Chapter 2

Valuation Related Accounting Standards

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¶2-100 IFRS 2 – Share-based Payment

Overview

IFRS 2 facilitates the proper valuation of share-based payments or instruments, by outlining the recognition, measurement and disclosure of these transactions. Based on IFRS 2, the standard requires an entity to recognize and measure share-based payment transactions (such as granted shares, share options, or share appreciation rights) on the fair value basis in its profit and loss accounts, including transactions with employees or other parties to be settled in cash, other assets, or equity instruments of the entity. Accordingly, valuation of share-based payment shall be complied with IFRS 2.

The History

Entities often grant shares or share options to employees or other parties as a form of remuneration or incentive payment, particularly among directors, managers and the C-suite executives. Some entities issue shares or share options to pay for commercial services, such as in a broker-led fundraising deal. To solve the growing concerns on how entities should account for these vehicles in their financial statements, particularly at a time when share-based payments grew exponentially across many areas, IFRS 2 was issued and came into affect for annual fiscal periods beginning on or after 1 January 2005. Since IFRS 1 was first issued, IASB has continuously made amendments on it to make it more accurate and adaptable to today's rapidly changing environment.

Scope

Any entity that utilizes or grants share-based payments must follow IFRS 2 in regards to accounting treatment, whether or not the entity can identify

specifically some or all of the goods or services received. According to IFRS 2, there are three main types of share-based payment transactions:

- Equity-settled share-based payment transactions;
- Cash-settled share-based payment transactions; and
- Transactions in which the entity receives or acquires goods or services and the terms of the arrangement provide either the entity or the supplier of those goods or services with a choice of whether the entity settles the transaction in cash (or other assets) or by issuing equity instruments.

While share-based payments typically involve an employee-employer relationship, it is important to note that IFRS 2 covers any payment arrangements for goods or services that utilize equity instruments or cash amounts that are derived from the value of an equity instrument.

However, there are three scenarios in which an entity may not need to adopt IFRS 2:

- The issuance of shares in a business combination should be accounted for under IFRS 3 Business Combinations;
- The commodity-based derivative contracts shall be settled in shares or equity-based instruments; and
- Share dividends, purchase of treasury stock, and issuance of additional shares are not within the IFRS 2.

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Share-based Payments

Definition

Share-based payments are transactions done by entities to pay for goods or services received or acquired, through equity instruments or liabilities for amounts based on the price of the entity's shares. Share-based payments may be settled in cash or equity.

Recognition related to Valuation

An entity shall recognize the goods or services received or acquired in a share-based payment transaction when it obtains the goods or as the services are received. Based on IFRS 2, the entity shall recognize a corresponding increase in **equity** if the goods or services were received in an equity-settled share-based payment transaction, or a **liability** if the goods or services were acquired in a cash-settled share-based payment transaction.

That is to say, the value of share-based payment is not fixed. Accordingly, we shall measure and reflect the fair value of share-based payment in financial statements to reflect the true value.

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Valuation Basis of Share-based Payment Transactions

According to IFRS 2, for equity-settled share-based payment transactions, the entity shall measure the goods or services received, and the corresponding increase in equity, directly, at the fair value unless it cannot be estimated reliably as at the grant date, which is the valuation date.

For cash-settled share-based payment transactions, the entity shall measure the goods or services acquired and the liability incurred at the fair value at the grant date, which is the valuation date.

If the entity cannot estimate reliably the fair value of the goods or services received, the fair value of the equity instruments granted forms the basis of the consideration.

Share-based Payment to Employees

Undoubtedly, one of the most popular forms of share-based payments is to employees, which are also sometimes written as "share-based compensation" in financial statements.

If the remuneration package is in the form of equity options, they are known as employee share options and is an effective tool to align the interest of employees. Usually, the employee share options are not easy to measure directly as they lack an actively traded market. As a result, they should be valued according to the fair value of the equity instrument granted.

Cash payment may also be in the form of remuneration package to the employees with retained earnings, or an entity might grant to employees a future cash payment in the form of option.

Some cash-settled share-based payments can be immediately vested and the employees are therefore not required to complete a specific period of employment. In these cases, the entity shall recognize the equity instrument just as the service has been received. In the other cases that the share options vest after a certain year of service, the entity shall not recognize the service received and the liability to pay for them before the vesting conditions are met.

Share-based Payment to Other Parties

If the receivers of the goods are parties not employees, care must be taken to ensure that the fair value of the goods and services received can be estimated in a reliable manner. If the fair value of the goods and services is not measurable, the measurement of the goods or services and the corresponding increase in equity shall be measured according to the fair value of the equity instrument granted on the date when the entity obtains the goods or the services.

