International Accounting Standards Board

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Note: These notes are based on the staff paper prepared for the Council. Paragraph numbers correspond to paragraph numbers used in the Council paper.

INFORMATION FOR OBSERVERS
SAC Meeting: November 2006, London
Project: Fair Value Measurements (Agenda Paper 6A)

International Accounting Standards Board

Standards Advisory Council
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Fair Value Measurements

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The views expressed in this presentation are those of the presenters, not those of the IASB

Background

- Fair Value Measurements project added to IASB's agenda in September 2005
- Part of the Memorandum of Understanding with the FASB
- Project intended to codify and simplify guidance for fair value measurements in IFRS
- Will not require any new fair value measurements
  - *However, the FVM project may result in changes to current practice for some entities*

Why have a project on Fair Value Measurements?

- Guidance on measuring fair value has evolved over time
  - *Dispersed throughout many standards*
  - *Not always consistent from standard to standard*
- Dispersed and inconsistent guidance causes unnecessary complexity and diversity in practice
- Improved disclosure of fair value measurements

Project Timeline

- Issue the FASB's final FVM statement as an IASB Discussion Paper (Late 2006)
- Develop and issue an IASB Exposure Draft considering the responses to the Discussion Paper (Late 2007/Early 2008)
- Issue a final IFRS (Late 2008/Early 2009)

Project Plan

- The FASB recently issued Statement of Financial Accounting Standards No. 157 *Fair Value Measurements (SFAS 157)*
- *The IASB plans to issue SFAS 157 as a Discussion Paper*
  - *The Invitation to Comment in the Discussion Paper will articulate the Board's preliminary views on SFAS 157*
- The Board will consider comments on the discussion paper in developing an Exposure Draft of an IFRS on Fair Value Measurements

Overview of SFAS 157

- **Revised definition of Fair Value**
  - ***'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.'***
- **Fair value considers attributes specific to the asset or liability, such as:**
  - ***Condition***
  - ***Location***
  - ***Restrictions on the sale or use***

Overview of SFAS 157

- **A fair value measurement assumes that an asset or liability is exchanged in an orderly transaction between market participants at the measurement date**

Overview of SFAS 157

- Assumes the transaction to sell occurs in the principal market
- In the absence of a principal market, use the most advantageous market

Overview of SFAS 157

- Market participants are:
  - *Independent of the reporting entity;*
  - *Knowledgeable;*
  - *Able to transact for the asset or liability;*
  - *Willing to transact for the asset or liability.*
- Market participants are similar to the definition of "knowledgeable, willing parties in an arm's length transaction" as defined in IAS 40.42-44.

Key provisions of the FVM Statement

- **Three-level hierarchy:**
  - ***Level 1 – quoted prices in active markets for identical assets or liabilities***
  - ***Level 2 – observable market inputs other than those in Level 1***
  - ***Level 3 – unobservable inputs***
    - **Reflects the reporting entity's assumptions about the assumptions that market participants would use.**
    - **While the reporting entity need not undertake all possible efforts to obtain information about market participant assumptions, they shall not ignore information available without undue cost and effort.**

Differences to IFRSs

- **Primary differences between current IFRSs and SFAS 157**
  - ***Definition of fair value***
  - ***Day-one gains***
  - ***Measuring fair value when inputs are based on bid and asked prices***
  - ***Determining on which market a fair value measurement should be based (principal or most advantageous market)***

Summary

- Deliberations on the IASB's Fair Value Measurements project are ongoing.
- The IASB might reach different conclusions that the FASB.

Questions for SAC members

- If the IASB were to reach different conclusions than the FASB, what does the SAC believe are the implications of the divergence?
- Specifically, what are the implications of divergence for:
  - *The usability of financial statements?*
  - *The cost of compliance (ie, for companies that must reconcile or for companies that report under both IFRS and US GAAP)?*
- What factors would SAC members consider in balancing convergence with differing views on how fair value should be defined and measured?