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International
Accounting Standards
Board

INFORMATION FOR OBSERVERS

Board Meeting: **25 May 2006, London**

Project: **Fair Value Measurements (Agenda Paper 8A)**

Principles and Definition

OVERVIEW OF THIS PAPER

1 This paper is organised into two parts. The first part discusses the principles that form the foundation of the Fair Value Measurements (FVM) project. The Staff recommends these principles to the Board and requests the Board to confirm they agree with the principles discussed in this paper. The second part of this paper discusses the revised definition of fair value in the working draft of the FASB's FVM statement (draft FVM statement). The Staff asserts the revised definition is consistent with the principles discussed in this paper. Further, as discussed in more detail below, the Staff concludes the changes to the definition of fair value in comparison to the FASB's October working draft are communicative rather than substantive. The Staff recommends the revised definition of fair value because it communicates the same measurement objective as the definition tentatively approved by the Board in December without the use of defined terms such as "reference market" and "current transaction.

PRINCIPLES OF THE FAIR VALUE MEASUREMENT PROJECT

2 An appropriate definition of fair value can only be developed once clear principles regarding its objective have been established. Further, the Staff reasons that much of the confusion and inconsistent practice when measuring fair value is due to the lack of clear principles regarding the fair value measurement objective. To identify the primary principles of the fair value measurements project the Staff considered guidance on fair value measurements in IFRS as well as in the FASB's draft FVM statement, basis of conclusions and the related FASB meeting minutes discussing the FVM project.

3 The Staff concluded the following principles form the foundation of the FVM project:

Principles for fair value measurements

The objective of a fair value measurement is to determine the price that would be received for an asset or paid to transfer a liability in a transaction between market participants at the measurement date.

The definition of fair value and its measurement objective should be consistent for all fair value measurements required by IFRS.

A fair value measurement should reflect market views of the attributes of the asset or liability being measured and should not include views of the reporting entity that differ from market expectations.

A fair value measurement should consider the utility of the asset or liability being measured. As such, the fair value measurement should consider the location and the condition of the asset or liability at its measurement date.

4 The Staff believes the basis for the above principles were discussed in conjunction with the discussion of Agenda Paper 6A in the December 2005 IASB meeting. Therefore, the Staff has not reproduced in this paper a discussion of the reasoning behind these principles.

Staff Recommendation

5 The Staff believes the above principles form the foundation of the FVM project. The Staff will use these principles to determine the appropriateness of the provisions of the draft FVM statement. Does the Board agree with the above principles?

REVISED DEFINITION OF FAIR VALUE

6 The Staff reasons the above principles form the basis for the FASB's revised definition of fair value: "*Fair Value* is the price that would be received for an asset or paid to transfer a liability in a transaction between market participants at the measurement date."

7 This revised definition is similar to the definition tentatively approved by the IASB in December 2005: "The price that would be received for an asset or paid to transfer a liability in a current transaction between marketplace participants in the reference market for the asset or liability."

8 The Staff notes the primary differences are:

(a) Elimination of defined term "reference market" from the definition.

(b) Rewording from "current transaction" to "transaction…at the measurement date."

9 External reviewers of the October working draft commented the "reference market" wording in the definition caused confusion. As a result, the FASB decided to:

(a) Clarify the reference market principle in the context of the principal market or, in the absence of a principal market, the most advantageous market in which the reporting entity would sell or otherwise dispose of the asset or transfer the liability, and

(b) Remove the references to "reference market" from the definition and elsewhere within the FVM Statement.

The revised wording regarding the principal market and most advantageous market are discussed in a Agenda Paper 8C.

10 The reference to a “current transaction” was reworded to minimize the use of defined terms and to more clearly articulate the measurement objective is to assess the fair value as if a transaction were to occur at the measurement date. The concepts and guidance that were discussed in the context of the definition of a “current transaction” have been retained in the standard in a discussion of the transaction (paragraph 10 of the draft FVM statement).

11 Consistent with the definition tentatively approved by the IASB last December, the Staff observes the revised definition of fair value has an exit price objective. The IFRS Framework for the Preparation and Presentation of Financial Statements defines assets in terms of future economic benefits and liabilities in terms of future outflows of resources embodying economic benefits. The Staff asserts the exit price objective for a fair value measurement is appropriate because it provides a measure of expected future inflows associated with an asset or outflows associated with a liability that is independent of the entity (ie, based on observable or unobservable market inputs).

Staff Recommendation

12 The changes to the definition of fair value are communicative rather than substantive. The revised definition is consistent with the measurement objective discussed in the December 2005 IASB meeting (please refer to Agenda Paper 6A of that meeting). Individual IASB members expressed concern regarding the use of some defined terms within the previous definition of fair value in the October working draft. This revised definition communicates the same measurement objective without the use of those terms. For these reasons, the Staff recommends the revised definition of fair value.