



Project **Fair Value Measurement**

Topic **Summary of views received on FASB staff position No. FAS 157-4**

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### Purpose of this paper

1. The purpose of this paper is to provide the Board with an analysis of the views the staff received in response to its *Request for views*. That is, whether FASB Staff Position (FSP) No. FAS 157-4 *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability has Significantly Decreased and Identifying Transactions that are Not Orderly* (see Appendix A of Agenda Paper 16 for a copy of the FSP) is consistent with the IASB Expert Advisory Panel report (Panel report) *Measuring and disclosing the fair value of financial instruments in markets that are no longer active*, published in October 2008. This paper contains the staff analysis and recommendations and asks the Board what guidance it wants to include in the ED for fair value measurements, if any.
2. FSP FAS 157-4 and other FSPs that the FASB published on 9 April 2009 amended some fair value **disclosure** requirements. This paper does not address amendments to fair value disclosures contained in those FSPs. The staff have prepared a separate paper on those amendments (refer to agenda paper 13A for the April 2009 Board meeting).

### Background

3. At its March 2009 meeting the Board noted the publication of the Proposed FASB Staff Position No. FAS 157-e *Determining Whether a Market is Not Active and a Transaction is Not Distressed* (proposed FSP). This document was published on 17 March 2009.
4. At that meeting the Board decided:

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This paper has been prepared by the technical staff of the IASB for the purposes of discussion at a public meeting of the IASB.

The views expressed in this paper are those of the staff preparing the paper and do not purport to represent the views of any individual members of the Board or the IASB.

Decisions made by the Board are reported in IASB *Update*.

Official pronouncements of the IASB are published only after the Board has completed its full due process, including appropriate public consultation and formal voting procedures.

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- (a) not to discuss the merits of the approach in the proposed FSP before publishing the exposure draft (ED) on fair value measurements
  - (b) that the invitation to comment on the ED should ask respondents to comment on both the approach in the ED and the approach in the FSP
5. Events since the March 2009 Board meeting:
- (a) on 20 March 2009, the IASB published a *Request for views* on the proposed FSP. Respondents were asked, among other things, whether they believed the proposed FSP was consistent with the Panel report. The comment period for the *Request for views* ended on 20 April 2009. The IASB also asked its Expert Advisory Panel to submit their views before the 20 April deadline.
  - (b) on 9 April 2009, the FASB published FSP FAS 157-4, which differs in some respects from the proposed FSP. The IASB updated its website, requesting that respondents include their views on FSP FAS 157-4 before the 20 April deadline.

### Summary of FSP FAS 157-4

- 6. FASB Statement 157 (SFAS 157) *Fair Value Measurements*, defines fair value as the price that would be received to sell an asset or transfer a liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions.
- 7. The FSP reaffirms this measurement objective and provides additional guidance on determining when the volume and level of activity for the asset or liability has significantly decreased. The FSP also provides guidance on identifying circumstances when a transaction may not be considered orderly.
- 8. The FSP provides a list of factors that an entity should evaluate to determine whether there has been a significant decrease in the volume and level of activity for the asset or liability in relation to normal market activity for the asset or liability. When the entity concludes there has been a significant decrease in the volume and level of activity for the asset or liability, further analysis of the information from that market is needed and significant adjustments to the related prices may be necessary to estimate fair value in accordance with SFAS 157.
- 9. Even if there has been a significant decrease in the volume and level of activity for the asset or liability, the FSP clarifies that it is not appropriate to conclude

that all transactions for that asset or liability are not orderly. The entity must evaluate the weight of the evidence to determine whether the transaction is orderly. The FSP provides a list of circumstances that may indicate that a transaction is not orderly.

10. A transaction price that is deemed not orderly is given little, if any, weight when estimating fair value. When an entity does not have sufficient information to conclude whether the transaction is orderly or not orderly, it shall consider that transaction price when estimating fair value. However, a reporting entity shall place less weight on transactions on which a reporting entity does not have sufficient information to conclude whether the transaction is orderly when compared with other transactions that are known to be orderly.

