

## TOPIC 29

# INDAS 108 OPERATING SEGMENTS



### INDEX

S.No.	Topic Name	Page No.
1	Objectives of IndAS 113	880
2	What is Fair Value	880
3	Principal Vs. Most Advantageous Market	882
4	The Price	883
5	Fair Value at Initial Recognition	885
6	Valuation Techniques	885
7	Fair Value Hierarchy	886
8	Disclosures	887
9	Questions	888

**Quote:-**

*Some things*

*The bad things that happen in our lives put us directly on the path to the best things that will ever happen to us.*



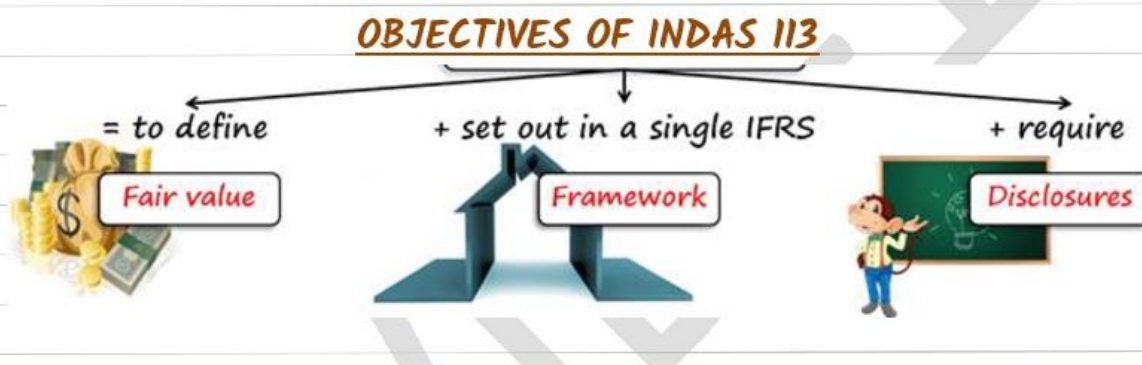
Many INDAS standards require you to measure the fair value of some items. Just name the examples: financial instruments, biological assets, assets held for sale and many other.

**INDAS 113 applies in all situations where another IndAS permits or requires the use of Fair Value.**

### Why INDAS 113?

The objectives of INDAS 113 are:

- to define fair value;
- to set out in a single INDAS a framework for measuring fair value; and
- to require disclosures about fair value measurements.



Fair value is a **MARKET-BASED** (Not Entity Based that means own situation) measurement, not an entity-specific measurement. It means that an entity:

- shall look at how the **market participants** would look at the asset or liability under measurement
- shall not take own approach (e.g. use) into account.

### What is Fair Value?

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.

Also called as **Exit Price**.

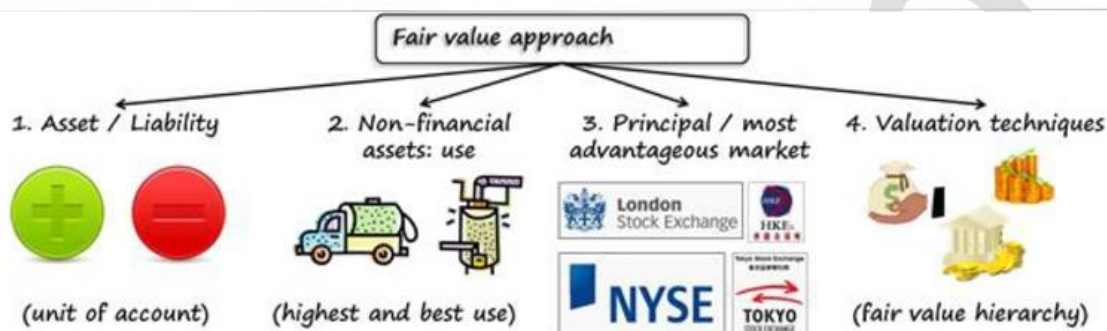
When an entity performs the fair value measurement, it must determine all of the following:

- the particular **ASSET OR LIABILITY** that is the subject of the measurement (consistently with its unit of account)
- for a non-financial asset, the valuation premise that is appropriate for the measurement (consistently with its highest and best use)





- the **PRINCIPAL (OR MOST ADVANTAGEOUS) MARKET** for the asset or liability
- the **VALUATION TECHNIQUES** appropriate for the measurement, considering:
  - o the availability of data with which to develop inputs that represent the assumptions that market participants would use when pricing the asset or liability; and
  - o the level of the fair value hierarchy within which the inputs are categorized.



