs, SSAPs and UITF Abstracts will be replaced by FRS 102.

Anyone who has perused the pages of FRS 102 will have noticed that there are consistent references throughout the standard to "fair value". This article will look at what areas of the standard are affected by "fair value" and how will they be dealt with.

Continued on Page 12

▶ Continued from Page 11

What is "Fair Value"?

FRS 102 defines fair value as "the amount for which an asset could be exchanged, a liability settled, or an equity instrument granted could be exchanged, between knowledgeably, willing parties in an arms length transaction" (Section 2.34(b) *Concepts and pervasive principles).*

The application of fair value can be analysed over the key areas where it will have the greatest impact.

(a) **Property, plant and equipment**
Under current Irish GAAP, a class of assets may be measured at fair value. For the first time adopters of FRS 102, the option does exist not to adopt the historical cost model but to use the fair value of a previous revaluation as your "deemed cost". This could give the preparer of the financial statements an opportunity to bring up to date the values at which some assets are shown at in the financial statements. One should also refer here to "Section 27 – *Impairment of assets*". Fair value is a key component in "testing for impairment" and as we are all aware the after effects of properties that were acquired during the boom years could be still lurking in financial statements and will need to be removed.

(b) **Investment properties**
An investment property is one held for rental income or capital appreciation. The investment property will be recognised initially at cost and revised to fair value at the end of each accounting period. The gain or loss should be recognised in the income statement. The "fair value" measurement should be reliable and should not incur undue expense.

(c) **Financial Instruments**
FRS 102 requires an analysis of financial instruments held at fair value and the standard has given us a three level hierarchy of valuations. I like to remember this hierarchy as a wedding cake - three tiers!

Level/Tier 1: Quoted price: The best evidence of fair value is the quoted price of an identical asset on an active market (e.g. value of a plc share is the price shown on an exchange).

Level/Tier 2: Recent transaction price of an identical asset. If a quoted price of an identical asset is not available, then the best evidence of fair value is obtained from a recent transaction, provided there has been no major changes in economic circumstances since the trade was completed and that trade was not done as part of a liquidation or forced disposal of the asset.

Level/Tier 3: Valuation technique: If a reliable valuation cannot be obtained using any of the two earlier levels, an estimate of fair value can be obtained by using a valuation technique. The purpose of the valuation technique is to estimate fair value and it will be the judgement of the practitioner or a specialist to determine what fair value is.

Under FRS 102 certain instruments must be measured at fair value with gains and losses recognised in profit and loss e.g. interest rate swaps/options, forward contracts, commodity contracts, some debt instruments, and investments in non-convertible and non-puttable shares that are publicly traded or their fair value can be estimated reliably.

(d) **Investments**
In individual entity accounts investments in subsidiaries, associates and jointly controlled entities may be held at cost less impairment or fair value with gains and losses recognised in a revaluation reserve or in certain circumstances profit and loss. A parent may also opt to recognise fair value gains and losses entirely in profit and loss. Any investments that are reclassified as "held for resale" will also be stated at fair value. Again, the "three tier" model can be used to determine what fair value is.

(e) **Business combinations**
Intangible assets whose fair value can be reliably measured should be recognised separately from goodwill on acquisition i.e. customer databases/relationships, research and development that is in process or intellectual property. It should be noted here also that these newly recognised intangible assets will create timing differences and so trigger a deferred tax liability. This will of course be reversed as the intangible assets are amortised and the deferred tax liability written down.

(f) **Biological assets**
A living animal or plant may be measured at fair value (if fair value can be measured reliably) with gains and losses recognised in profit and loss. This is one area where fair value can prove very difficult to establish. For practitioners who operate in the agricultural, bloodstock or forestry industries the problem of determining values will be recognised as a common occurrence. The policy must be applied consistently to each class of biological asset and its related agricultural produce.

With the above brief summary along with all of the other material that is available at the moment on FRS 102 accountants must decide on how the accounting policies used in their financial statements will change or be impacted upon and what measurement changes might be brought about. The use of "fair value" in FRS 102 will impact on the carrying values of assets, the profits/losses being reported and the value of distributable reserves that will be shown in the financial statements.

The adoption of FRS 102 brings about a set of challenges to the preparer of financial statements with the changes in accounting policies etc., but it also presents an opportunity to use the transition arrangements to regularise values shown in financial statements at historically outdated costs and replace them with fair value. There may well be the necessity to call on the services of an expert in the particular area that the fair values are being introduced to e.g. financial trader/broker, property valuer, actuary. The amounts concerned would of course at all times have to be material to the financial statements and it will certainly be a requirement of any audited entity that the fair values adopted be based on external written evidence of an expert.

What has been outlined in this article is only an introduction to the details of FRS 102 and fair value. It would certainly be advisable to deepen your knowledge of the standard.

The current CPA Ireland Skillnet Certificate in FRS 102 commenced on August 30th. This Certificate may be run again, to register your interest in a future certificate please contact Jenny Andersson, jandersson@cpaireland.ie.