

Evaluation of the Impact of IND AS 113 Fair Value Measurement on Financial Statements

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Abstract

Fair value is the mantra of today in financial reporting across borders. In India also, the Institute of Chartered Accountants of India (ICAI) converged its accounting standards with IFRSs and accordingly, corporate financial statements beginning accounting year 2016-17 started disclosing financial figures based on fair value measurement. One of the purposes of fair value measurement is to narrow the gap between balance sheet value and market value of a company. Fair value measurement aims at fair recording of a business transaction so that the financial statements are able to show a true and fair view of the profitability and financial position. Fair value measurement can be applied to different elements of financial statements. I put this measurement basis to test through a case with reference to fair value mechanism applicable to purchase of current investments and their continuing holding on the balance sheet date. The results clearly supported the philosophy behind the fair value measurement basis. To sum up, it was found that the FV measurement does away with window dressing, makes the financial statements more transparent, closer to real market value, less volatile, and more predictable in accordance with the principle of substance over form, which is becoming all pervasive now.

Keywords: block deal, historical cost, fair value, FASB, financial reporting, ICAI, IFRS, Ind AS, measurement bases

JEL Classification: G38, M41, M48

Paper Submission Date : June 4, 2018 ; **Paper sent back for Revision :** August 13, 2018 ; **Paper Acceptance Date :** October 16, 2018

Fair value is the mantra of today in financial reporting across the borders. Perhaps it is, and it continues to be, one of the most controversial, talked about, discussed, debated, and criticized as well as appreciated financial reporting issue in the recent years. Zyla (2012) emphasized that fair value accounting has changed the way financial information is presented. Where once financial statements were based primarily on historical costs, now under certain circumstances, fair value is often the basis of measurement for reporting for both financial and non financial assets and liabilities. Measuring fair value often requires experience and judgment. The trend away from historical costs, which has been the bedrock of traditional accounting, towards fair value accounting has been challenging for preparers, auditors, standard setters, and regulators.

Literature Review

The concept of fair value (FV) as a measurement basis in financial statements and reporting thereof, though of recent origin in India, has evolved internationally at institutional levels over a long period. The evolution and development of FV can be attributed to:

(1) Financial Accounting Standards Board (FASB), USA : The first comprehensive effort, bundling together the

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earlier pronouncements on fair value, at laying a conceptual framework of FV and its application to financial reporting was attempted by FASB when it was issued in September 2006 (Financial Accounting Standards Board, 2006 Statement No. 157 now codified as FASB ASC 820, “Fair Value Measurements and Disclosures”) for compliance by the U.S. corporates. The statement applies to financial statements issued for fiscal years beginning after November 15, 2007. FASB (2006) defined fair value, established a framework for measuring fair value in Generally Accepted Accounting Principles (GAAP), and expanded disclosures about fair value measurements.

(2) International Financial Reporting Standards Foundation: Following FASB, the IFRS Foundation issued, in May 2011, “IFRS 13 Fair Value Measurement,” making it effective for annual periods beginning on or after January 1, 2013. Outside the USA, it was this standard which led to widespread adoption of fair value measurement across geographies and economies. As the standard was developed as a joint project with FASB, the IFRS Foundation (2011) essentially retains the same definition of fair value, methods used to measure fair value, and disclosure requirements as propagated by the FASB. Its real contribution lies in its worldwide propagation and adoption.

(3) Institute of Chartered Accountants of India (ICAI) : In India also, the ICAI has converged its accounting standards with IFRS. The corresponding FV standard in India is "Indian Accounting Standard (Ind AS) 113: Fair Value Measurement." The standard was issued by the ICAI in February 2013 and notified by the Ministry of Corporate Affairs in February 2015. Accordingly, corporate annual reports beginning accounting year 2016-17 started disclosing financial figures based on fair value measurement. Again, Ind AS-113 is more or less similar in substance to FASB Statement No. 157 and IFRS 113 in all respects, that is, definition of fair value, methods used to measure fair value, and disclosure requirements (ICAI, n.d. a.).

Coming to academics, Chandrasekar and Kumar (2017) said that studies related to IFRS in India are very limited, and the studies carried out also have mostly been case studies analyzing a particular company. It is not surprising when looked at in the context of convergence of Indian accounting standards with IFRS as late as 2016-17 only. After a thorough search on the net, only one research paper related to Ind AS 113, titled "Adoption of Fair Value Accounting in Indian Accounting System" by Bhattacharya (2018) was found. In his paper, Bhattacharya (2018) described the road map set by the Government for Ind AS implementation in India in general and then briefly described Ind AS 113, albeit, theoretically only. In yet another paper, Gupta (2014) made passing references to fair value. He observed that since IFRSs (IND ASs in India) are based on the concept of fair value, instead of historical cost, these are bound to be complex and this poses a challenge before the IFRS Foundation.

Clearly, the research on issues involved in various IFRSs (IND ASs) in India needs to get its due attention. With this background, it was felt that there is a need for a research paper which quantitatively examined and measured the impact of one such IFRS Ind AS 113 fair value measurement, the concept which is at the heart of IFRSs, on corporate financial statements to practically understand its implications. This paper is a humble contribution towards partly narrowing this gap.

Objectives of the Study

In the above context, this paper is written with the following objectives in mind :

- (1)** To explain the concept of fair value and objective & significance of fair value measurement.
- (2)** To examine the implications of Ind AS 113 fair value measurement vis-à-vis historical cost for financial reporting at initial recognition.

- (3) To examine implications of Ind AS 113 fair value measurement vis-à-vis historical cost for financial reporting at subsequent measurement.
- (4) To examine the final impact of Ind AS 113 fair value measurement on the subsequently reported annual financial statements.
- (5) To be able to assess whether the fair value based financial statements are able to show a true and fair view of the profitability and financial position or not.

Sources of Data and Information

Data and information pursuant to the objectives of this paper have been collected from :

- (1) “FASB Statement No. 157: Fair Value Measurements” issued by the FASB.
- (2) “Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standards” issued by the ICAI (hereinafter referred to as 'The Framework').
- (3) Indian Accounting Standard (Ind AS) 113 “Fair Value Measurement” issued by the ICAI.
- (4) “IFRS 113: Fair Value Measurement” issued by the IFRS Foundation.
- (5) Sections on “Top 100 Companies by Market Capitalization” and “Block Deals Disclosures in the Cash Segment” from the website of BSE Ltd.
- (6) 2016-17 annual reports of Hindustan Unilever Ltd., ITC Ltd., Maruti Suzuki India Ltd., Reliance Industries Ltd., and TCS Ltd. available on their respective sites.
- (7) Research papers and books as mentioned in the text as well as in the list of references.

Full details of these sources have been listed in the list of references. It is clarified that no claim to originality in the language is made in respect of references and extracts from the websites and publications covered in this paper, which represent legal and regulatory issues.

Methodology

This paper is based on a case study approach. The implications of fair value have been examined not just theoretically, but illustrated with numeric data also. The tool of comparative financial analysis has been extensively used in the paper. It is further supported by descriptive and qualitative analysis. This research was conducted during January to May 2018.

Various Measurement Bases of the Elements of Financial Statements

'The Framework' defines measurement as the process of determining the monetary amounts at which the elements of the financial statements are to be recognized and carried in the balance sheet and statement of profit and loss. This involves the selection of the particular basis of measurement. 'The Framework' further specifies a number of different measurement bases that are employed to different degrees and in varying combinations in financial statements (ICAI, n.d.b.). They include the following:

- (1) **Historical Cost** : Accordingly, assets are recorded at the amount of cash or cash equivalents paid or the fair

value of the consideration given (entry price) to acquire them at the time of their acquisition, and liabilities are recorded at the amount of proceeds received in exchange for the obligation, or in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business. Historical cost basis is thus based on fair value from the perspective of a market participant (buyer) that wants to hold an asset or owe the liability (that is an entry price).

(2) Current Cost : Accordingly, assets are carried at the amount of cash or cash equivalents that would have to be paid if the same or an equivalent asset was acquired currently, and liabilities are carried at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.

(3) Realisable (Settlement) Value : Accordingly, assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the asset in an orderly disposal, and liabilities are carried at their settlement values, that is, the undiscounted amounts of cash or cash equivalents expected to be paid to satisfy the liabilities in the normal course of business.

(4) Present Value : Accordingly, assets are carried at the present discounted value of the future net cash inflows that the item is expected to generate in the normal course of business, and liabilities are carried at the present discounted value of the future net cash outflows that are expected to be required to settle the liabilities in the normal course of business.

(5) Fair Value : Accordingly, assets and liabilities are recorded and carried at their fair values from the perspective of a market participant that holds the asset or owes the liability, that is, who wants to sell an asset or discharge a liability. Fair value is thus the price that would (should) be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants (seller and the buyer) at the measurement date. As we will see a little later, the historical cost or transaction cost is treated as fair value at the time of initial recognition unless the circumstances suggest identification of a different value as fair value.

(6) Most Commonly Adopted Measurement Bases : 'The Framework' goes on to add that the measurement bases most commonly adopted by entities in preparing their financial statements are : (a) Historical cost basis and (b) Fair value basis (now, with the advent of IFRS Converged Indian Accounting Standards (Ind AS)).

These are usually combined with other measurement bases. For example, inventories are usually carried at the lower of cost and net realisable value, current investments are be carried at lower of cost and fair value, investments in subsidiaries may be carried at cost or fair value, and pension liabilities are carried at their present value. Furthermore, some entities use the current cost basis as a response to the inability of the historical cost accounting model to deal with the effects of changing prices of non-monetary assets, known as inflation accounting, albeit, only by way of supplemental financial statements.

Pursuant to its objectives, the rest of the paper now concentrates on fair value measurement as enunciated under IndAS 113.

Latest Corporate Financial Practices in India on Measurement Bases

The Ind ASs have laid a strong emphasis on fair value measurement. 2016-17 was the first year of application of Ind AS. Let us see a sample of how leading corporates have responded to fair value measurement in their 2016-17 annual reports. For this purpose, accounting policies of top five companies in terms of market capitalization as on

Table 1. Top 5 Companies in Terms of Market Capitalization

Sl. No.	Company	Market Capitalization (₹ Crore)	Market Cap Rank	Sector	Website
1.	TCS Ltd.	6,62,458	1	IT	www.tcs.com
2.	Reliance Industries Ltd.	6,26,261	2	Diversified	www.ril.com
3.	ITC Ltd.	3,47,479	4	Diversified	www.itcportal.com
4.	Hindustan Unilever Ltd.	3,26,042	5	FMCG	www.hul.co.in
5.	Maruti Suzuki India Ltd.	2,63,966	7	Cars	www.marutisuzuki.com

Source: Compiled from BSE Ltd.(n.d.a.)

Table 2. Corporate Policies of Top 5 Market Cap Companies on the Basis of Preparation of Financial Statements**1. TCS Ltd.**

- These financial statements were prepared on the historical cost basis, except for certain financial instruments which were measured at fair values at the end of each reporting period, as explained in the accounting policies below.
- Historical cost is generally based on the fair value of the consideration given in exchange for goods and services. 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.

2. Reliance Industries Ltd.

- These financial statements were the company's first Ind AS standalone financial statements. The company's financial statements are presented in Indian Rupees (₹), which is also its functional currency.
- The financial statements were prepared on the historical cost basis except for following assets and liabilities which have been measured at fair value amount :

(i) Certain financial assets and liabilities (including derivative instruments),

(ii) Defined benefit plans - plan assets and,

(iii) Equity settled share based payments.

3. ITC Ltd.

- The financial statements were prepared in accordance with the historical cost convention, except for certain items that are measured at fair values, as explained in the accounting policies.
- 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, regardless of whether that price is directly observable or estimated using another valuation technique.
- In estimating the fair value of an asset or a liability, the company takes 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.
- Fair value for measurement and / or disclosure purposes in these financial statements is determined on such a basis, except for share-based payment transactions that are within the scope of Ind AS 102 - Share-based Payment, leasing transactions that are within the scope of Ind AS 17 - Leases, and measurements that have some similarities to fair value but are not fair value, such as net realisable value in Ind AS 2 - Inventories or value in use in Ind AS 36 - Impairment of Assets.

4. Hindustan Unilever Ltd.

- These financial statements were prepared under the historical cost convention unless otherwise indicated.
(Note : Unilever has specified the use of fair value in accounting policies related to specific elements of financial statements.)

5. Maruti Suzuki India Ltd.

- The financial statements were prepared on the historical cost convention on accrual basis except for certain financial instruments which were measured at fair value at the end of each reporting period, as explained in the accounting policies mentioned below.
- Historical cost is generally based on the fair value of the consideration given in exchange of goods or services.

Source: Respective annual reports 2016-17 of the companies retrieved from their respective websites mentioned in Table 1.

May 11, 2018 listed at Bombay Stock Exchange (BSE) (other than banks/finance companies as Ind ASs are not yet applicable to them) were studied. The Table 1 provides the details of these companies.

The accounting policies followed by them on the 'Basis of Preparation of Financial Statements' are provided in the Table 2. Common to all of them is the statement that these financial statements have been prepared in accordance with Ind AS notified under the Companies (Indian Accounting Standards) Rules 2015 read with Section 133 of the Companies Act, 2013.

From shorter to longer description, emphasis on fair value measurement is amply clear. It also needs to be noted that historical cost represents fair value from the perspective of the buyer at entry as pointed out earlier.

Ind AS 113 : Fair Value Measurement

We will now dwell at length on the concept of fair value measurement as the Ind ASs have laid a strong emphasis on this measurement basis, particularly for financial instruments, that is, financial assets including investments and financial liabilities. The subject is covered by Ind AS-113: 'Fair Value Measurement' (ICAI, n.d. a.).

This Ind AS applies when another Ind AS requires or permits (i.e., provides option):

- ↪ Fair value measurements (for example, investments) or disclosures about fair value measurements (for example, investment property) and,
- ↪ Measurements, such as fair value less costs to sell (that is, NRV in the case of PPE held for sale etc.), based on fair value.

This Ind AS thus sets out in a single Ind AS a framework for measuring fair value and disclosures about fair value measurements.

The measurement and disclosure requirements of this Ind AS do not apply to the following :

- ↪ Leasing transactions within the scope of Ind AS 17, Leases,
- ↪ Share-based payment transactions within the scope of Ind AS 102, Share based Payment, and
- ↪ Certain measurements that have some similarities to fair value but are not fair value, such as net realisable value in Ind AS 2, Inventories, or value in use in Ind AS 36, Impairment of Assets.

The fair value measurement framework described in this Ind AS applies to both initial and subsequent measurement if fair value is required or permitted by other Ind ASs (ICAI, n.d.a.).

The fair value measurement framework described in Ind AS 113 is the Indian avatar of "IFRS 113: Fair Value Measurement" issued by the IFRS Foundation for the first time in May 2011 for world wide application for annual periods beginning on or after January 1, 2013. Ind AS 113 contains the same provisions that IFRS 113 contains. They are similar in both letter and spirit. Major standard financial reporting principles established by Ind AS 113 are discussed and illustrated hereunder.

(1) Fair Value Meaning : To recall, fair value is the price that would (should) be received to sell an asset or paid to transfer a liability :

- ↪ In an orderly transaction,
- ↪ Between market participants (seller and buyer),
- ↪ At the initial and subsequent measurement dates.

Fair value thus represents an exit price from the perspective of the owner of asset/obligator of liability. Transaction will be termed as having taken place at fair value:

- ↪ If it takes place between knowledgeable and willing parties,
- ↪ That to in an arm's length distance.

(2) Fair Value vs. Transaction Price at Initial Recognition : When determining whether fair value at initial recognition equals the transaction price, an entity needs to take into account factors specific to the transaction and to the asset or liability. For example, the transaction price might not represent the fair value of an asset or a liability at initial recognition if any of the following conditions exist :

- (i) The transaction is between related parties,
- (ii) Either of the party to the transaction does not have full knowledge of the prevailing market prices,
- (iii) The transaction takes place under duress or the seller is forced to accept the price in the transaction. For example, that might be the case if the seller is experiencing financial difficulty,
- (iv) The buyer is in urgent need of assets,
- (v) The transaction price includes transaction costs,
- (vi) The market in which the transaction takes place is different from the principal market (or most advantageous market). For example, those markets might be different if the entity is a dealer that enters into transactions with customers in the retail market, but the principal (or most advantageous) market for the exit transaction is with other dealers in the dealer market.

(3) Treating Transaction Price as Fair Value : Therefore, if none of the above conditions exist, the entry price of the transaction will be treated as its exit price as well. In the case of a business, day-to-day transactions, revenue as well as capital entered into the regular markets, are therefore, assumed to have taken place at their fair value, except under the situations cited above. Therefore, the transaction price generally represents a fair value for all practical purposes in most cases. Likewise, estimates of provisions and deferred tax assets (liabilities), since they are initially determined on the reporting date itself, represent their fair value.

Implications of Fair Value Measurement for Financial Reporting at Initial Recognition

In cases where the transaction price is different than the fair value, the transaction is initially recognized at fair value and not at its historical cost. The resultant impact of the FV treatment of the transaction on the financial statements of the seller at initial recognition is illustrated by way of the following case :

Case : Senior Consolidated Ltd.

Senior Consolidated Ltd. (SCL) and Junior Subsidiary Ltd. (JSL) are two group companies under the same control and management. JSL owned 2,00,000 equity shares of ABC Ltd. Assume that the quoted price of ABC Ltd.'s share on Bombay Stock Exchange on January 1, 2018 was ₹ 856. That day, SCL purchases these shares, intending them to be current investments, in a Block Deal* from JSL through a member broker of the exchange. Assume two scenarios as under :

*A Block deal happens when two parties agree to buy or sell a listed security at a price, other than the quoted price, agreed to between themselves. The deal is executed through a stock broker in a single transaction (of not less than ₹ 10 crore at BSE (as on the date of writing this paper) on the special "Block Deal Window" of the exchange (BSE Ltd., n.d.b.)).

↪ In Scenario 1 : At ₹ 864 per share, and

↪ In Scenario 2 : At ₹ 849 per share.

The broker charges ₹ 0.40 per share brokerage from both the seller as well as the buyer.

Determine the treatment of this transaction in the financial records of SCL at initial recognition based on historical cost as well as FV measurement bases. Analyze the implications of FV treatment.

(1) Measurement on Initial Recognition : The quoted price of the ABC Ltd. share on January 1, 2018 was ₹ 856, evidently being its fair value. Since the transaction is between related parties, transaction price of either ₹ 864 or ₹ 849, though relevant for historical cost basis, does not represent the fair value of the share for the purposes of the fair value measurement.

The Table 3 shows the accounting treatment of this transaction under the historical cost measurement basis on initial recognition on January 1, 2018.

Table 3. Treatment of Investment on Initial Recognition as per Historical Cost Measurement Basis

SCL Ltd.	(Amount ₹)	
	Scenario 1	Scenario 2
	Transaction Price (TP) > FV	TP < FV (Fair Value)
Number of shares purchased	2,00,000	2,00,000
Transaction price per share	864.00	849.00
• Total transaction price	17,28,00,000	16,98,00,000
Transaction (Brokerage) cost per share	0.40	0.40
• Total transaction cost	80,000.00	80,000.00
Total cost per share	864.40	849.40
• Total cost of Investment at historical cost	17,28,80,000	16,98,80,000

The Table 4 shows the accounting treatment of this transaction under the FV measurement basis on initial recognition.

Table 4. Treatment of Investment on Initial Recognition as per FV Measurement Basis

SCL Ltd.	(Amount ₹)	
	Scenario 1	Scenario 2
	TP > FV	TP < FV
Number of shares purchased	2,00,000	2,00,000
Fair value per share	856.00	856.00
• Total cost of Investment at Fair Value	17,12,00,000	17,12,00,000
Unrealized gain/(loss) at Initial Recognition:		
Total cost of investment at fair value	17,12,00,000	17,12,00,000
Less: Total transaction price	17,28,00,000	16,98,00,000
• Unrealized gain/(loss)	(16,00,000)	14,00,000

Table 5. Depiction of ABC Ltd.'s Investment Transaction in the Statements of Profit and Loss at Initial Recognition

SCL Ltd.	(Amount ₹)			
	Historical Cost Measurement		Fair Value Measurement	
	Scenario 1	Scenario 2	Scenario 1	Scenario 2
	TP > FV	TP < FV	TP > FV	TP < FV
Income:				
Unrealized gain on shares	14,00,000
Expenses :				
Total transaction cost (Brokerage)	80,0000	80,000
Unrealized loss on shares	16,00,000	.....
PBT	(16,80,000)	13,20,000

Table 6. Depiction of ABC Ltd.'s Investment Transaction in the Balance Sheets at Initial Recognition

SCL Ltd.	(Amount ₹)			
	Historical Cost Measurement		Fair Value Measurement	
	Scenario 1	Scenario 2	Scenario 1	Scenario 2
	TP > FV	TP < FV	TP > FV	TP < FV
Assets:				
Investments in ABC Ltd.	17,28,80,000	16,98,80,000	17,12,00,000	17,12,00,000
Equity and Liabilities:				
Other equity:				
PBT	....	.....	(16,80,000)	13,20,000

Note. Tax on PBT ignored.

The Table 5 shows the depiction of ABC Ltd.'s investment transaction in the statements of profit and loss at initial recognition on January 1, 2018 under both the measurement bases.

The Table 6 shows the depiction of ABC Ltd.'s investment transaction in the balance sheets at initial recognition on January 1, 2018 under both the measurement bases.

(2) Analysis of Implications of FV Measurement at Initial Recognition : From the Table 3, Table 4, Table 5, and Table 6, the following implications of fair value measurement vis-à-vis historical cost measurement can be noted:

↳ In either scenario, whether the shares are purchased above fair value or below fair value, same value, that is, the fair value is considered as the cost. That is the real value of the shares. Thus, the impact of related party influence is removed from the financial statements, enabling them to become more transparent and predictable and show a true and fair view.

↳ Transaction cost, being brokerage paid, has been straightaway charged to revenue following the principle that current investments are meant for disposal within the accounting period and therefore, capitalizing their transaction cost will serve no purpose. Better record the charges in the beginning itself.

↳ Unrealized loss when TP > FV and unrealized gain when TP < FV have been recognized immediately on the date of transaction without waiting for the subsequent reporting date. The day-to-day determined profit/loss will thus be inclusive of initial unrealized gain/loss.

↳ The FV measurement thus enables the financial statements to highlight the net loss /gain on the transaction immediately on its recognition without waiting for their disposal.

↳ The FV measurement thus moves beyond the principle of conservatism to market led treatment.

(3) Fair Value Hierarchy : All assets and liabilities for which fair value is measured or disclosed in the financial statements, particularly the financial instruments like investments, are categorized within the fair value hierarchy that is categorized into three levels, described as follows, the inputs to valuation techniques used to measure fair value. The fair value hierarchy gives the highest priority to quoted prices in active markets (Level 1 inputs) and the lowest priority to unobservable inputs (Level 3 inputs).

↳ **Level 1 :** The fair value of financial instruments quoted in active markets is based on their quoted closing price at the balance sheet date.

↳ **Level 2 :** The fair value of financial instruments that are not traded in an active market is determined on the following bases:

(i) Quoted prices for similar assets or liabilities in active markets.

(ii) Quoted prices for identical or similar assets or liabilities in markets which are not active.

(iii) Inputs other than quoted prices which are observable for the asset or liability. This involves using such valuation techniques such as discounted cash flows and standard valuation models using observable market parameters for interest rates, yield curves or foreign exchange rates, dealer quotes for similar instruments, and use of other comparable arm's length transactions.

↳ **Level 3 :** The fair value of financial instruments that are measured on the basis of entity specific valuations using inputs that are not based on observable market data (unobservable inputs). For example, break-up value in case of unquoted investments or DCF value based on their forecast profits.

(4) Objective and Significance of Fair Value Measurement : By now, it is clear and as emphasized by Gupta (2018) also, fair value measurement aims at fair recording of a business transaction so that the financial statements are able to show a true and fair view of the profitability and the financial position. It goes beyond the form and stresses on substance. Fair value is a market - based measurement, not an entity-specific measurement. For some assets and liabilities, observable market transactions or market information might be available. For other assets and liabilities, observable market transactions and market information might not be available. However, the objective of a fair value measurement in both cases is the same :

↳ 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 (i.e., an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability).

↳ To recognize the transaction at that price.

↳ Recognize the unrealized gain/loss immediately in case of Levels 1 and 2, and defer in case of Level 3 for review later on.

(5) Implications of Fair Value Measurement for Financial Reporting at Subsequent Measurement : We now examine the implications of FV measurement on the subsequent financial reporting date, say, the date of closing of annual financial statements. We continue with the case of Senior Consolidated Ltd.

Case : Senior Consolidated Ltd. (Contd.) : The financial year of SCL closes on March 31. Suppose, the quoted price of ABC Ltd.'s share at BSE on March 31, 2018 were as under:

↪ Scenario 1: ₹ 796 per share.

↪ Scenario 2: ₹ 903 per share.

Show the treatment of these investments in the financial statements of SCL at subsequent measurement on March 31, 2018 based on historical cost as well as FV measurement bases. Analyze the implications of FV treatment.

(i) Measurement on Subsequent Reporting Date : The quoted price of the ABC Ltd.'s share on March 31, 2018 is evidently its fair value. The total FV of the shares works out to ₹ 15, 92, 00,000 (that is 2, 00,000 * 796) in Scenario 1 and ₹ 18, 06, 00,000 (that is 2, 00,000 * 903) in Scenario 2.

(ii) Historical Cost Measurement Basis : The Tables 7 and 8 show the accounting treatment of this investment under the historical cost measurement basis on subsequent measurement on the financial reporting date of March 31, 2018, as under :

When Fair Value is ₹ 796 :

Table 7. Treatment of Investment on Subsequent Measurement on Financial Reporting Date as per Historical Cost Measurement Basis

SCL Ltd.	(Amount ₹)	
	Scenario 1	Scenario 2
	TP > FV	TP < FV
Historical cost of investments	17,28,80,000	16,98,80,000
FV on March 31, 2018 @ 796	15,92,00,000	15,92,00,000
Investments to be reported in the balance sheet at (lower of cost and fair value).....	15,92,00,000	15,92,00,000
Unrealized loss (to be charged to statement of profit and loss for year ended March 31, 2018 in both cases)	(1,36,80,000)	(1,06,80,000)

When Fair Value is ₹ 903 :

Table 8. Treatment of Investment on Subsequent Measurement on Financial Reporting Date as per Historical Cost Measurement Basis

SCL Ltd.	(Amount ₹)	
	Scenario 1	Scenario 2
	TP > FV	TP < FV
Historical cost of investments	17,28,80,000	16,98,80,000
FV on March 31, 2018 @ 903	18,06,00,000	18,06,00,000
Investments to be reported in the balance sheet at...	17,28,80,000	16,98,80,000
Unrealized gain (not to be recognized in the statement of profit and loss for year ended March 31, 2018 in either case)	77,20,000	1,07,20,000

(iii) **Fair Value Measurement Basis** : The Tables 9 and 10 show the accounting treatment of this investment under the fair value measurement basis on subsequent measurement on financial reporting date of March 31, 2018, as under :

When Fair Value is ₹ 796 :

Table 9. Treatment of Investment on Subsequent Measurement on Financial Reporting Date as per Fair Value Measurement Basis

SCL Ltd.	(Amount ₹)	
	Scenario 1	Scenario 2
	TP>FV	TP<FV
FV cost of investments	17,12,00,000	17,12,00,000
FV on March 31, 2018 @ 796	15,92,00,000	15,92,00,000
Investments to be reported in the balance sheet at...	15,92,00,000	15,92,00,000
Unrealized loss (to be charged to statement of profit and loss for year ended March 31, 2018 in both cases)	(1,20,00,000)	(1,20,00,000)

When Fair Value is ₹ 903:

Table 10. Treatment of Investment on Subsequent Measurement on Financial Reporting Date as per Fair Value Measurement Basis

SCL Ltd.	(Amount ₹)	
	Scenario 1	Scenario 2
	TP>FV	TP<FV
FV Cost of Investments	17,12,00,000	17,12,00,000
FV on March 31, 2018 @ 903	18,06,00,000	18,06,00,000
Investments to be reported in the balance sheet at...	18,06,00,000	18,06,00,000
Unrealized gain (to be recognized in the statement of profit and loss for year ended March 31, 2018 in both cases)	94,00,000	94,00,000

(iv) **Analysis of Implications of FV Measurement at Subsequent Reporting Date** : From the Table 7, Table 8, Table 9, and Table 10, the following implications of fair value measurement on the financial reporting date vis-à-vis historical cost measurement can be noted :

Under Historical Cost Measurement Basis :

↪ When the FV on the balance sheet date is less than the historical cost, in either case (whether **TP>FV** or **TP<FV**), the unrealized loss is charged to the statement of profit and loss. Of course, the amount of loss differs due to difference in initial cost. *Thus, the investment is reported at fair value on the balance sheet date.*

↪ When the FV on the balance sheet date is more than the cost, in either case (whether **TP > FV** or **TP < FV**), the unrealized gain is not credited to the statement of profit and loss. Of course, the amount of gain differs due to difference in initial cost. *Thus, the investment is reported at cost and not fair value on the balance sheet date.*

Under Fair Value Measurement Basis:

- ↪ When the FV on the balance sheet date is less than the cost, in either case (whether **TP > FV** or **TP < FV**), the unrealized loss is charged to the statement of profit and loss. Of course, the amount of loss differs due to difference in initial cost. *Thus, the investment is reported at fair value on the balance sheet date, just like in historical cost basis.*
- ↪ When the FV on the balance sheet date is more than the cost, in either case (whether **TP > FV** or **TP < FV**), the unrealized gain is *to be credited* to the statement of profit and loss. Of course, the amount of gain differs due to difference in initial cost. *Thus, the investment is again reported at fair value on the balance sheet date, unlike the historical cost basis.*
- ↪ Thus, both unrealized gains as well as losses are recognized in the statement of profit and loss which saves the statement from showing volatile results on the succeeding reporting date.
- ↪ Thus, reporting of FV of investments also spares the subsequent balance sheet from showing volatile results.
- ↪ This FV treatment does away from window dressing, makes the financial statements more transparent, closer to real market value, and more predictable in accordance with the principle of substance over form which is becoming all pervasive gradually.
- ↪ Reporting of the same balance sheet values of identical assets across corporate balance sheets make inter-firm comparisons more meaningful and decisive.

Final Impact of Fair Value Measurement on the Subsequently Reported Annual Financial Statements

Continuing with Senior Consolidated Ltd., we now attempt the final impact of fair value measurement on its annual financial statements for 2017-18. For this purpose, the results of initial recognition and subsequent measurement have been combined since it is the final figures that will be reported in the financial statements.

(1) Measurement of the Impact : Accordingly, the Table 11 presents the final depiction of income/expenses related to ABC Investments in the statement of profit and loss for the year ended March 31, 2018.

The Table 12 presents the final depiction of ABC Investments and related liabilities in the balance sheet as on March 31, 2018.

(2) Analysis of the Impact : These tables summarize the net (combined) impact of FV measurement and further confirm the earlier findings. It is clear that :

- ↪ Historical cost measurement fails to show the real picture when the FV on the reporting date is more than cost and thus understates the profitability and value of investment, consequently understating the net worth of the company and negatively impacting its market value.
- ↪ FV measurement undoes this anomaly, thus leading to a fairer (higher) measurement of profitability by recognizing unrealized gains, recognition of the existence of deferred tax liability, valuation of the investment and net worth.
- ↪ This leads to a higher EPS and ,therefore, companies are supposed to command a higher market value.
- ↪ The fair value measurement ensures an equitable spread of gains on investments over two reporting periods.

Table 11. Final Depiction of Income/Expenses Related to ABC Investments in the Statement of Profit and Loss for the Year Ended March 31, 2018

SCL Ltd.	(Amount ₹ Lakh Except FV per Share which is in ₹)							
	Historical Cost Measurement				Fair Value Measurement			
	Scenario 1		Scenario 2		Scenario 1		Scenario 2	
	TP > FV	TP < FV	TP > FV	TP < FV	TP > FV	TP < FV	TP > FV	TP < FV
When FV per share on 31-03-2018 is	796	903	796	903	796	903	796	903
INCOME:								
Unrealized gain on shares	....	....	....	....	----	94.00		108.00
EXPENSES:								
Total transaction cost (Brokerage)	....	....	....	....	0.80	0.80	0.80	0.80
Unrealized loss on shares	136.80	....	106.80	....	136.00	...	106.00	....
Profit/(Loss) Before Tax	(136.80)	....	(106.80)	....	(136.80)	93.20	(106.80)	107.20
• Current tax asset/(liability)	....	....	....	....	0.24	0.24	0.24	0.24
• Deferred tax asset/(liability)	41.04	....	32.04	....	40.80	(28.20)	31.80	(32.40)
• Total tax	41.04	....	32.04	....	41.04	(27.96)	32.04	(32.16)
Profit/(Loss) After Tax	(95.76)	....	(74.76)	....	(95.76)	65.24	(74.76)	75.04

Notes.

1. Tax on PBT assumed @ 30%.
2. Tax on transaction cost treated as current since it will be merged with the overall profit/(loss) for the period.

Table 12. Final Depiction of ABC Investments and Related Liabilities in the Balance Sheet as on March 31, 2018

SCL Ltd.	(Amount ₹ Lakh except FV per share which is in ₹)							
	Historical Cost Measurement				Fair Value Measurement			
	Scenario 1		Scenario 2		Scenario 1		Scenario 2	
	TP > FV	TP < FV	TP > FV	TP < FV	TP > FV	TP < FV	TP > FV	TP < FV
When FV per share on 31-03-2018 is.....	796	903	796	903	796	903	796	903
Investments in ABC Ltd.	1592.00	1728.80	1592.00	1698.80	1592.00	1806.00	1592.00	1806.00
Current tax asset	....	....	....	....	0.24	0.24	0.24	0.24
Deferred tax assets	41.04	....	32.04	....	40.80	....	31.80	....
Equity and Liabilities:	....	....	....	....	----	....	....	....
Other equity:	....	....	....	....	----	....	....	....
PBT	(95.76)	....	(74.76)	....	(95.76)	65.24	(74.76)	75.04
Deferred tax liabilities	....	....	....	....	----	28.20	....	32.40

Unrealized part in the first reporting period and realized part in the succeeding period, thus ensuring least volatility in the year-to-year reported profits and making them more predictable than historical cost measurement.

Conclusion

It is stated in the paper earlier that fair value measurement aims at fair recording of a business transaction so that

the financial statements are able to show a true and fair view of the profitability and financial position. Fair value measurement can be applied to different elements of financial statements. We have put this measurement basis to test through a case with reference to fair value mechanism applicable to purchase of current investments and their holding on the balance sheet date. The results have clearly supported the stated claim of the accounting standard setters.

To sum up, the FV measurement does away from window dressing, makes the financial statements more transparent, closer to real market value, less volatile, and more predictable in accordance with the principle of substance over form which is becoming all pervasive now.

Research Implications, Limitations of the Study, and Scope for Further Research

The quality of financial statements - their transparency due to market based measurement basis and therefore a far better predictability - should lead to better informed decision-making by the various stakeholders associated with the corporates and the capital markets. As mentioned in the beginning, due to the dearth of research on IND AS 113, the results of this study could not be compared with any other. This paper will enable further researchers to make a comparative analysis of their results vs-a-vis results of this study. Also, further research can be done with reference to other elements of the balance sheet to analyze their impact.

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