### Asset or liability

When measuring fair value, an entity takes into account the **characteristics** of the asset or liability that a market participant would take into account when pricing the asset or liability at measurement date.

These characteristics include for example:

- the **condition and location** of the asset
- the **restrictions** on the sale or use of the asset.

### Transaction

A fair value measurement assumes that the asset or liability is exchanged in an **orderly transaction** between **market participants** at the measurement date under current market conditions.

### Orderly transaction

The transaction is orderly when 2 key components are present:

- there is adequate market exposure in order to provide market participants the ability to obtain knowledge and awareness of the asset or liability necessary for a market-based exchange
- market participants are motivated to transact for the asset or liability **(Not Forced)**.

## Market participants

Market participants are buyers and sellers in the principal or the most advantageous market for the asset or liability, with the following characteristics:

- independent
- knowledgeable
- able to enter into transaction
- willing to enter into transaction.

## Principal vs. Most Advantageous Market

A fair value measurement assumes that the transaction to sell the asset or transfer the liability takes place either:

- in the principal market for the asset or liability; or
- in the absence of a principal market, in the most advantageous market for the asset or liability.

### PRINCIPAL MARKET

**Principal market** is the market with the **GREATEST VOLUME AND LEVEL OF ACTIVITY** for the asset or liability.

Different entities can have different principal markets, as the access of an entity to some market can be restricted (please watch the video below for deeper explanation).

#### Example

Share of a company which is listed at BSE and NYSE has different closing prices at the year end. The price at BSE has greatest volume and activity whereas at NYSE it is less in terms of volume transacted in the period. Since BSE has got highest volume and significant level of activity comparing to other market although the closing price is higher at NYSE, the closing price at BSE would be taken.

### MOST ADVANTAGEOUS MARKET

The Most Advantageous market is the market **THAT MAXIMIZES THE AMOUNT THAT WOULD BE RECEIVED TO SELL THE ASSET OR MINIMIZES THE AMOUNT THAT WOULD BE PAID TO TRANSFER THE LIABILITY**, after taking into account transaction costs and transport costs.

#### Example:

Diamond (a commodity) has got a domestic market where the prices are lesser comparing to the price available for export of similar diamonds. The Government has a policy to cap the export of Diamond, maximum upto 10% of total output by any such manufacturer. The normal activities of diamond are being done at domestic market only i.e. 90% and balance 10% only





can be sold via export. The highest level of activities with highest volume is being done at domestic market. Hence, principal market for diamond would be domestic market. Export prices are more than the prices in the principal market and it would give highest return comparing to the domestic market.

Therefore, the export market would be considered as most advantageous market. However, if principal market is available, then its prices would be used for fair valuation of assets/ liabilities.

## THE PRICE

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions (i.e. an exit price).

A fair value is being assessed based on principal market and if principal market is not available then based on the most advantageous market

### (a) Transaction cost

Principal (or most advantageous) market is where significant level of transactions and activities takes place and it eventually covers/ considers all such transaction costs. Hence, it would not be appropriate to consider any transaction cost further while assessing fair values from such principal markets.

**Note:** Transaction costs do not include transport costs.

### (b) Transport cost

If location is a characteristic of the asset (as might be the case, for example, for a commodity), the price in the principal (or most advantageous) market shall be adjusted for the costs, if any, that would be incurred to transport the asset from its current location to that market. It would be considered, if in case it is an inherent part of the Assets/ Liability so transacted e.g. commodity.

#### **Example:**

An entity sells certain commodity which are available actively at location A and which is considered to be its principal market (being significant volume of transactions and activities takes place). However, fair value of the commodity is required to be assessed for location B which is far from location A and requires a transport cost of INR 100. Since the transport cost is not a transaction cost and it is not specific to any transaction but it is inherent cost which requires to be incurred while bringing such commodity from location A to location B, it will be considered while evaluating fair value from the principal market.





## Application to Non-financial assets

Fair value of a non-financial asset shall be measured based on its **Highest And Best Use** from a market participant's perspective.