### **Responses to the *Request for views***

11. The staff received 48 responses to the *Request for views* relating the guidance in FSP FAS 157-e and FSP FAS 157-4. They are on our web site at [www.iasb.org](http://www.iasb.org)
12. Overall, respondents welcomed the IASB's initiative in seeking views. Many respondents also commented that the 30 day period given to submit views was appropriate.
13. Almost all respondents emphasised the importance of following due process should the IASB decide to propose any amendments. Respondents also noted that any proposals should have an appropriate comment period. Moreover, several respondents were critical of the lack of due process exercised in finalising the FSP. Respondents were concerned about whether the consequences of the FSP and the constituents' comment letters were adequately considered. Respondents noted that the FSP proposals were issued for a 15 day comment period and finalised within 1 day of the comment deadline.

14. **Respondents to the *Request for views* confirmed that FSP FAS 157-4 is broadly consistent with the principles set out in the Panel report. They indicated that FSP FAS 157-4:**
  - (a) **will not result in a significant change in valuation practice**
  - (b) **will not result in practical differences in fair value measurement between US GAAP and IFRS**
15. They noted that the factors listed in paragraphs 12 and 16 of FSP 157-4 are similar to the principles in the Panel report. In particular, the FSP makes it clear in paragraph 15 that, even if there is a reduction in the normal level of activity and regardless of the valuation technique adopted, the objective of fair value measurements remains the same. That is, a price that would be paid in an orderly transaction between market participants.
16. Few respondents favoured the two-step approach in the proposed FSP. These respondents favoured the presumption that a transaction is deemed not orderly when markets are not active. They believed it is impossible to prove that a transaction is not orderly when a market is inactive.
17. Some respondents raised minor concerns on the consistency between FSP FAS 157-4 and the Panel report. This paper addresses those concerns.
18. This paper discusses respondents' views and staff analysis on:
  - (a) the scope of the documents
  - (b) factors indicating that a market is not active or no longer active
  - (c) factors indicating that a transaction is not orderly
  - (d) sources of information used for a fair value measurement
  - (e) guidance to be included in the ED for fair value measurements.

## Comparison of FSP FAS 157-4 and the Panel report

### Scope of the documents

FSP FAS 157-4	Panel report
<p>This FSP applies to <b>all assets and liabilities</b> within the scope of accounting pronouncements that require or permit fair value measurements (<i>see paragraph 10 of the FSP</i>).</p>	<p>This non-authoritative guidance provides a summary of the discussion of the expert advisory panel. The document describes practices used for measuring <b>financial instruments</b> when markets are no longer active and disclosure in such situations.</p>

19. One respondent noted that the proposed FSP applied only to financial instruments, while the final FSP applies to all assets and liabilities measured at fair value. The respondent is concerned about the factors identified in paragraph 12 of FSP FAS 157-4 (see the table below paragraph 20). Specifically, the respondent believes that these factors are present more often than not for many non-financial asset classes. These respondents stated that this could lead to the objective of a fair value measurement for non-financial assets being undermined, despite the requirement for the entity to use the list of factors to determine whether there has been a significant decrease in the level of activity for the asset or liability.
20. The staff agrees with the respondent that the factors identified in paragraph 12 of FSP FAS 157-4 are present more often than not for many non-financial asset and non-financial liability classes. However, the staff does not agree that this will undermine the objective of fair value measurements for non-financial assets or liabilities. The staff thinks that the FSP provides helpful perspective in measuring a non-financial asset or non-financial liability at fair value. It does so by emphasising that the measurement of an asset (financial or non-financial) or liability (financial or non-financial) requires further analysis when there has been a significant decrease in the volume and level of activity for the asset or liability. Therefore, when the factors in paragraph 12 are present, significant adjustments to the related prices **may** be necessary to estimate fair value in accordance with SFAS 157.

