

What is the Fair Value Measurement Hierarchy?

Worksheet

The fair value hierarchy classifies valuation inputs into Level 1 (quoted prices in active markets), Level 2 (observable inputs other than quoted prices), and Level 3 (unobservable inputs based on management's own assumptions).

Questions

1. Which level uses quoted prices in active markets for identical items?

- A) Level 1
- B) Level 2
- C) Level 3
- D) Level 4

2. A discounted cash flow model based on management's internal growth assumptions is an example of:

- A) Level 1
- B) Level 2
- C) Level 3
- D) Historical cost

3. Which IFRS standard governs fair value measurement?

- A) IFRS 9
- B) IFRS 13
- C) IAS 16
- D) IAS 36

4. Observable prices for similar (not identical) assets fall under:

- A) Level 1
- B) Level 2
- C) Level 3
- D) No level applies

5. A company holds shares of a publicly traded corporation on the NYSE, quoted at \$45 per share. Which level applies?

6. A company owns a corporate bond that doesn't trade often, but similar bonds trade actively and yield curves are observable. Which level?

7. A company must value a private equity investment in a startup with no market comparables, using a discounted cash flow model with internally-forecast growth rates. Which level?

8. Define: What is Level 1 fair value input?

9. Define: What is Level 2 fair value input?

10. Define: What is Level 3 fair value input?

Answer Key

1. A) Level 1 - Level 1 inputs are quoted prices in active markets for identical assets or liabilities.
2. C) Level 3 - Unobservable, entity-generated assumptions define Level 3 inputs.
3. B) IFRS 13 - IFRS 13 sets out the framework for fair value measurement and disclosure.
4. B) Level 2 - Level 2 inputs are observable but not direct quoted prices for the identical item.
5. The shares trade in an active market with a directly observable quoted price. This is a Level 1 input - no adjustment or model is required. Fair value = quoted price number of shares held.
6. No direct quoted price exists for this specific bond. However, comparable bond prices and market interest rates are observable. This is a Level 2 input - fair value is estimated using observable market data for similar instruments.
7. There is no active market and no comparable observable inputs. The valuation relies on management's own unobservable assumptions (growth rate, discount rate). This is a Level 3 input - the least reliable but sometimes only feasible method.
8. Quoted prices in active markets for identical assets or liabilities - the most reliable input.
9. Observable inputs other than quoted prices, such as prices for similar assets or observable interest rates.
10. Unobservable inputs based on the entity's own assumptions, such as a discounted cash flow forecast.

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