The highest and best use takes into account the use of the asset that is:

- **physically possible** – it takes into account the physical characteristics that market participants would consider (for example, property location or size);
- **legally permissible** – it takes into account the legal restrictions on use of the asset that market participants would consider (for example, zoning regulations); or
- **Financially feasible** – it takes into account whether a use of the asset generates adequate income or cash flows to produce an investment return that market participants would require. This should incorporate the costs of converting the asset to that use.

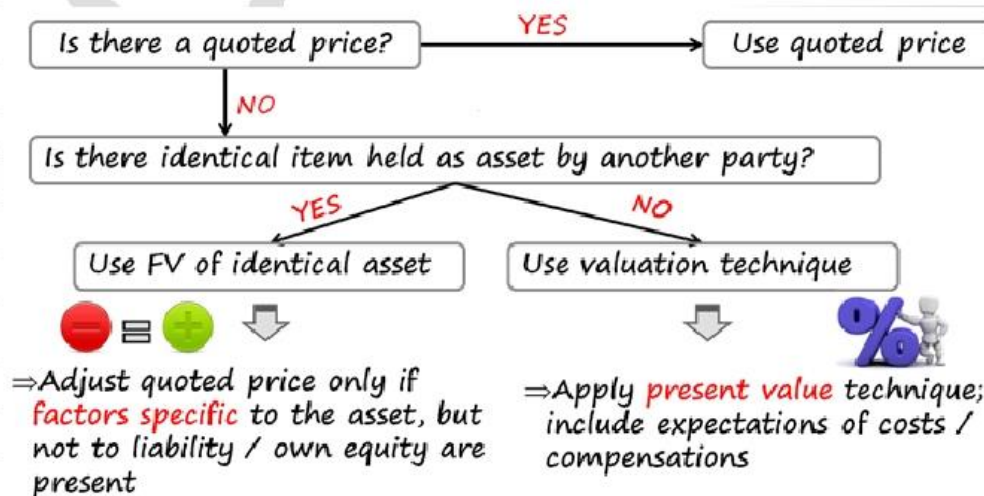
## Application to financial liabilities and own equity Instruments

In the first instance, an entity shall set the fair value of the liability or equity instrument by the reference to the **QUOTED MARKET PRICE** of the identical instrument, if available.

If the quoted price of identical instrument is not available, then the fair value measurement depends on whether the liability or equity instrument is held by other parties as assets or not:

- If the liability or equity instrument is held by other party as an asset, then
  - If there is the quoted price in an active market for the identical instrument held by another party, then use it (adjustments are possible for the factors specific for the asset, but not for the liability/equity instrument)
  - If there is no quoted price in an active market for the identical instrument held by another party, then use other observable inputs or another valuation technique
- If the liability or equity instrument is not held by other party as an asset, then use a valuation technique from the perspective of market participant

This is illustrated in the following simplified scheme:





## Fair value at Initial Recognition

When an entity acquires an asset or assumes a liability, the price paid/received or the **transaction price is an entry price.**

However, INDAS 113 defines fair value as the price that would be received to sell the asset or paid to transfer the liability and that's **an exit price.**

In most cases, transaction or entry price equals to exit price or fair value. But there are some situations when transaction price is not necessarily the same as exit price or fair value:

- The transaction happens between **related parties**
- The transaction takes place **under duress** or the seller is forced to accept the price in the transaction
- The **unit of account** represented by the transaction price is **different** from the unit of account for the asset or liability measured at fair value
- The market in which the transaction takes place is **different** from principal or the most advantageous market.

If the transaction price differs from the fair value, then an entity shall recognize the resulting gain or loss ("**Day 1 profit**") to profit or loss unless another INDAS standard specifies other treatment.

## Valuation Techniques

When determining fair value, an entity shall use valuation techniques:

- Appropriate in the circumstances
- For which sufficient data are available to measure fair value
- Maximizing the use of relevant observable inputs
- Minimizing the use of unobservable inputs.

Valuation techniques used to measure fair value shall be applied **consistently.**

However, an entity **can change** the valuation technique or its application, if the change results in equally or more representative of fair value in the circumstances.

