Project **Fair Value Measurement**

Topic **Valuation premise for non-financial assets**

Purpose of this paper

1. This paper addresses the valuation premise for non-financial assets in a fair value measurement.

2. This paper does not address the valuation premise for financial assets or for liabilities. