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

International
Accounting Standards
Board

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These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

Board Meeting: **January 2009, London**

Project: **Fair Value Measurement**

Subject: **Cover note (Agenda paper 3)**

Agenda papers for this meeting

1 We have prepared the following agenda papers for this meeting:

Agenda Paper No.	Title	Objective
3	Cover note	Outlines the meeting objectives and timeline
3A	Comment period	Recommends a 120-day comment period for the exposure draft
3B	Transition requirements	Addresses the transition requirements upon adoption of an IFRS on fair value measurement guidance
3C	Scope assessment	Provides an assessment of which fair value measurements in current IFRSs should be included or excluded from the scope of an IFRS on fair value measurement
3D	Disclosures	Discusses the fair value disclosure requirements in SFAS 157 and IFRSs and whether additional disclosures are necessary

Agenda Paper No.	Title	Objective
3E	Day one gains—service contracts	Discusses whether the transaction price is generally the best evidence of the fair value of an asset or liability at initial recognition in a contract to provide services

Meeting objectives

2 At this meeting, the staff will present the remaining issues to be deliberated before the Board can publish an exposure draft of an IFRS on fair value measurement guidance.

Tentative decisions to-date

3 The Board has made the following tentative decisions in this project. These tentative decisions form the basis for future discussions about particular topics (see ‘Next steps’ below) as we develop the exposure draft.

Single source of guidance

4 The Board reaffirmed its preliminary view that having a single source of guidance would be an improvement over the disparate guidance in IFRSs.

Definition of fair value

5 The Board tentatively decided 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’.

6 **Follow-up**:

a In January 2009, the staff will present a scope assessment for uses of fair value in current IFRSs. In situations for which the Board decides that an exit price definition of fair value is not appropriate (eg perhaps at initial recognition), it could, for example, require an entity to use its transaction price or another measurement basis instead of fair value.

b In January, the Board will also discuss whether it or its predecessor intended a transfer price notion when existing IFRSs refer to the fair value of a liability. If that was not the intention, the Board will discuss whether to exclude the measurement of that particular liability from the scope of an IFRS on fair value measurement.

Market participant view

7 The Board reaffirmed its preliminary view that the market participant view in SFAS 157 is generally consistent with the concepts of knowledgeable, willing parties in an arm's length transaction that are currently in IFRSs.

Reference market

8 The Board tentatively decided that:

a a fair value measurement assumes that the transaction to sell an asset or transfer a liability occurs in the most advantageous market for the asset or liability. The most advantageous market is the market in which the reporting entity would sell the asset or transfer the liability with the price that maximises the amount that would be received to sell the asset or minimises the amount that would be paid to transfer the liability, considering transaction cost and transportation cost in the respective market(s).

b an entity need not undergo an exhaustive search of all possible markets when identifying the most advantageous market. The entity may use the principal market for the asset or liability unless there is evidence that a more advantageous market exists. The principal market is the market with the greatest volume of activity for the asset or liability, provided that the entity would sell the asset or transfer the liability in this market. There is a rebuttable presumption that the principal market is the most advantageous market and that it is the market in which the entity would normally transact.

c when there is not an observable market, an entity should consider the characteristics of market participants with whom the entity would transact to sell an asset or to transfer a liability.

Attributes specific to an asset or liability

9 The Board reaffirmed its preliminary view that it is appropriate to consider attributes specific to the asset or liability that a market participant would consider when pricing

the asset or liability. When location is an attribute of the asset or liability, the price in the principal (or most advantageous) market should be adjusted for costs that would be incurred to transport the asset or liability from its current location to the principal (or most advantageous) market.

10 The Board also tentatively decided that:

a if a restriction on the use or sale of an asset would transfer to market participants, the restriction is an attribute (characteristic) of the asset and affects the fair value of that asset. If a restriction on an asset would not transfer to a market participant buyer, it does not affect the fair value of the asset. The existence of a restriction depends on the characteristics of the asset that the market participant buyer receives, and therefore would pay for, not on the characteristics of the asset in the hands of the existing holder.

b a restriction on the transfer of a liability does not affect the fair value of that liability. The fair value of a liability, unlike an asset, is not a function of marketability, but of performance. A market participant transferee would be obliged to perform and would take that into account when considering the amount that it would demand to assume the liability.

c 'the ability to access' in the definition of a Level 1 input means that the entity can access the market for a restricted asset when the restriction ceases to exist. The entity does not need to be able to sell the asset on the measurement date.

11 The Board also reaffirmed its preliminary view that transaction costs are an attribute of the transaction rather than an attribute of the asset or liability. Thus, they should be considered separately from fair value. This is consistent with current IFRSs.

Highest and best use

12 The Board tentatively decided the following:

a the fair value of an asset should reflect its highest and best use. The highest and best use is the use by market participants that would maximise the value of the asset or of the group of assets in which the asset would be used. It considers uses of the asset that are physically possible, legally permissible and financially feasible at the measurement date. The Board tentatively decided to provide a description of each criterion and an explanation of how they apply in a fair value measurement.

b the exposure draft should state explicitly that an entity does not need to perform an exhaustive search to find other potential uses on which to base the valuation if there is no evidence to suggest that the current use of the asset is not its highest and best use.

c when the highest and best use of an asset that is used together with another asset differs from the asset’s current use, an entity may need to split the fair value of the asset group into components:

i the value of the assets in the asset group assuming their current use and

ii the incremental value reflecting the difference between the value of the assets in their current use and the fair value of the asset group.