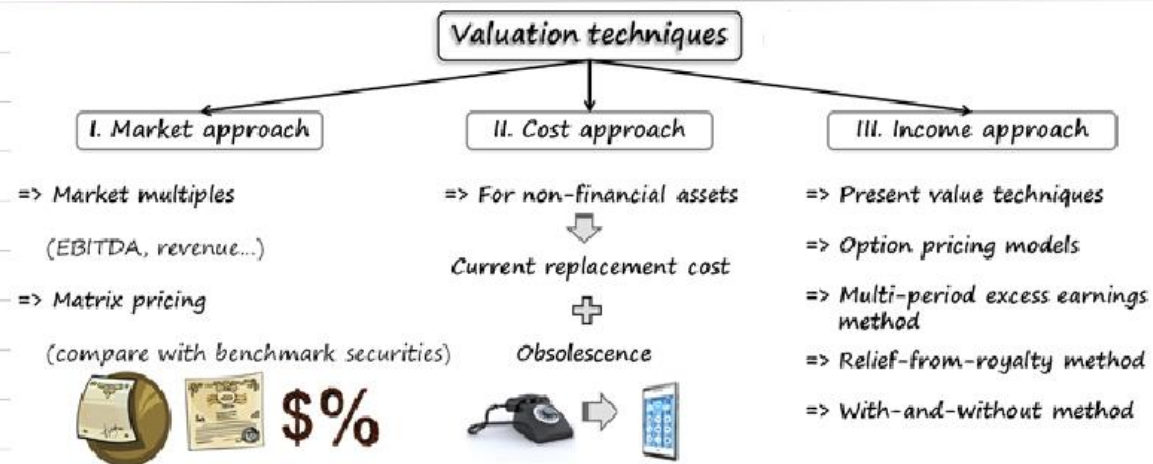
An entity accounts for the change in valuation technique in line with **IAS 8** as for a change in accounting estimate.

INDAS 113 allows 3 valuation approaches:

- **Market approach:** uses prices and other relevant information generated by market transactions involving identical or comparable (ie similar) assets, liabilities, or a group of assets and liabilities, such as a business
- **Cost approach:** reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost).



- *Income approach: converts future amounts (e.g. cash flows or income and expenses) to a single current (i.e. discounted) amount. The fair value measurement is determined on the basis of the value indicated by current market expectations about those future amounts.*



### Fair Value Hierarchy

INDAS 113 introduces a **fair value hierarchy** that categorizes inputs to valuation techniques into 3 levels. The highest priority is given to Level 1 inputs and the lowest priority to Level 3 inputs.

An entity must **maximize the use of Level 1** inputs and **minimize the use of Level 3** inputs.

#### **Level 1 inputs**

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.

An entity shall not make adjustments to quoted prices, only under specific circumstances, for example when a quoted price does not represent the fair value (ie when significant event takes place between the measurement date and market closing date).

#### **Level 2 inputs**

Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.



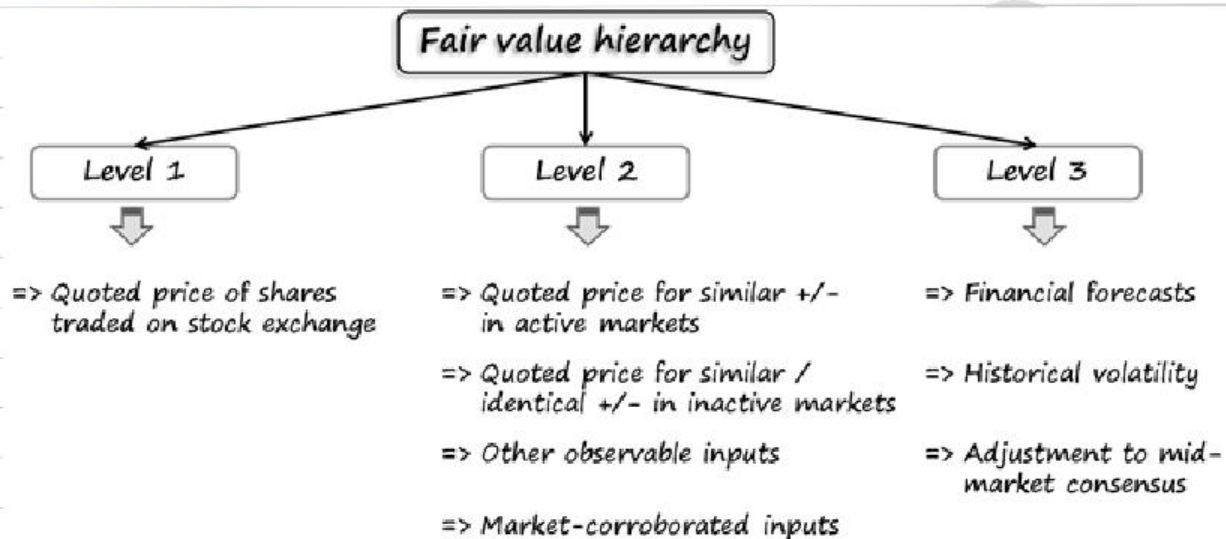


### Level 3 inputs

Level 3 inputs are unobservable inputs for the asset or liability.

