30 Cannon Street, London EC4M 6XH, United Kingdom
Tel: +44 (0)20 7246 6410   Fax: +44 (0)20 7246 6411
Email: iasb@iasb.org   Website: www.iasb.org

International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting: **17 October 2007, London**

Project: **Fair Value Measurement**

Subject: **Project Objective (Agenda Paper 2B)**

INTRODUCTION

1 The purpose of this agenda paper is to ask the Board to affirm the objectives of the fair value measurement project.

2 The fair value measurement project was initiated to:

a clarify the fair value measurement objective;

b develop a single source of guidance for all fair value measurements currently required or permitted by IFRSs in order to simplify IFRSs and eliminate the dispersed and inconsistent fair value measurement guidance; and

c improve and harmonise the disclosure requirements for items measured at fair value.

3 Because the FASB had recently issued a fair value measurement standard (SFAS 157), the Board used the FASB's standard as the starting point for its deliberations. As the first stage of the fair value measurement project, the

Board published a discussion paper that contained its preliminary views on the principal issues contained in SFAS 157.

OUTLINING THE PROJECT OBJECTIVE

4 SFAS 157 defines 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' (an exit price). By comparison, IFRSs generally define fair value as 'the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction'. Both definitions of fair value are exchange prices and contemplate an exchange transaction. The main distinction between the two is that SFAS 157 explicitly refers to the exit (selling) price, whereas IFRSs do not explicitly refer to an exit price or an entry (buying) price.

5 Because of this distinction, the discussion paper indicated that there will be a standard-by-standard review of fair value measurements required or permitted in IFRSs to assess whether each standard's measurement basis is consistent with an exit price. As part of the standard-by-standard review, the staff envisages enlisting the input of a group of constituents to gain an understanding about whether an exit price or entry price notion is applied in practice.

6 If the Board decides that a particular fair value measurement currently required or permitted in IFRSs should *not* be defined explicitly as an exit price, the discussion paper contemplates that the measurement basis in that standard could be labelled as something other than fair value (eg 'current entry price'). Alternatively, the term 'fair value' could be replaced with terms that are more descriptive of the measurement basis, such as 'current entry price' and 'current exit price'.

7 In the comment letters, many respondents note that IFRSs use 'fair value' in situations in which US GAAP does not. They think that, in some circumstances, the fair value measurement basis in IFRSs might not be consistent with the exit price measurement basis in SFAS 157 and that changing the definition of fair value to an exit price would change the measurement basis for some fair value measurements currently required or

permitted by IFRSs. Specifically, respondents characterise fair value measurements at initial recognition as an entry price rather than an exit price. Additionally, many respondents object to an exit price measurement basis at initial recognition when an asset or liability is not measured at fair value in subsequent periods. In such situations, they think it is more appropriate to use an entry price.

8 Furthermore, many respondents think of ‘fair value’ in IFRSs as a family of measurements comprising both entry price and exit price. They recognise that both entry price and exit price form a part of the exchange transaction contemplated in the current definition of fair value—the entry price for one party is the exit price for the other.[1]

9 Based on these comments, the standard-by-standard review will entail assessing whether the measurement basis in each standard in which the term ‘fair value’ is used is an exit price or an entry price (or perhaps another measurement basis). In some cases the intended measurement basis will be clear. However, there are likely to be situations in which it is not clear. In such situations, the staff will seek input from the Board and the group of constituents mentioned in paragraph 5.

10 If the measurement basis in a particular standard is consistent with an exit price, the definition and measurement guidance could be developed with SFAS 157 in mind, although the Board might decide to modify or reword some aspects of the guidance in that Statement.

11 If the measurement basis in a particular standard is not consistent with an exit price, the Board will need to decide whether to proceed with developing definitions and measurement guidance for the other (non-exit price) measurement bases (eg ‘current entry price’). Any differences between an exit price and an entry price (or other measurement basis) will need to be understood and articulated. (***Please note***—the staff does not intend to expand the scope of the project to develop measurement guidance for each measurement basis identified in the standard-by-standard review. However, if

[1] The staff notes that the exit price for the selling party is not necessarily the exit price for the buyer on initial recognition. This will be explored further in the deliberations when discussing the differences between entry prices and exit prices.

measurement bases other than entry price and exit price are identified, the staff will bring it to the Board's attention and the Board can decide on a case-by-case basis how to proceed.)