**Factors indicating a significant decrease in the volume and level of activity for assets or liabilities**

FSP FAS 157-4	Panel report
<ul style="list-style-type: none"> <li>a. there are few recent transactions</li> <li>b. price quotations are not based on current information</li> <li>c. price quotations vary substantially either over time or among market makers (for example, some brokered markets)</li> <li>d. indexes that previously were highly correlated with the fair values of the asset or liability are demonstrably uncorrelated with recent indications of fair value for that asset or liability</li> <li>e. there is a significant increase in implied liquidity risk premiums, yields, or performance indicators (such as delinquency rates or loss severities) for observed transactions or quoted prices when compared with the reporting entity's estimate of expected cash flows, considering all available market data about credit and other non-performance risk for the asset or liability</li> <li>f. there is a wide bid-ask spread or significant increase in the bid-ask spread</li> <li>g. there is a significant decline or absence of a market for new issuances (that is, a primary market) for the asset or liability or similar assets or liabilities</li> <li>h. little information is released publicly (for example, a principal-to-principal market)</li> </ul> <p><i>(See paragraph 12 of the FSP).</i></p>	<p>Characteristics of an inactive market include significant decline in the volume and level of trading activity, the prices vary significantly over time among market participants, or the prices are not current.</p>

21. Some respondents commented that FSP FAS 157-4 provides more factors than were listed in the Panel report to indicate a significant decrease in the volume

and level of activity for the asset or liability. However, the respondents did not believe the additional factors in the FSP, compared to the Panel report, would result in practical differences in fair value measurements.

22. Some respondents commented that the Panel report concluded that there was no ‘bright line’ between active and inactive markets, but by including the list of factors in paragraph 12 the FSP would appear to be drawing such a line. Even though the respondents agreed with the content of the list of indicators, they believe that there is an inherent contradiction between:
  - (a) the presentation of a list of matters that the entity ‘should’ evaluate to determine relative activity
  - (b) the subsequent acknowledgement that significant judgement is required in the determination of fair value.
23. The factors indicated in paragraph 12 frame the discussion of markets where there has been a significant decrease in the volume and level of activity for the asset or liability. The staff does not think that those factors will compromise the application of judgement when estimating fair value.
24. This is because:
  - (a) the list is not exhaustive (as stated in paragraph 12)
  - (b) these factors do not influence the fair value measurement directly, rather, these factors help the preparer identify if there has been a significant decrease in the volume and level of activity for the asset or liability. The preparer will have to determine the price at which willing market participants would transact at the measurement date under the identified market conditions; this still requires the use of judgement.
25. Other respondents commented that the Panel report places less emphasis than the FSP does on the need to distinguish when an active market becomes inactive. This is because the emphasis of the Panel report is on assessing all available evidence, applying judgement and using a valuation technique where there is insufficient transactional or pricing data. This difference in wording is not significant as both documents encourage the consideration of all available evidence in determining fair value and the emphasis of both is on relevant observable data whether a market is active or inactive. The staff agrees that the different wording is not significant.

26. Some respondent raised concerns about the relevance of the factors listed in FSP FAS 157-4 that indicate if there has been a significant decrease in the volume and level of activity for the asset or liability. However, the staff and many respondents believe that these factors are broadly consistent with those in the Panel report. Because the factors are broadly consistent, the staff think it is appropriate for the Board to include these factors in the ED for fair value measurements. It is not helpful to have two sets of standards that are thought to be equivalent but whose wording varies significantly.

**Factors indicating that a transaction is not orderly**

FSP FAS 157-4	Panel report
<p>a. there was not adequate exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities under current market conditions</p> <p>b. there was a usual and customary marketing period, but the seller marketed the asset or liability to a single market participant</p> <p>c. the seller is in or near bankruptcy or receivership (that is, distressed), or the seller was required to sell to meet regulatory or legal requirements (that is, forced)</p> <p>d. the transaction price is an outlier when compared with other recent transactions for the same or similar asset or liability</p> <p><i>(See paragraph 16 of the FSP).</i></p>	<p>a. a legal requirement to transact, for example a regulatory mandate</p> <p>b. a necessity to dispose of an asset immediately and there is not sufficient time to market the asset to be sold</p> <p>c. the existence of a single potential buyer as a result of the legal or time restrictions imposed</p>

