June 2018 – KB1

Question 07 (iv)

What is the FV of Investment portfolio???

~~Price one: External buyer agreed to buy it at 50mn~~

~~Price two: Cost 150mm~~

~~Price three: valuation models of Rock present a fair value of Rs. 140 million,~~

based on the analysis of quoted prices of similar assets, Rs. 75 million could be reasonably expected to be realized under the prevalent condition.

Answer:

As per SLFRS 13, Fair value is a market-based measurement, not an entity-specific measurement. That is the price at which an *orderly transaction* to sell the asset or to transfer the liability would take place between *market participants* at the measurement date under current market conditions.

Therefore, the FV of the investment portfolio would be Rs. 75mn since it considered the information from the market and its current condition.

Additional Question – Conceptual framework

AC co. has purchased a motor vehicle at 100, 000 three years ago and decided to depreciate it over ten years on straight line basis.

Entity estimated its vehicle will use for another seven years and will generates 12,000 net cashflow in each year. the residual value at the end of useful life will be 10,000. The cost of capital of the entity is 10%. However, to buy same type of vehicle entity wants to incur 65,000.

Base on the analysis of similar assets in the market the assets was measured at 60,000/-

Advice, how entity use measurement techniques in the conceptual framework for the measurement of the vehicle.

Answer

As per conceptual framework for presentation of FS, entity can measure the motor vehicle as,

1. Historical cost

2. Current Value

    FV / Value in use / Current cost

Therefore, the vehicle can be measured as follows,

1. historical value

   Cost – Acc. Dep= CV

  100000 – 30000 = 70,000

2. Current value

  FV – value in between market participant where asset transfer at the measurement date under current market condition. That is 60,000/-

  Value in Use – PV of the future net cashflows which can be derived from the asset.

	0	1	2	3	4	5	6	7
Net cashflow		12000	12000	12000	12000	12000	12000	12000
RV		0	0	0	0	0	0	10000
		12000	12000	12000	12000	12000	12000	22000
DCF 10%	1	0.909	0.826	0.751	0.683	0.621	0.564	0.513
PV		10909.0909	9917.355	9015.778	8196.161	7451.056	6773.687	11289.48
TOTAL PV		63,553						
(value in use)								

Current Cost- cost to be incurred to buy the asset 65,000/-

Practice Questions

Question 01

(a) "Fair value is a market-based measurement, not an entity-specific measurement; also, fair value reflects the current market condition."

Required.

(i) Describe the different levels of inputs explained in SLFRS 13 - Fair Value Measurement, in measuring fair value. (3 marks)

(ii) According to SLFRS 13, state the three (03) different approaches that can be used to derive the fair value. (3 marks)

(b) ABC (Pvt) Ltd (ABC) is a real estate company, specialising in industrial property development. ABC measures its industrial investment property using the fair value method. <u>Fair value is arrived at using the estimated value to be incurred to build similar kind of investment property less any obsolescence</u>. Valuations are conducted by a member of the finance division. Obsolescence is determined based on the age of the property and the nature of its use. Sale prices for a similar kind of investment property in a similar location, as well as market rent data for similar kind of industrial property are also available.

Required.

Comment on the method used by ABC in measuring the fair value of its industrial investment property. (4 marks)

(Total: 10 marks)

Answer:

As per SLFRS 13, FV measurement is a market base approach and not an entity specific measurement. However, in this scenario entity has been used their own method to measure the FV of their investment properties. Using estimated cost to construct a similar asset is not a market base approach.

Entity would have to use available market information such as Sale prices for a similar kind of investment property in a similar location, as well as market rent data for similar kind of industrial property instead of their own estimated cost of construction.

Hence, method used in this scenario is incorrect.