An entity shall use Level 3 inputs to measure fair value only when relevant observable inputs are not available.

The following scheme outlines the fair value hierarchy together with examples of inputs to valuation techniques:



### Disclosure

INDAS 113 requires extensive disclosure of sufficient information to assess:

- Valuation techniques and inputs used to develop fair value measurement for both recurring and non-recurring measurements;
- The effect of measurements on profit or loss or other comprehensive income for recurring fair value measurements using significant Level 3 inputs.

As the disclosures are really extensive, here, the examples of the minimum requirements are listed:

- Fair value measurement at the end of the reporting period;
- The reasons for measurement (for non-recurring)
- The level in which they are categorized in the fair value hierarchy,
- Description of valuation techniques and inputs used;
- And many others.



## Questions

### Q411 (ICAI MODULE)

An asset is sold in 2 different active markets at different prices. An entity enters into transactions in both markets and can access the price in those markets for the asset at the measurement date.

#### In Market A:

The price that would be received is Rs. 26, transaction costs in that market are Rs. 3 and the costs to transport the asset to that market are Rs. 2.

#### In Market B:

The price that would be received is Rs. 25, transaction costs in that market are Rs. 1 and the costs to transport the asset to that market are Rs. 2.

You are required to calculate:

- (i) The fair value of the asset, if market A is the principal market, and
- (ii) The fair value of the asset, if none of the markets is principal market.

#### Answer:

##### (i) If Market A is the principal market

If Market A is the principal market for the asset (i.e., the market with the greatest volume and level of activity for the asset), the fair value of the asset would be measured using the price that would be received in that market, after taking into account transport costs.

Fair Value will be

	Amount
Price Receivable	26
Less - Transportation Cost	(2)
<b>Fair Value of Asset</b>	<b>24</b>

##### (ii) If neither of the market is the principal market

If neither of the market is the principal market for the asset, the fair value of the asset would be measured using the price in the most advantageous market. The most advantageous market is the market that maximises the amount that would be received to sell the asset, after taking into account transaction costs and transport costs (i.e., the net amount that would be received in the respective markets).





	Market A	Market B
Price Receivable	26	25
Less - Transaction Cost	(3)	(1)
Less - Transportation Cost	(2)	(2)
<b>Fair Value of Asset</b>	<b>21</b>	<b>22</b>

Since the entity would maximise the net amount that would be received for the asset in Market B i.e. Rs. 22, the fair value of the asset would be measured using the price in Market B.

**Fair value**

	Amount
Price Receivable	25
Less - Transportation Cost	(2)
<b>Fair Value of Asset</b>	<b>23</b>

### Q412 (ICAI MODULE)

Company J acquires land in a business combination. The land is currently developed for industrial use as a factory site. Although the land's current use is presumed to be its highest and best use unless market or other factors suggest a different use, Company J considers the fact that nearby sites have recently been developed for residential use as high-rise apartment buildings. On the basis of that development and recent zoning and other changes to facilitate that development, Company J determines that the land currently used as a factory site could be developed as a residential site (e.g., for high-rise apartment buildings) and that market participants would take into account the potential to develop the site for residential use when pricing the land.

Determine the highest and best use of the land.

**Answer:**

The highest and best use of the land is determined by comparing the following:

- The value of the land as currently developed for industrial use (i.e., an assumption that the land would be used in combination with other assets, such as the factory, or with other assets and liabilities); and
- The value of the land as a vacant site for residential use, taking into account the costs of demolishing the factory and other costs necessary to convert the land to a vacant site. The value under this use would take into account risks and uncertainties about



whether the entity would be able to convert the asset to the alternative use (i.e., an assumption that the land would be used by market participants on a stand-alone basis).

The highest and best use of the land would be determined on the basis of the higher of these values. In situations involving real estate appraisal, the determination of highest and best use might take into account factors relating to the factory operations (e.g., the factory's operating cash flows) and its assets and liabilities (e.g., the factory's working capital).



### Student Notes:-

COVID-19







Student Notes:-

COVID-19





Student Notes:-

COVID-19