In some cases, when the consideration (i.e. the goods or services received by the entity) and the equity are both measurable, but the identifiable consideration is less than the fair value of the equity instrument, the entity is assumed to still be receiving an identifiable consideration. For

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example, when an entity donates to charity via a share based payment, the consideration may be an improved corporate image. In this case, the entity shall measure the unidentifiable goods and services using the guidance in IFRS 2.

For cash-settled transactions, however, the fair value of the liability should be re-measured on each financial reporting date and at the date of settlement. The changes shall be recognized in profit & loss for the period.

Valuation Factors of Equity Instruments Granted

Valuation Date

Normally, to measure the fair value of the equity instrument granted, the valuation date should be on the grant date.

New equity instruments granted may be granted as a replacement of cancelled equity instruments. In those cases, the accounting treatment should be the same as the old equity instrument. The fair value of the replacement equity instruments is determined at grant date. The fair value of the cancelled instruments is determined at cancellation date.

Market Price

If there is an active market, the market price may be adopted. If the market price is not available, an entity shall estimate the fair value of the equity instrument granted using valuation techniques to estimate it based on IFRS 2. This shall be consistent with the valuation methodology to value financial instruments.

Options with Reload Features

An option with a reload feature is one that automatically grants additional options whenever an employee exercises previously granted options through shares of stock as opposed to cash. The new or "reload" options are granted at the time of exercise by the employee using shares. It is important to note that when calculating fair value, the reload feature shall not be taken into consideration when calculating the fair value.

Post-Vesting Date

After the vesting date, if the recognized goods or services received which cause an increase in equity, the entity shall make no adjustment to total equity value. For example, if services received later than the vesting date, the fair value of the equity shall not be adjusted.

Vesting Conditions

Vesting conditions are pre-specified conditions that must be met before the grantee may fully own or exercise the share/option. In general, vesting conditions can be classified in one of two categories:

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- Service conditions, i.e. one which encourages an employee to stay with an entity until the vesting period is over; and
- Performance conditions, i.e. one which requires a specified performance condition to be met and can either be market-based, such as those that correspond to an entity's equity price, or non-market based such as those relating to an entity's net income.

Vesting conditions, other than market conditions (those relating to the market price of an entity's equity), shall not be taken into account when estimating the fair value of the shares or share options at the measurement date. Instead, vesting conditions shall be taken into account by adjusting the number of equity instruments included in the measurement of the transaction amount so that, ultimately, the amount recognized for goods or services received as consideration for the equity instruments granted shall be based on the number of equity instruments that eventually vest.

In other words, IFRS 2 suggests estimating the number of equity instruments that will likely vest based on the probability of meeting the performance condition. Hence, on a cumulative basis, no amount is recognized for goods or services received if the equity instruments granted do not vest because of failure to satisfy a vesting condition, e.g. the counterparty fails to complete a specified service period, or a performance condition is not satisfied.

The entity shall recognize the amount for the goods or services received during the vesting period under the most optimistic scenario, and adjust the amount if indicators show that the expected equity granted may differ from the previous case. On vesting date, the entity shall revise the estimate to equal the number of the equity instrument that ultimately vested [IFRS 2(20)]. Market conditions such as share prices exceeding the vesting condition shall also be taken into account for valuation of fair value.

If an entity was faced with non-vesting conditions (conditions other than service and performance conditions, and are entirely in the control of the employee) when estimating the fair value of equity instrument granted, the entity shall recognize the goods or services received from the granter, irrespective of whether the conditions are met. Non-vesting conditions are ignored for the purpose of estimating the number of equity instruments that will vest.

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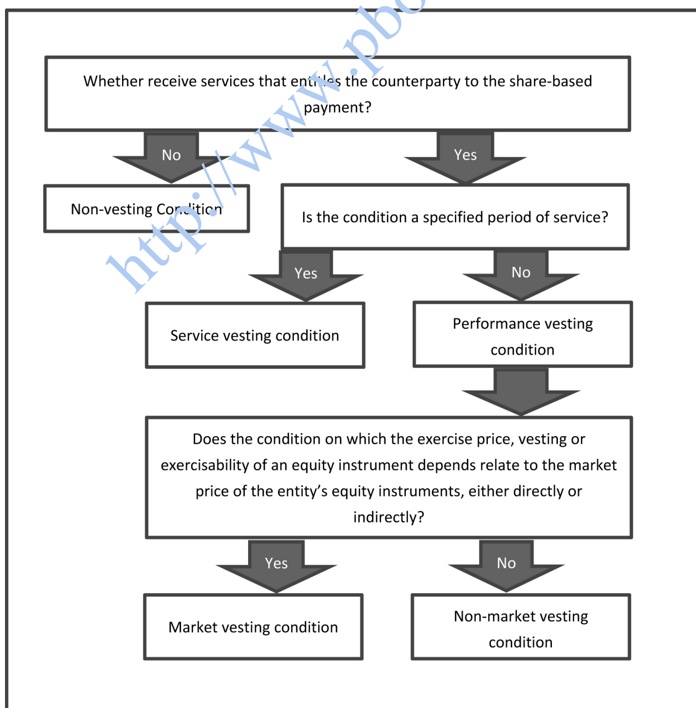
Transactions Involving Services