Question 02

Yellow owns several farms and also owns a division which sells agricultural vehicles. It is considering selling this agricultural retail division and wishes to measure the fair value of the inventory of vehicles for the purpose of the sale. Three markets currently exist for the vehicles. Yellow has transacted regularly in all three markets. At 30 April 2015, Yellow wishes to find the fair value of 150 new vehicles, which are identical. The current volume and prices in the three markets are as follows:

Market	Sales price – per vehicle $	Historical volume – vehicles sold by Yellow	Total volume of vehicles – sold in market	Transaction costs per vehicle $	Transport cost to the market – per vehicle $
Europe	40,000	6,000	150,000	500	400
Asia	38,000	2,500	750,000	400	700
Africa	34,000	1,500	100,000	300	600

Yellow wishes to value the vehicles at $39,100 per vehicle as these are the highest net proceeds per vehicle, and Europe is the largest market for Yellow product.

Required.

Comment on the method used by Yellow in measuring the fair value of Agricultural Vehicles

(5 marks)

Answer

As per SLFRS 13, A fair value measurement assumes that the transaction to sell the Agricultural vehicles take place either:

(a) in the *principal market* for the Agricultural vehicles; or

"The market with the greatest volume and level of activity for the asset or liability".

(b) in the absence of a principal market, in the *most advantageous market* for the Agricultural vehicles.

"The market that maximises the amount that would be received to sell the asset or minimises the amount that would be paid to transfer the liability, after taking into account transaction costs and transport costs."

Selling price- Transport cost

Therefore, entity shall determine their principle mkt in order to measure FV. The principle

Market is the market with the **greatest volume** and **level of activity** for the agricultural vehicles

which is **Asia Market** since its reported 750,000 transactions.

FV base on Principle market, Asia market:

Price x Quantity = Total FV

(SP – Transport cost) x 150

(38000 – 700)150 = $ 5,595,000

If entity unable to obtain information about their principle market, then entity can select the most advantageous market to measure the FV.

The most advantageous market is the market that entity can obtain highest gain. The highest gain will be calculated as follows,

	SP -		Transaction cost -		Transport cost	=	Gain
Europe	**40,000**	**-**	**500-**		**400**		**= 39,100**
Asia	38,000	-	400	-	700		= 36,100
Africa	34,000	-	300	-	600		= 33,100

Therefore, entity shall consider Europe market as the most advantageous market when entity unable to find their principle market.

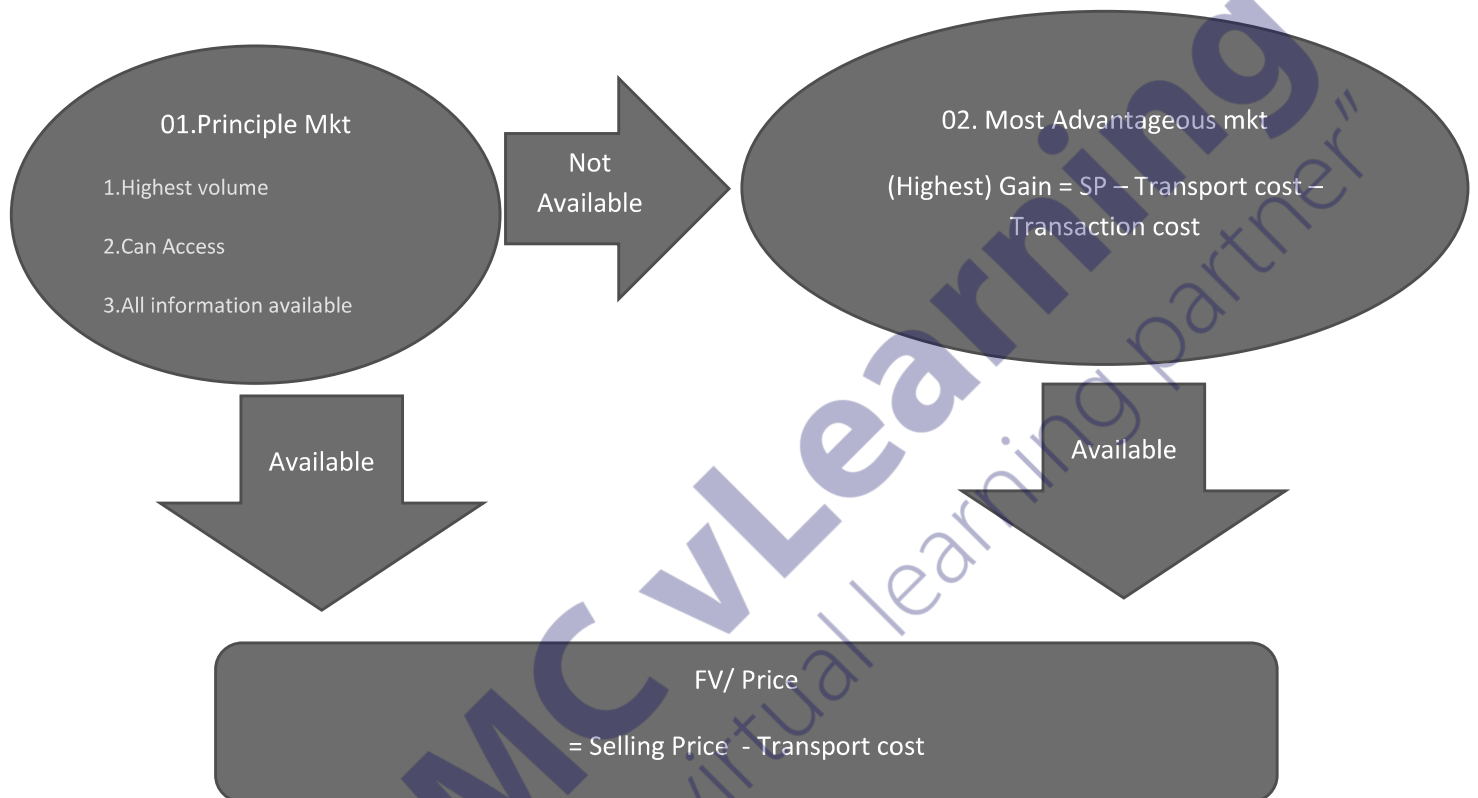FV base on most advantageous market, Europe market:

Price x Quantity = Total FV

(SP – Transport cost) x 150

(40,000 – 400)150 = $ 5,940,000

Therefore, the method followed by the entity is incorrect since they have used information from the most advantageous market initially without getting information from the principle market. Further the determination of the price also incorrect since they have deducted both transport and transaction cost from the selling price.

USING THE MKT CORRECTLY

01.Principle Mkt

1.Highest volume

2.Can Access

3.All information available

Not Available →

02. Most Advantageous mkt

(Highest) Gain = SP – Transport cost – Transaction cost

Available ↓

Available ↓

FV/ Price

= Selling Price - Transport cost

Question 03 – Dec. 2019 CFR (ABR)

Multi PLC measures its properties at fair value and such properties include land and building classified as property, plant and equipment and investment properties. The finance director is unhappy about the valuations carried out as at 31 March 2018. The details of such valuations for each property are as follows.

(i) Kadawatha property (land) – a donor has given this land to Multi PLC to construct a walking path and a play area for children in 2016. The donor has specified in the title transfer documents that the land should be used only for this purpose even if the land is sold to another party. The adjoining land was sold closer to the year-end at Rs. 600,000 per perch. Multi PLC valued the land using this price per perch.

(ii) Kelaniya property (land) – this land is located closer to the Kelaniya river and was affected by floods during the heavy rain seasons. Due to the unavailability of recent prices of nearby lands, the per perch price of Rs. 1 million pertaining to a recently sold land in Kelaniya facing the Colombo-Kandy main road was used in valuing this land of Multi PLC.

Required:

Evaluate each of the above valuations in accordance with the principles set out in SLFRS 13, Fair value measurement.   (10 marks)

Answer

As per SLFRS 13, A fair value measurement is for a particular asset or liability. Therefore, when measuring fair value an entity shall take into account the characteristics of the asset or liability 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:

(a) the condition and location of the asset; and

(b) restrictions, if any, on the sale or use of the asset.

(i) Kadawatha Land

Entity cannot use the price of the adjoining land in order to measure the FV of the land. Because of the land of the entity has special restriction about it use. It cannot be used any purpose other than the walking path and children garden.

Multi PLC shall consider the restriction connected with the land even they use a price of a similar land.