27. In paragraph 16(c) of FSP FAS 157-4, one indicator of a transaction that is not orderly is a seller that is near bankruptcy, in receivership or is required to sell to meet regulatory or legal requirements. Some respondents commented that this appears to be inconsistent with the Panel report. This is because the Panel report



states that such transactions should not automatically be assumed to be forced. The staff does not think that Panel report and FSP FAS 157-4 are materially different in this regard. Paragraph 16 of FSP FAS 157-4 clearly states that the factors listed *may indicate* that a transaction is not orderly. Paragraph 16 further states that a reporting entity shall evaluate the circumstances to determine whether the transaction is orderly based on the weight of the evidence. The staff think that this is consistent with the Panel report despite the use of different words.

28. Some respondents indicated that there are some differences in emphasis between the Panel report and FSP FAS 157-4. The Panel report assumes a transaction is orderly unless proven otherwise. The FSP is more neutral on the point indicating that if a transaction cannot be proven orderly or distressed then less weight should be given to the transaction than if it could be proven orderly. However, the respondents did not believe this difference in emphasis would result in practical differences in fair value measurements. The staff agrees with these respondents.
29. Another respondent noted that paragraph 17 states “a reporting entity need not undertake all possible efforts, but shall not ignore information that is available without undue cost and effort”. This respondent did not think that such words should be included in authoritative literature and that entities need to make best efforts to present their accounts fairly and in accordance with the relevant authoritative literature. The staff thinks it is important to emphasise that entities always need to make best efforts to estimate their fair value measurement regardless of the fact that there has been a significant decrease in the volume and activity for the asset or liability.

***Sources of information used for a fair value measurement***

30. Paragraph 19 of FSP 157-4 discusses the use of pricing services or broker quotes for determining a fair value. Few respondents specifically commented on this paragraph.
31. The staff thinks that this discussion is appropriate because entities will need to look to other corroborating sources of information to determine fair value when a market is not active or is no longer active.

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32. The staff think that the discussion in the FSP about other sources of information and how to apply them to a fair value measurement in a market that is not active or is no longer active is consistent with the discussion in the Panel report.
33. In summary the FSP states:
- (a) an entity should evaluate whether those quoted prices are based on current information that reflects orderly transactions or a valuation technique that reflects market participant assumptions
  - (b) a reporting entity should place less weight on quoted prices that do not reflect the result of transactions
  - (c) the nature of the quote should be considered when weighting the available evidence, with more weight given to quotes being based on binding offers.

### ***Guidance to be included in the ED on fair value measurements***

34. The staff would like to revisit the decision the Board reached at its March 2009 meeting regarding the treatment of the proposed FSP (refer to paragraph 4 of this paper).
35. The staff believe that it is necessary to revisit this decision because of:
- (a) the changes the FASB made from the proposed FSP in developing the final requirements in FSP 157-4
  - (b) the views received in response to the *Request for views* that consider the guidance in the FSP broadly consistent with that in the panel report
36. The staff think that generally there is a need for guidance on how to apply fair value in markets where there has been a significant decrease in the volume and level of activity for the asset or liability, hence the publication of the Panel report in October 2008. However, this report is non-authoritative.
37. Respondents raised concerns that the FSP uses different words than the Panel report to express similar principles. These respondents do not believe that this will result in practical difference in fair value measurements. However, they believe that using different words does not aid convergence and might create confusion. The staff agrees with these respondents.

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38. Because respondents believe that the guidance in the Panel report is broadly consistent with the guidance in FSP FAS 157-4, the staff think that it is appropriate to include this guidance, largely using the same words, in the ED for fair value measurements.

### Staff recommendation and question

#### Question 1

The staff think that the guidance in FSP FAS 157-4 is broadly consistent with the guidance provided in the Panel report. Does the Board agree? If not, why not?

39. If the Board agrees that the guidance is broadly consistent, then:

### Staff recommendation and question

#### Question 2

The staff recommends that the Board add the guidance in FSP FAS 157-4 in the exposure draft on an IFRS on fair value measurements. Does the Board agree? If not, why not and what alternative course of action does the Board want to pursue and why?