If the equity instruments granted can be vested immediately (otherwise known as having no *vesting period*, see Exhibit[1]), the counterparty is not required to complete a specified period of service before becoming unconditionally entitled to those equity instruments. In these cases, the entity shall presume that services rendered by the counterparty as consideration for the equity instruments have been received. In this case, on grant date the entity shall recognize the services received in full, with a corresponding increase in equity based on IFRS 2.

On the other hand, if the equity instruments granted do not vest until the receiver completes a specified period of service (service conditions), the entity shall presume that the services will be received in the future during the vesting period. Accordingly, the entity shall account for those services as they are rendered by the counterparty during the vesting period, with a corresponding increase in equity. For example:

- If an employee is granted share options conditional upon completing five years' service, then the entity shall presume that the services to be provided by the employee as consideration for the share options will be received in the future, over that five year vesting period; and
- If an employee's performance condition exists (either market or non-market based), the entity shall presume that these requirements shall be satisfied in the vesting period. The entity shall measure the length of the vesting period at the grant date based on the most possible outcome of the employee's performance. If the performance condition is a market condition, the estimate of the expected vesting period shall be consistent with the assumptions used in estimating the fair value of options granted and shall not be subsequently revised. However, if the performance condition is not market related, the entity should revise the period of estimating fair value of the options granted to match the vesting period.

Exhibit [1]



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Share-based Payment Transactions with Cash Alternatives

In some cases, the receiver or the granter may have a choice to choose whether the transaction is in cash or in the form of issuing equity instruments [IFRS 2(34)]. If the consideration is in the form of cash, this may be called a "share-based payment transaction with cash alternatives" and is a compound instrument.

This can be classified into two situations:

The Receiver Has the Right to Choose

If an entity has granted the counterparty the right to choose whether a share-based payment transaction is settled in cash or by issuing equity instruments, the entity has granted a compound financial instrument with both a debt component and an equity component. If the counterparty is other than employees, the entity shall measure the equity component of the compound financial instrument as the difference between the fair value of the goods or services received and the fair value of the debt component, at the date when the goods or services are received.

If the counterparty is employees, the entity shall measure the fair value of the compound financial instrument, taking into account the conditions of rights of cash and equity instrument grants.

The Entity Has the Right to Choose

In other cases, entity has the right to choose whether to pay in cash or in equity. If the entity has a present obligation to settle in cash, the measurement guideline shall refer to the cash-settled share-based payment transactions. If no such obligation exists, the entity shall refer to the requirements of equity-settled share-based payment transactions. Following are some examples:

- If the entity settles in cash, the cash payment will be treated as the repurchase of an equity interest (a deduction from equity);
- If the entity elects to settle by issuing equity instruments, this shall be treated as the same as equity-settled share-based payment; and
- If the entity elects the settlement alternative with the higher fair value only at the date of settlement, the entity shall recognize an additional expense for the difference between the cash to pay and the fair value of the equity instruments to pay.

¶2-200 IFRS 3 – Business Combinations

Overview

IFRS 3 provides guidance on the valuation of the purchase price allocation (the "PPA) for business combinations. Based on IFRS 3, the acquirer is required to identify the assets, the non-controlling interest and the liabilities presumed in its financial statements. Besides, the business combination's goodwill or the profits from the negotiated purchase shall also be measured

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to improve relevance and reliability of information provided in the reporting. Accordingly, valuation of PPA shall be complied with IFRS 3.

The History

Business transactions has been happening in financial world more and more frequently, and the concerns on how entities should account for these transactions in their financial statements was growing. In order to solve this concern, IFRS 3 was introduced and has been revised since it was issued. The lasted version of IFRS 3 was issued in January 2008 and applies to business combinations occurring in an entity's first annual period beginning on or after 1 July 2009

Scope

IFRS 3 is not applicable in the following circumstances:

- A joint venture formation;
- A grouping of businesses or entities that come under one common control. Details related to this can be found in paragraphs B1 to B4; and
- Acquisition of assets that do not constitute a business:
    - The identifiable personnel assets are to be identified by the acquirer with the assumed liabilities. The group cost will be distributed to the acquirer's individual liabilities and assets with the basis being on their relatively fair values when purchased. The acquirer's assets will also include those that meet the recognition criteria for and the definition of intangible assets as explained in the IAS 38 Intangible Assets section. No goodwill arises from a transaction of this type.