12 The staff thinks such an approach would build upon the work that has been done in developing SFAS 157 and would move the debate forward, providing an opportunity for convergence in many circumstances.

RELATIONSHIP WITH THE MEASUREMENT PHASE OF THE CONCEPTUAL FRAMEWORK PROJECT

13 Some are concerned that the effort that will go into a standard-by-standard review might duplicate and prejudge the discussions occurring in the measurement phase (Phase C) of the conceptual framework project. There are many reasons for having a separate, standards-level project on fair value measurement. As stated in the agenda proposal for the fair value measurement project:

> The lack of consistent, integrated guidance on developing FVM has emerged as an issue. The issue is becoming even more significant as the Board discusses the use of FVM in current Board projects (for example, Business Combinations, Revenue Recognition, and Insurance Contracts). Recent comments by the SEC, in its off-balance-sheet financing report, and by the SAC, in its discussion of agenda priorities, raise a number of other potential projects for which guidance on fair value will play a vital role.
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> This issue spans all jurisdictions. It affects all companies that are required to measure assets and liabilities at fair value under IFRS. Not only will the issue persist if it is not resolved by the Board, it will become more pervasive as fair value is adopted as the measurement attribute in future Board pronouncements. Stated simply, even if the IASB does not advance the use of fair value by one foot (.3048 metres) in the next 10 years, we would still need a project to provide integrated guidance on FVM.

14 Regardless of whether the Board adopts an exit price for all fair value measurements, this project will overlap with some of the efforts being done in the measurement phase of the conceptual framework project. For example, an important step in the fair value measurement project will be to determine, for each standard that currently requires or permits fair value as a measurement

basis, whether the Board or the IASC intended it to be a current exit price or some other measurement basis. Although this intention will be easy to determine in some standards, the staff thinks there will be circumstances in which the intention is not clear. In these situations the Board will need to determine what the measurement is meant to communicate to the users of financial statements. The conceptual framework project team will be doing the same thing, only they will be seeking to develop a framework and foundation on which *future* decisions can be made rather than directly clarifying current IFRSs. Clearly, both project teams need to work together to avoid any inconsistencies between the conceptual framework and the standards level.

15 A key difference between the two projects is that the fair value measurement project seeks *to provide guidance* related to fair value measurements when fair value is required or permitted in current standards. The conceptual framework project, on the other hand, will not address practical issues with the application of current standards, nor will it determine when a particular measurement basis should be used at the standards level. The measurement phase of the conceptual framework project will acknowledge the existence of each measurement basis, but each standard will specify which measurement basis to use.

CONVERGENCE

16 The staff recognises that introducing other measurement bases (eg ‘current entry price’) might appear to be a move away from convergence under the Memorandum of Understanding. On the contrary, we think IFRSs and US GAAP could be converged with regard to the principles underlying an exit price measurement basis when it is used (which is the focus of SFAS 157). We also think this gives the IASB the opportunity to develop, and the FASB the opportunity to modify, fair value measurement guidance that provides the ‘best answer’ for both IFRSs and US GAAP because we will be able to learn from the implementation of SFAS 157 as we go through the deliberations process at the IASB.

SUMMARY

17 The deliberations plan outlined in Agenda Paper 2D has been developed assuming that the project objective is to:

a develop principles and measurement guidance for a current exit price measurement basis; and

b complete a standard-by-standard review of fair value measurements required or permitted in IFRSs to assess whether each standard's measurement basis is an exit price. If there are circumstances in which it the measurement basis is not an exit price, the staff will ask the Board to identify what that measurement basis is (eg 'current entry price') and to decide on a case-by-case basis whether or not to develop measurement guidance for it.

QUESTIONS FOR THE BOARD

18 **Does the Board agree that the project objective is to:**

a **develop principles and measurement guidance for an exit price measurement basis; and**

b **complete a standard-by-standard review of fair value measurements required or permitted in IFRSs to assess whether each standard's measurement basis is an exit price? If it is not, does the Board agree to decide on a case-by-case basis whether or not to develop measurement guidance for those other measurement bases?**