(ii) Kelaniya Land

The similar land is located facing to Colombo road and it is in a different condition when comparing to Kelaniya land. Therefore, entity cannot use the price of the similar land as its to measure the FV of Kelaniya land.

Entity shall take the price of the similar land and do necessary adjustment according to the condition and location of their land in Kelaniya. That is entity wants to discount the price due to the flood and other issues having with the land.

Question 04

ACCA Question June 2016 Question (2)

(a) Mehran, a public limited company, has just acquired a company, which comprises a farming and mining business. Mehran wishes advice on how to fair value some of the assets acquired.

One such asset is a piece of land, **which is currently used for farming**. The fair value of the land if used for farming is $5 million. If the land is used for farming purposes, a tax credit currently arises annually, which is based upon the lower of 15% of the fair market value of land or $500,000 at the current tax rate. The current tax rate in the jurisdiction is 20%.

Mehran has determined that market participants would consider that the land could have an alternative use for residential purposes. The fair value of the land for residential purposes before **associated costs** is thought to be $7·4 million. In order to transform the land from farming to residential use, there would be legal costs of $200,000, a viability analysis cost of $300,000 and costs of demolition of the farm buildings of $100,000.

Additionally, permission for residential use has not been formally given by the legal authority and because of this, market participants have indicated that the fair value of the land, after the above costs, would be discounted by 20% because of the risk of not obtaining planning permission.

ANSWER

As per SLFRS 13, 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* or by selling it to another market participant that would use 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 physically possible, legally permissible and financially feasible,

Therefore, FV as a farming land can be calculated as follows,

currently used for farming

FV $5mn + tax credit

5mn + 0.1mn = **$5.1mn**

Tax credit = (5mn x 15% or 500,000) x 20%

(750,000 or 500,000) x 20%

500,000 x 20% = $ 100,000 ($0.1mn)

As well as we can measure the land as a residential land since market participants would like to consider this purpose. However, we need to incorporate the associate cost of conversion into alternative purpose and also need to consider the risk of not getting permission from legal authorities via discounting the value by 20%
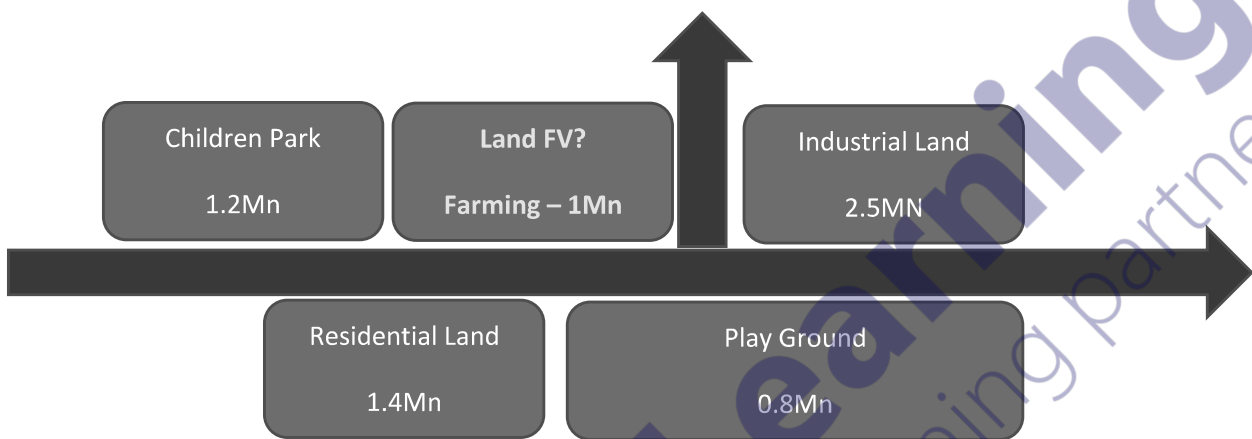
Therefore, FV as a residential land as follows,