IFRS 3 is applicable to any transaction or occurrence that meets the business combination definition.

The acquisition cost can be affected by the following:

- **A bidding war**. The prospective buyers engage in a bidding war and the final buyer overpays;
- **Stock-price flux**. In a stock transaction, the exchange ratio is fixed at a point, but when the deal closes, the price drops precipitously;
- **Synergies.** Acquirer anticipated that there would be significant synergies unavailable to others; and
- **Non-economic.** The acquirer has non-economic motives to make a deal, for instance, if the CEO wants to create empire from the entity.

The reasons above may drive the purchase price away from the "fair" price of the subject significantly. Therefore, valuing PPA on the fair value basis is

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important for reliability of financial information of business combination recorded in financial statements.

In order to have an understanding of effects that IFRS 3 has on valuation, we must first start with the definition and covered scope of a business combination, which is regarded as our valuation subject.

Business Combination

Definition

Business

At first, we shall figure out the definition of business. According to IFRS 3, business is defined as

> "An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants."

From the definition, we can clearly find that a business consists of inputs and processes that have the ability to create outputs. That is to say, there are three elements to any business:

- **Input.** Any economic resource that creates or has the ability to create outputs when one or more processes are applied;
- **Process.** Any system, standard, protocol, convention or rule that when applied to an input or inputs, creates or has the ability to create outputs; and
- **Output.** The result of inputs and processes applied to those inputs that provide or have the ability to provide a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants.

IFRS 3 points out that meeting the definition that it "is capable of being conducted and managed", a "business" does not necessarily have to include all the processes or inputs that a seller uses in the business operations, if market participants are capable of acquiring the business and continuing to produce outputs.

According to IFRS 3, in cases whereby a business in the development stage has no output, the acquirer may determine if the subject is a business following the set of questions listed below:

- Will the entity be able to obtain access to customers that will purchase the outputs?
- Have the principal activities planned already begun?
- Is the subject pursuing a plan on how to generate output?

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- Does the subject have employees, intellectual property and or other inputs and processes that could be applied to those inputs?

The factors above need not be present in their entirety for specific incorporated assets and activities for a business in its development stage to qualify as a business, because the specific sets of activities and assets are based on their capability of being managed and conducted by the market participant in a business capacity. It is not relevant whether a seller operated the set as a business or whether the acquirer intends to operate the set as a business.

The presence of goodwill should be recognized to be a business if the evidence stated above is absent. It is, however, not a requirement for a business to have goodwill.

Business Combination

Business combination is a kind of transaction that the acquirer obtains control of another business.

According to IFRS 3, the acquirer can have control over the business by:

- Issuing equity interests;
- Transferring assets (this includes the net assets) and cash (or cash equivalents);
- Without transferring consideration but solely by contract;
- Incurring liabilities; and
- Giving out more than one type of consideration.

Procedure of Business Combination

IFRS 3 insists on using the acquisition method for a business combination. The steps followed on this acquisition method are:

- Acquirer's identification;
- Determination of the acquisition date;
- Measuring and recognizing the identifiable liabilities assumed, the assets acquired and the non-controlling interest in the acquire; and
- Measuring and recognizing gain from a bargain, purchase or goodwill.

Recognition related to PPA Valuation

Based on IFRS 3, the acquirer is required to measure the identifiable assets acquired and the liabilities assumed at the acquisition date, which is the valuation date. The acquirer should also recognize, aside from the goodwill, the identified assets acquired, the liabilities assumed and any non-controlling interest in the acquiree.

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IFRS 3 also requires the following are in order to qualify for the recognition as part of the acquisition method application:

- The identifiable assets acquired and liabilities assumed must be part of what the acquirer and the acquiree exchanged in the business combination transaction rather than the result of separate transactions; and
- The identifiable assets acquired and liabilities assumed must meet the definitions of assets and liabilities in the Framework for the Preparation and Presentation of Financial Statements at the acquisition date.

Furthermore, IFRS 3 also clearly states that in the application of the above recognition and conditions, some of the liabilities and assets that were not previously recognized shall be recognized. Common examples are intangible assets that are internally developed and not recognized on the balance sheet of the acquiree. Thus the related cost is an added expense.

