



Project	Fair Value Measurement
Topic	Highest and best use

Purpose of this paper

1. This paper addresses the highest and best use concept in a fair value measurement.
2. This paper asks the boards:
 - (a) to confirm that a fair value measurement of an asset considers the highest and best use of the asset by market participants
 - (b) to provide a description of ‘physically possible’, ‘legally permissible’ and ‘financially feasible’.
3. This paper does not address:
 - (a) the application of the highest and best use concept to financial assets or to liabilities (measuring the fair value of financial instruments is discussed in Agenda Paper 2D (IASB)/3D (FASB))
 - (b) when the current use of an asset by an entity differs from the highest and best use of the asset, which is discussed in Agenda Paper 2B (IASB)/3B (FASB)
 - (c) the valuation premise for non-financial assets, which is discussed in Agenda Paper 2C (IASB)/3C (FASB).
4. The boards have already had detailed technical discussions on this topic in developing the IASB’s exposure draft *Fair Value Measurement* and FASB

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Statement of Financial Accounting Standards No. 157 *Fair Value Measurements* (SFAS 157).¹ As a result, the meeting will focus on analysing the differences between those two documents, the comments received on the IASB's proposals and feedback received about the implementation of the FASB Accounting Standards Codification Topic 820 (Fair Value Measurements and Disclosures). This paper does not replicate the analyses already discussed by the boards in developing the IASB's exposure draft and SFAS 157/Topic 820. Board members should contact the staff for the relevant background materials if needed.

Summary of differences between the IASB's exposure draft and Topic 820

5. Both the IASB's exposure draft and Topic 820 state that a fair value measurement considers the highest and best use of an asset. Both documents describe highest and best use as:

The use by market participants that would maximise the value of the asset or the group of assets within which the asset would be used.

6. The IASB's exposure draft also clarifies the meaning of physically possible, legally permissible and financially feasible in context of highest and best use. Paragraph 17 of the exposure draft states:
 - (a) **physically possible** takes into account the physical characteristics of the asset that market participants would consider when pricing the asset (eg the location or size of a property).
 - (b) **legally permissible** takes into account any legal restrictions on the use of the asset that market participants would consider when pricing the asset (eg the zoning regulations applicable to a property).
 - (c) **financially feasible** takes into account whether a use of the asset that is physically possible and legally permissible generates adequate income

¹ Topic 820 codified SFAS 157.

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or cash flows (taking into consideration the costs of converting the asset to that use) to produce an investment return that market participants would require from an investment in that asset put to that use.

7. In addition to the guidance in Topic 820, the IASB's exposure draft states that an entity does not need to perform an exhaustive search for other potential uses if there is no evidence to suggest that the current use of an asset is not its highest and best use.

Overview of comments received on the IASB's exposure draft

8. The invitation to comment for the IASB's exposure draft asked interested parties whether the proposed guidance for measuring an asset at its highest and best use is appropriate. In particular, it asked whether the fair value of an asset should consider a market participant's ability to generate economic benefit by using the asset or by selling it to another market participant who will use the asset in its highest and best use.
9. The comments received are summarised below.

The highest and best use of an asset by market participants

10. Many respondents agree with the proposal that the fair value of an asset reflects a market participant's ability to generate economic benefit by using the asset in its highest and best use. This is because observed market prices reflect the highest and best use of an asset. Some also note that the highest and best use concept is a standard part of valuation practice for measuring the market-based value (eg fair value) of an asset.
11. Furthermore, many respondents find the descriptions of physically possible, legally permissible and financially feasible in the IASB's exposure draft to be helpful.

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12. However, some respondents disagree with the proposal that a fair value measurement considers the highest and best use of an asset by market participants for the following reasons:
 - (a) they think information about the highest and best use of an asset will be misleading when the entity's current use of the asset differs from its highest and best use. Agenda Paper 2B(IASB)/3B (FASB) describes this situation
 - (b) they are concerned that determining the highest and best use of an asset will be onerous. They are concerned that entities will constantly need to monitor whether their assets might be used differently by market participants
 - (c) they are concerned that the highest and best use concept will result in an overvaluation of assets. These respondents view highest and best use as a hypothetical 'free-for-all' and that entities can pick whatever use they want to justify a higher fair value.
13. Most of these respondents also do not support using fair value as a measurement basis for the types of assets for which this concept is applicable (eg property, plant and equipment) and for which there is not an active market.
14. Some respondents ask for clarification about the following:
 - (a) whether 'legally permissible' relates to what is *currently* legally permissible or to what *is expected to be* legally permissible in the future
 - (b) which costs to convert an asset to an alternative use are to be taken into account when assessing highest and best use
 - (c) how likely an alternative use needs to be for it to be considered the asset's highest and best use (ie can it be 'possible' or must it be 'probable'?).
15. All of the points in paragraph 14 are inter-related and the staff will consider these comments in drafting.

Staff analysis and recommendation

16. At their January 2010 meeting the boards tentatively decided:
 - (a) to define fair value as an exit price
 - (b) to confirm that a fair value measurement reflects market participant views.
17. The highest and best use concept is a consequence of these tentative decisions because market participant buyers will consider how they will use the asset when determining the price they will be willing to pay for the asset. In addition, a seller will seek to sell the asset to the buyer who will pay the best price for the asset, in other words the price that reflects the asset's highest and best use.
18. A quoted market price reflects the highest and best use of any asset because a market participant seller presumably is motivated to maximise the price that it would receive to sell the asset. If there is no quoted price, an entity will need to estimate the market's perception of highest and best use.
19. The staff recommends that a fair value measurement should consider the highest and best use of an asset by market participants.
20. In addition, the staff recommends that a converged fair value measurement standard describes the meaning of 'physically possible', 'legally permissible' and 'financially feasible'.

Question 1 – The highest and best use of an asset by market participants

Do the boards agree with the staff recommendation in paragraph 19?

If not, what do you propose and why?

Question 2 – The meaning of physically possible, legally permissible and financially feasible

Do the boards agree with the staff recommendation in paragraph 20?

If not, what do you propose and why?