13 This difference might arise for asset groups comprising both depreciable and non-depreciable assets. The value of an asset assuming its current use differs from the fair value of the asset in that the current use value does not reflect the asset’s highest and best use. However, it reflects other market participant assumptions.

Valuation premise

14 The Board tentatively decided that:

a a fair value measurement should consider whether market participants would maximise the value of an asset principally through its use in combination with other assets as a group (in-use) or on a stand-alone basis (in-exchange). The exposure draft will explain the valuation premise concept and how it is relevant to an exit price notion.

b the valuation premise and highest and best use concepts are not relevant for liabilities and for financial assets.

c the exposure draft should highlight the fact that an exit price considers a market participant’s ability to generate economic benefit by using an asset or by selling it to a third party. However, the definition of fair value should not refer explicitly to this fact.

d the exposure draft should not replace the terms ‘in-use’ and ‘in-exchange’.

Fair value hierarchy

15 Because IFRSs do not have a consistent hierarchy that applies to all fair value measurements, the Board tentatively decided to introduce a single hierarchy, such as the one in SFAS 157, to reduce complexity and increase comparability.

Fair value at initial recognition

16 The Board tentatively decided that:

a the transaction price is the best evidence of the fair value of an asset or liability at initial recognition unless:

i the transaction is between related parties;

ii the transaction is made under duress or the seller is forced to accept the price in the transaction;

iii the unit of account represented by the transaction price is different from the unit of account for the asset or liability measured at fair value; or

iv the market in which the transaction is made is different from the market in which the reporting entity would sell the asset or transfer the liability.

b if there is evidence that the transaction price does not represent fair value at initial recognition, an entity recognises a day 1 gain or loss, even when the initial fair value measurement is derived using unobservable inputs.

c when an entity recognises a day 1 profit or loss, the entity must disclose:

i the amount of profit or loss recognised at inception for the period and the level in the fair value hierarchy on which the fair value measurement is based;

ii the reason(s) the entity determined that transaction price was not the best evidence of fair value; and

iii information about the entity's price verification procedures and review processes, including the control environment surrounding them.

17 **Follow-up**: As part of the scope assessment to be presented in January 2009, the Board will determine for each IFRS that requires or permits a fair value measurement at initial recognition whether an entity may recognise a day 1 profit or loss.

Liabilities

18 The Board confirmed its preliminary view that the fair value of a liability reflects non-performance risk (including credit standing). The exposure draft will clarify how this conclusion relates to other conclusions in this project that exclude consideration of actions that are not legally permissible.

19 The Board noted that many commentators continue to question whether decision-useful information results from including the effect of non-performance risk in the measurement of a liability. The Board noted that this question is beyond the scope of the fair value measurement project, but instructed the staff to develop a separate document on this topic for public comment.

20 The Board also tentatively decided that the exposure draft will describe what a transfer price represents, including how it relates to a settlement amount with a counterparty. It will also provide guidance on how to measure the fair value of a liability when there is not an observable market price for the liability.

Bid-ask spreads

21 The Board reaffirmed its preliminary view that fair value measurements should be determined using the price within the bid-ask spread that is most representative of fair value in the circumstances.

22 The Board also tentatively decided:

a not to preclude the use of mid-market pricing or another pricing convention as a practical expedient for a fair value measurement within a bid-ask spread.

b to specify that the bid-ask spread guidance applies in all levels of the fair value hierarchy.

c not to include guidance on offsetting positions. This is because the bid-ask pricing guidance allows entities to determine, for each position, the price within the bid-ask spread that is most representative of fair value in the circumstances.

Blockage factors

23 The Board confirmed its preliminary view, as expressed in the discussion papers on *Fair Value Measurements* and *Reducing Complexity in Reporting Financial Instruments*, that the measurement objective should be to measure fair value at the individual instrument level. The Board tentatively decided:

a to exclude blockage factors from a fair value measurement at all levels of the fair value hierarchy.

b that a fair value measurement should exclude other discounts or premia (such as a control premium) that apply to a holding of financial instruments and do not apply to the individual instrument.

Defensive intangible assets

24 The Board tentatively decided to confirm its decision in IFRS 3 *Business Combinations* (as revised in 2008) that an acquirer should, in a business combination, recognise defensive intangible assets and measure them at fair value. Defensive intangible assets are assets that the acquirer does not intend to use directly or does not intend to use in the same way as other market participants.

25 The Board also tentatively decided:

a not to provide explicit guidance on measuring the fair value of such intangible assets. The exposure draft will describe how these intangible assets are identified and the implications of the notions of highest and best use, valuation premise and market participant.

b not to address subsequent accounting for these intangible assets.

c not to require additional disclosures about these intangible assets.

Next steps

26 The staff has begun drafting an exposure draft of an IFRS on fair value measurement.

27 This timing is consistent with the tech plan presented at the January 2009 IASB meeting.