Below is Exhibit [1] that summarizes the balance sheet with items and how they are recognized in a business combination.

Exhibit [1]

Item	Recognition
Cash	• Review foreign exchange adjustments and confirm bank balances. • Never the subject of virtual valuation.
Marketable securities Cash	• Refer to market quotations. • Bonds, quoted derivatives and the like.
Accounts receivable	• Investigate the uncollectible possibility for large items.
Inventories	• Assessed at net realisable value.
Plant and equipment	• For transportation and manufacturing companies, the machinery is to be assessed by a professional specialized in Property and Machine.
Land and property	• Valued by a professional property valuer.
Intangible assets	• Focuses on companies, regulatory authorities and auditors.

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Intangible Asset Recognition

The acquirer shall recognize, separately from goodwill, the identifiable intangible assets acquired in a business combination. An intangible asset is identifiable if it meets either the separability criterion or the contractual-legal criterion.

The separability criterion means that an acquired intangible asset is capable of being separated or divided from the acquiree and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability.

The contractual-legal criterion is met by a combined entity or an intangible asset that is not separable individually from the acquiree only if they are separable in combination with a contract that is related, a liability or an identifiable asset.

The types of intangible assets found in a business combination are shown in Exhibit [2]:

Exhibit [2]

Intangible Asset Classification				
Marketing-related	**Customer-related**	**Art-related**	**Contract-based**	**Technology-based**
• Trademarks, trade names • Service marks, collective marks, certification marks • Trade dress • Newspapers mastheads • Internet domain names • Non-competition agreements	• Customer names • Order or production backlogs • Customer contracts and related customer relationships • Non-contractual customer relationships	• Plays, operas, ballets • Books, magazines, newspaper, and other literary works • Musical works such as compositions, song lyrics, advertising jingles • Pictures and photographs • Video and audio visual material	• Licenses and royalty agreements • Lease agreements • Construction permits • Franchise agreements • Operating and broadcast rights • Service contracts • Employment contracts	• Patented technology • Computer software and mask works • Unpatented technology • Databases, including title plants • Trade secrets, such as secret formulas, processes and recipes

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Goodwill Recognition

According to IFRS 3, for the acquirer, goodwill is recognised as follows:

- The aggregate of:
  - The amount of any non-controlling interest in the acquiree measured;
  - In a business combination achieved in stages, the acquisition-date fair value of the acquirer's previously held equity interest in the acquire; and
  - The consideration transferred measured, which requires the acquisition-date fair value.
- The net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed measured.

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The acquirer shall determine the amount of goodwill by using the acquisition-date fair value of the acquiree's equity interests instead of the acquisition-date fair value of the equity interests transferred.

If only equity interests are exchanged between the acquiree and the acquirer in a business combination, the acquisition-date fair values of the equity interests of the acquiree are measurable than the acquirer's equity interests.

Consideration

Consideration is an amount equal to the total funds required to consummate the offer as contemplated by the undertaking agreement and the tender documents.

IFRS 3 has the following guideline with the consideration of bargain purchases that have a direct impact on the acquirer's profit and loss account:

- The consideration transferred;
- The identifiable assets acquired and liabilities assumed;
- The acquirer's previously held equity interest in the acquire; and
- The non controlling interest in the acquiree.

Value Basis of Consideration

The consideration transferred includes assets or liabilities of the acquirer that carry amounts differ from their fair values at the acquisition date. In such a case, the acquirer shall then re-measure the transferred assets or liabilities to their fair values as of the acquisition date to determine the consideration.

The consideration transferred in a business combination shall be measured at fair value, which shall be calculated as the sum of the acquisition-date fair values of the assets transferred by the acquirer, the liabilities incurred by the acquirer to former owners of the acquiree and the equity interests issued by the acquirer.

However, any portion of the acquirer's share-based payment awards exchanged for awards held by the acquiree's employees that are included in consideration and transferred in the business combination shall be measured in accordance IFRS 2 rather than at fair value. Examples of potential forms of consideration include cash, other assets, a business or a subsidiary of the acquirer, contingent consideration, ordinary or preference equity instruments, options, warrants and member interests of mutual entities.

Sometimes, the control of the acquiree by the acquirer happens without any consideration transferred. The acquisition method of accounting for a business combination applies to those combinations for instance when:

- The acquiree and acquirer agree to merge their businesses only by contract. The acquirer transfers no consideration in exchange for control of an acquiree and holds no equity interests in the acquiree, either on the acquisition date or previously. For instance, bringing

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two businesses together in a stapling arrangement or forming a dual-listed corporation;

- Minority veto rights lapse that kept the acquirer from controlling an acquiree in which the acquirer held the majority voting rights; and
- The acquiree purchases a sufficient number of its own shares for an existing investor (the acquirer) to obtain control of on an additional occasion.