As a residential Land

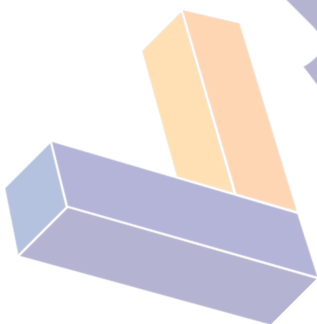- ✓ FV = $7.4 - $0.6 = $6.8 x 80% = **$ 5.44mn**

Finally, according to the highest and best use, fair value of the land shall be $ 5.44mn

If you need to assume a difference purpose such as industrial or any, you need to convert the land for that purpose. Therefore,

1. original purpose (Farming) FV = 1MN

2. alternative Purpose (ex. Industrial) FV = 2.5Mn – conversion cost but,

There are 3 conditions,

b) In addition, Mehran has acquired the **brand name associated with the produce from the farm**. Mehran has <u>decided to discontinue</u> the brand on the assumption that it will gain increased revenues from its own brands. Mehran has determined that *__if it ceases__* to use the brand, then the indirect benefits will be $20 million. If it continues to use the brand, then the direct benefit will be $17 million. (8 marks)

ANSWER

<u>Brand name</u>

If it discontinues = $20mn

If continue = $17mn

FV measurement is to estimate the price at which an *orderly transaction* to sell the asset or to transfer the liability would take place between *market participants* **at the measurement date under current market conditions**

Since, brand name still using by the entity and not yet discontinued,

The FV would be $ 17mn

(b) Mehran wishes to fair value the inventory of the entity acquired. There are three different markets for the produce, which are mainly **vegetables**. The first is the <u>local domestic market where Mehran can sell</u> direct to retailers of the produce. The second <u>domestic market is one where Mehran sells directly to manufacturers</u> of canned vegetables. There are no restrictions on the sale of produce in either of the domestic markets other than the demand of the retailers and manufacturers. The final market is the <u>export market</u> <u>but the government limits the amount of produce which can be exported</u>.

Mehran needs a license from the government to export its produce. Farmers tend to sell all the produce that they can in the export market and, when they do not have any further authorization to export, they sell the remaining produce in the two domestic markets.

<u>It is difficult to obtain information on the **volume** of trade in the domestic market where the produce is sold locally direct to retailers</u> but Mehran feels that the market is at least as large as the

domestic market – direct to manufacturers. The volumes of sales quoted below have been taken from trade journals.

	Domestic market – direct to retailers	Domestic market – direct to manufacturers	Export market
Volume – annual	Unknown	20,000 tonnes	10,000 tonnes
Mehran – sales per month	10 tonnes	4 tonnes	60 tonnes
Price per tonne	$1,000	$800	$1,200
Transport costs per tonne	$50	$70	$100
Selling agents' fees per tonne	–	$4	$6

Required:

Discuss the way in which Mehran should fair value the above assets with reference to the principles of *IFRS 13 Fair Value Measurement.*

Answer

As per SLFRS 13, the fair value measurement assumes that the transaction to sell the

Vegetable takes place either:

(a) in the *principal market* for the vegetable; or

(b) in the absence of a principal market, in the *most advantageous market* for the vegetable.

Therefore, entity shall determine their principle mkt in order to measure FV. The principle

market is the market with the greatest volume and level of activity for the vegetables.

However, in this scenario we cannot obtain principle market because of the following reasons,

1. No information available about the market volume in the domestic mkt to retailer.

2. Export mkt volume is not represented the actual volume since its operating under government restrictions on export volumes.

Hence, we need to obtain information from the most advantageous market for the Mehran which will calculate as follows.

	DMTR	DMTM	EXPORT
Price per tonnes	$1,000	$800	$1,200
Transport costs per tonnes	($50)	($70)	($100)
Selling agents' fees per tonns	–	($4)	($6)

950	726	**1094**

Therefore, export mkt shall be considered as the most advantageous mkt and entity shall measure FV 1tone of vegetable as follows,

SP – transport cost   = FV
1200 -   100   = $ 1,100

Requirement to obtain a license and restriction on quantity can be exported is not a matter when assessing the MEHRAN ability to access the market in order to measure FV of vegetable. Because Government not restricted the suppliers in the market. They have restricted only the volume of the market.