

Snapshot: Fair Value Measurement

This snapshot is a brief introduction to the exposure draft of an IFRS on *Fair Value Measurement*. It provides a non-technical, high level overview of the main proposals in the exposure draft.

The project is included in the Memorandum of Understanding between the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) that sets out a roadmap towards convergence of IFRSs and US GAAP.

Project objectives: To establish a single source of guidance for all fair value measurements, to clarify the definition of fair value, to enhance disclosures about fair value and to increase convergence with US GAAP.

Project stage: The exposure draft was published in May 2009. It is the result of extensive consultations and confirms guidance published as a result of discussions by an Expert Advisory Panel that was created by the IASB in 2008. The proposed guidance is also consistent with existing US requirements, including recent amendments.

Comment deadline: The exposure draft is open for public comment until 28 September 2009.

Next steps: Comment letters received during the consultation process will be published on the IASB's website. The IASB will discuss the feedback received in public board meetings. The IASB expects to issue the envisaged IFRS in 2010.



Why is the IASB undertaking this project?

IFRSs require some assets and liabilities to be measured at fair value. However, guidance on measuring fair value has been added to IFRSs piecemeal over many years.

The project addresses the following issues:

- the guidance on measuring fair value is dispersed across many standards and is not always consistent;
- the guidance is sometimes incomplete and provides neither a clear measurement objective nor a sufficiently robust framework for measuring fair value;
- there is a need for convergence of IFRSs and US GAAP; and
- the financial crisis has highlighted the need for additional guidance for measuring fair value in inactive markets.

How does the future standard relate to other IFRSs?

The standard resulting from this project will *define* fair value, provide guidance on *how to* measure fair value and will set the disclosure requirements relating to fair value measurements.

If adopted the proposed standard would apply only when an existing IFRS already requires an asset or liability to be measured at fair value.

How should the entity recognise and measure the asset or liability?



Refer to the appropriate IFRS



Does the IFRS use fair value?

Yes

Refer to *Fair Value Measurement* for:

- definition of fair value
- measurement
- disclosure

What was the basis for the exposure draft?

Existing requirements for fair value measurements in IFRSs and the US standard on fair value measurement, Statement of Financial Accounting Standards No. 157 *Fair Value Measurements* (SFAS 157), are based on the same underlying concepts. However, SFAS 157 provides more detailed and consistent guidance. It is for this reason that the Board used SFAS 157 as the starting point for its discussion paper *Fair Value Measurements*. The discussion paper was published in November 2006.

The exposure draft is the result of extensive discussions by the IASB of the proposals contained in the discussion paper. It reflects the IASB's consideration of the comment letters and discussions held with the IASB's Standards Advisory Council and other interested parties. The IASB also considered valuation issues raised by members of the FASB's Valuation Resource Group.

The exposure draft reflects the experience gained from the financial crisis. The IASB's proposals are also consistent with the report of the IASB's Expert Advisory Panel about fair value measurement in markets that are no longer active and incorporate recent guidance published by the FASB on measuring fair value in inactive markets.

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What is the IASB proposing?

The proposals contained in the exposure draft have four objectives.

1. Clarify the definition of fair value

The exposure draft proposes a revised definition of fair value that addresses shortcomings in the current definition. The existing definition of fair value:

- does not specify whether an entity is buying or selling the asset
- is unclear what is meant by 'settling' a liability because it refers not to the creditor, but to knowledgeable, willing parties
- does not state explicitly whether the exchange or settlement takes place at the measurement date or at some other date.

The IASB believes that the proposed definition of fair value addresses these deficiencies and conveys more clearly that fair value assumes an orderly transaction (ie it is not a forced transaction or distress sale) while retaining the exchange price notion contained in the existing definition of fair value.

Existing fair value measurement guidance in other IFRSs would be replaced with a reference to the fair value measurement standard.

2. Establish a single source of guidance

Based on the proposed definition of fair value, the IASB proposes a single set of guidance for measuring fair value.

The IASB proposes to define 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.

In addition, the exposure draft proposes to simplify the existing guidance for developing fair value measurements. A single set of guidance should increase consistency in application and comparability and facilitate the measurement of fair value where required.

3. Enhance disclosure about fair value

Incorporating the changes introduced in the recent amendments to IFRS 7 *Disclosures*, the ED proposes a three-level fair value hierarchy that categorises observable and non-observable market data used as inputs for fair value measurements.

Level 1 inputs - highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.

Level 2 inputs - are either directly (ie as prices) or indirectly (ie derived from prices) observable inputs other than quoted prices included within Level 1.

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Level 3 inputs - are inputs for the asset or liability that are not based on observable market data (unobservable inputs). Unobservable inputs shall reflect the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk.

The proposals also include disclosures in addition to those in SFAS 157 that users of financial statements have suggested would be useful for fair value measurements.

The additional disclosures will allow for a better assessment of the subjectivity of the information used to measure the fair value of an asset or a liability.

4. Increase convergence with US GAAP

The IASB believes that the proposals in the exposure draft are largely consistent with SFAS 157 with a few exceptions. The IASB believes that the differences are improvements over SFAS 157. These differences are listed in the Basis for Conclusions that accompany the exposure draft.

If adopted, the proposed definition of fair value, measurement guidance and disclosure requirements will become the mandatory framework for assets and liabilities measured at fair value.

What happens now?

Please send us your comments on the proposals contained in the exposure draft.

After the comment deadline, the IASB will hold public round-table meetings to receive further input on the proposals.

The deadline for comments on the exposure draft is 28 September 2009. To view the exposure draft and submit your comments, visit www.iasb.org.

The exposure draft includes specific questions on the Board's proposals. Respondents may choose to answer all or selected questions but are also welcome to comment on any other matter that they think the IASB should consider. The IASB's deliberations will, as usual, take place in public board meetings as announced on its website www.iasb.org.