Contingent Consideration

IFRS 3 states that the acquirer shall classify an obligation to pay contingent consideration as a liability or as an equity on the basis of the definitions of an equity instrument and a financial liability. The acquirer shall classify as an asset the right to the return previously transferred consideration if specified conditions are met.

According to IFRS 3, the consideration the acquirer transfers in exchange for the acquiree includes any asset or liability resulting from a contingent consideration arrangement. The acquirer shall recognize the acquisition-date fair value of a contingent consideration as part of the consideration transferred in exchange for the acquiree.

Contingent consideration classified as equity shall not be measured again and its subsequent settlement shall be accounted for as equity, whilst for the classification into asset or liability, a financial instrument shall be measured at fair value.

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Part of the Business Combination Transaction

A transaction entered into by or on behalf of the acquirer or primarily for the benefit of the acquirer or the combined entity, rather than primarily for the benefit of the acquiree (or its former owners) before the combination, is likely to be a separate transaction. Separate transactions that do not apply the acquisition method are as follows:

- A transaction that reimburses the acquiree or the previous owner for paying the acquirer's acquisition costs and related costs;
- A transaction that in effect settles pre-existing relationships between the acquiree and the acquirer; and
- A transaction that remunerates employees or previous owners of the acquirer for future services.

The acquirer and the acquiree may have a pre-existing relationship before the business combination took place, or they may enter into an arrangement during the negotiations that are separate from the business combination. In either situation, the acquirer shall identify any amount that was not part of what the acquirer and the acquiree (or former owners) exchanged in the business combination, for example amounts that are not part of the exchange for the acquiree. The acquirer shall recognize, as part of applying

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the acquisition method, only the consideration transferred for the acquiree and the assets acquired and liabilities assumed in the exchange for the acquiree. Separate transactions shall be accounted for in accordance with the relevant IFRSs.

Business Combination Measurement Period

The measurement period is the period after the acquisition date during which the acquirer may adjust the provisional amounts recognized for a business combination.

During the measurement period, the acquirer shall acknowledge additional assets or liabilities if new information is obtained about facts and circumstances that existed as of the acquisition date and, if they had been known at that time, would have resulted in the recognition of those assets and liabilities as of that date. The measurement period ends as soon as the acquirer receives the information it was seeking about facts and circumstances that existed as of the acquisition date or learns that additional information is not available. However, the measurement period shall not exceed one year from the acquisition date.

The measurement period requirements of this IFRS are as follows:

- The resulting goodwill;
- The consideration transferred for the acquire;
- The identifiable assets acquired, liabilities assumed and any non-controlling interest in the acquire; and
- An equity interest in the acquiree that was held previously by the acquirer in a business combination.

The acquirer shall consider all pertinent factors in determining whether the information obtained after the acquisition date should result in an adjustment to the provisional amounts recognized or whether that information results from events that occurred after the acquisition date. Pertinent factors include the date when additional information is obtained and whether the acquirer can identify a reason for a change to provisional amounts. Information that is obtained shortly after the acquisition date is more likely to reflect circumstances that existed at the acquisition date than is information obtained several months later. For instance, unless an intervening event that changed its fair value can be identified, the sale of an asset to a third party shortly after the acquisition date for an amount that differs significantly from its provisional fair value determined at that date is likely to indicate an error in the provisional amount.

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer shall report in its financial statements provisional amounts for the items for which the accounting is incomplete. During the measurement period, the acquirer shall retrospectively adjust the provisional amounts recognized

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at the acquisition date to reflect new information obtained about facts and circumstances that existed as of the acquisition date and, if known, would have affected the measurement of the amounts recognized as of that date.

The acquirer acknowledges an increase (or decrease) in the provisional amount established for an identifiable asset (liability) by means of a decrease (or increase) in goodwill. However, new information obtained during the measurement period may sometimes result in an adjustment to the provisional amount of more than one asset or liability. For instance, the acquirer might have assumed a liability to pay for damages related to an accident in one of the acquiree's facilities, part or all of which are covered by the acquiree's liability insurance policy. If the acquirer obtains new information during the measurement period about the acquisition-date fair value of that liability, the adjustment to goodwill resulting from a change to the provisional amount recognized for the liability would be offset (in whole or in part) by a corresponding adjustment to goodwill resulting from a change to the provisional amount recognized for the claim receivable from the insurer.

During the measurement period, the acquirer shall recognize adjustments to the provisional amounts as if the accounting for the business combination had been completed at the acquisition date. Thus, the acquirer shall revise comparative information for prior periods presented in financial statements as needed, including making any changes in depreciation, amortization or other income effects recognized upon completion of the initial accounting.

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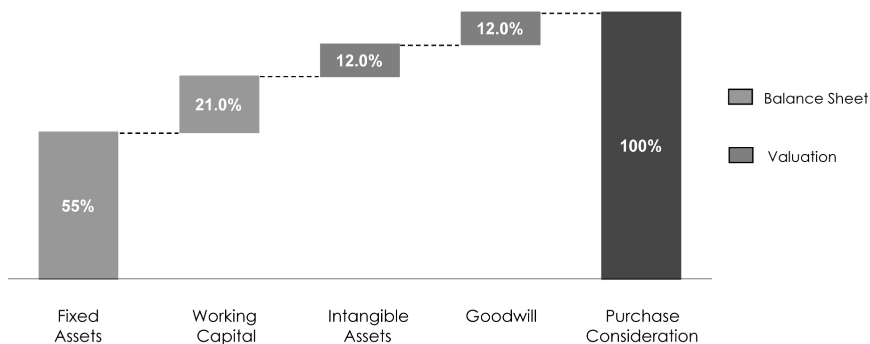
Purchase Price Allocation Valuation

The acquirer recognizes and measures the identifiable acquiree's balance sheet assets at fair value when the business combination fulfils the IFRS 3 requirements. Exhibit [3] is a typical illustration of a Purchase Price Allocation.

Exhibit [3]

Typical Illustration of PPA



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¶2-300 IFRS 13 – Fair Value Measurement

Overview

In IFRS, fair value measurement has been mentioned many times. IFRS 13 provides framework for measuring fair value. The standard defines fair value on the basis of an exit price notion and specifies that the fair value is market-based rather than entity-based.

History

In some IFRSs, the entity asks the entities to measure or disclose the fair value of assets, liabilities and equity. The requirements may differ. Sometimes, there even does not exist a measurement guidance. This may cause inconsistency problems in financial reports. To standardize the measurement method for fair value, IFRS 13 came out.

IFRS 13 was originally issued in May 2011 and applies to annual periods beginning on or after 1 January 2013.

Scope

The fair value measurement have been required in many standards, including but not limited to IFRS 2, IFRS 3, and IAS 40. According to IFRS 13, following are exceptions:

- Share-based payment transactions within the scope of IFRS 2;
- Leasing transactions within the scope of IAS 17; and
- Measurements that have some similarities to fair value but are not fair value, such as net realizable value in accordance with IAS 2 and value in use in accordance with IAS 36.

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Fair value

Definition

IFRS 13 defines fair value 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 definition of fair value is a current exit price. If there exists an active market, the quoted price in the market can be measurement base and shall not be adjusted according to the fair value.

If an entity has a single asset or liability that is traded in an active market, the fair value of the asset or liability can be measured by the quoted price, even if the quantity cannot be wholly absorbed by the market. However, if an active market for the target does not exist, comparable cases shall be found indirectly:

- Quoted Price for similar assets in an active market;

- Quoted Price in a market that is not active;
- Inputs other than quoted price; and
- Inputs by some observable market data.

When observable inputs cannot be found, the fair value shall depend on unobservable data. Sometimes there does not exist an active market for the target, the fair value measurement shall base on information such as internal data and the entity's own data.

Recognition

Measuring fair value at initial recognition uses both observable and unobservable inputs. There are cases that transaction price might not be the best evidence of the fair value of an asset or a liability at initial recognition.

The board did not address the recognition of a day 1 gain or loss but stated that an entity would recognize such gains or losses unless another IFRS specifies otherwise.

Measurement

The objective of a fair value 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.

Fair value measurement requires an orderly market between market participants. The transaction taking place in the principal market is the most advantageous market for the asset or liability.

Assets can be classified into financial assets and non-financial assets. Financial assets have specific terms and contracts. The non-financial assets shall be measured according to the highest and best use principle. Entities shall take into account the characters of assets and liabilities being measured.

The fair value of a liability reflects the risk of not meeting the obligation, including an entity's own credit risk and assuming the same non-performance risk before and after the transfer of the liability.

There exist exceptions for certain financial assets and financial liabilities with offsetting positions in market risks or counterparty credit risk. In these cases, additional disclosure is required.

Valuation Method

Valuation Model

Following are the most commonly used valuation methods:

- **Market Approach.** An entity "uses prices and other relevant information generated by the market transactions involving identical or comparable assets, liabilities or a group of assets and liabilities;

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- **Income Approach.** An entity converts future amounts to a single current amount; and
- **Cost Approach.** An entity determines the value which reflects the amount that would be required currently to replace the service capacity of an asset.

The accounting standard allows using a discount or premium to adjust the fair value. They may include: marketability discount, lack of control discount, control premium, risk premium, etc. This is for them implying the characters of the asset or liability in different aspects which may affect the fair value of assets or liabilities.

Fair Value Hierarchy

IFRS 13 contains a fair value hierarchy. The highest priority is given to Level 1 inputs, Level 3 inputs get the lowest priority.

Level 1 Inputs

According to IFRS 13, Level 1 inputs are quoted prices in active markets for identical assets or liabilities that the entity can access at the measurement date.

A quoted market price in an active market provides the most reliable evidence of fair value and is used without adjustment to measure fair value whenever available, with limited exceptions.

If an entity holds a position in a single asset or liability and the asset or liability is traded in an active market, the fair value of the asset or liability is measured within Level 1 as the product of the quoted price for the individual asset or liability and the quantity held by the entity, even if the market's normal daily trading volume is not sufficient to absorb the quantity held and placing orders to sell the position in a single transaction might affect the quoted price.

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Level 2 Inputs

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

Level 2 inputs include:

- Quoted prices for similar assets or liabilities in active markets;
- Quoted prices for identical or similar assets or liabilities in markets that are not active;
- Inputs other than quoted prices that are observable for the asset or liability, for example, interest rates and yield curves observable at commonly quoted intervals, implied volatilities and credit spreads; and

- Inputs that are derived principally from or corroborated by observable market data by correlation or other means ('market-corroborated inputs').

Level 3 Inputs

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

Unobservable inputs are used to measure fair value to the extent that relevant observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. An entity develops unobservable inputs using the best information available in the circumstances, which might include the entity's own data, taking into account all information about market participant assumptions that is reasonably available.

Application

Application to Non-financial Assets

Non-financial assets measurement is different from financial assets measurement, for financial assets do not have alternative use because a financial asset has specific contractual terms and can have a different use. Measurement principle may change when asset characters change.

Highest and best use principle applies to fair value measurement of non-financial assets. The highest and best use principle shall be physically possible, legally permissible and financially feasible. IFRS 13 states that this principle is from the perspective of market participants. Even if an entity acquires an asset but, to protect its competitive position or for other reasons, the entity does not intend to use it actively or does not intend to use the asset in the same way as other market participants, an entity must recognize such an asset at fair value because the intention of IFRS 13 was that assets, both tangible and intangible, should be measured at their fair values regardless of how or whether the acquirer intends to use them.

IFRS 13 does not require an entity to seek for alternative use of non-financial assets without obvious evidence that the non-financial asset is not at its highest use. If such evidence exists, entity shall find alternative use for the asset. When an entity uses a non-financial asset different from the highest and best use, the entity should disclose the conflict.

The standard has also proposed the accounting treatment when an asset's highest and best use within a group of assets is different from its current use. IASB requires that entity should separate the fair value of the asset group into its current use and fair value components.

Application to Liabilities

Liability, in its essence, is destined to be transferred to a market participant in the future. In some cases, the entity does not want to put the liability on an active market, for the entity has its own advantage to settle the liability

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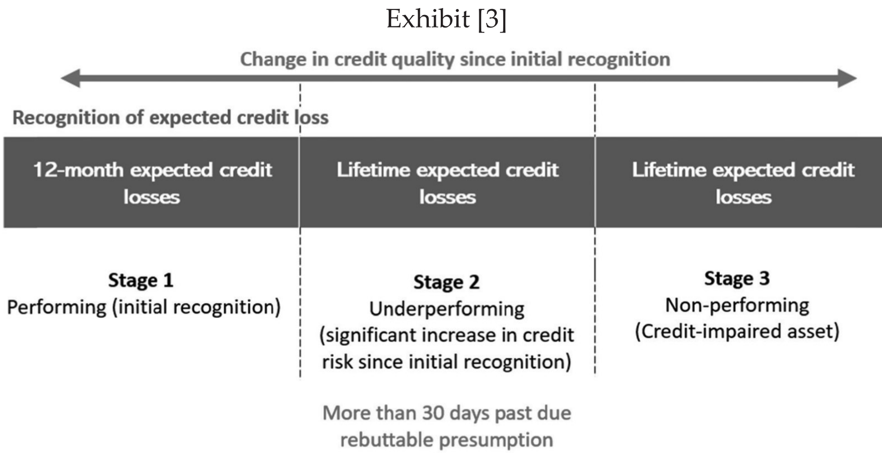
Exhibit [3]



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