Think Ahead ACCA

Technical factsheet

Fair value accounting and distributable reserves

Contents

This factsheet has been produced in partnership with Future Finance Training.

INTRODUCTION

Fair value accounting is fundamental to FRS 102. This factsheet explores which items in a company's balance sheet must be or may be measured at fair value, and considers how changes in fair value are recognised. The recognition of changes in fair value may have an impact on distributable reserves. This is an area where there are often misunderstandings and the factsheet refers to available guidance that should be considered when determining what dividend a company should pay.

WHAT CAN BE MEASURED AT FAIR VALUE?

	FRS 102	When?
Property, plant and equipment	Optional	Sufficiently regularly that carrying amount is not materially different to fair value
Intangible assets	Optional if active market	
Investment property	Required	At each reporting date
Investments in subsidiaries, associates, jointly controlled entities	Optional	At each reporting date
Biological assets	Required unless can't be measured reliably	At initial recognition and each reporting date
Heritage assets	Optional	Sufficiently regularly that carrying amount is not materially different to fair value
Financial instruments	Depends on type	At each reporting date

FRS 105 does not permit does not permit the use of fair values.

HOW ARE CHANGES IN FAIR VALUE RECOGNISED?

Property, plant and equipment	OCI/revaluation reserve (unless impairment/reversal of impairment)
Intangible assets	OCI/revaluation reserve (unless impairment/reversal of impairment)
Investment property	Profit or loss/retained earnings
Investments in subsidiaries, associates, jointly controlled entities	Profit or loss/retained earnings or OCI/revaluation reserve
Biological assets	Profit or loss/retained earnings
Heritage assets	OCI/revaluation reserve (unless impairment/reversal of impairment)
Financial instruments	Profit or loss/retained earnings

WHAT ARE DISTRIBUTABLE RESERVES?

The realised profits test	Distributions must be out of accumulated realised profits less accumulated realised losses as included in the relevant accounts.

DO FAIR VALUE GAINS AND LOSSES AFFECT DISTRIBUTABLE RESERVES?

- In a **transaction** an accounting profit is realised if there is **qualifying consideration** (cash, a receivable in cash or an asset readily convertible to cash).
- In a **remeasurement to fair value** an accounting profit is realised if the asset is readily convertible to cash (ie a phone call on the reporting date would achieve a sale for carrying amount).

Property is not generally deemed to meet the ‘readily-convertible-to-cash’ test and so is not immediately distributable.

As property, plant or equipment or an intangible asset measured using the revaluation model is depreciated, the additional depreciation charge over that based on historic cost represents the realisation of the previous fair value gain. This therefore becomes distributable on a gradual basis.

Quoted shares are likely to meet the ‘readily-convertible-to-cash’ test, whereas unquoted shares are not.

ARE THERE OTHER CONSIDERATIONS REGARDING DISTRIBUTABLE RESERVES?

- Regardless of the level of distributable reserves, there must be sufficient cash reserves to pay a dividend.
- Although not a requirement, best practice is to disclose reserves split into distributable and non-distributable.

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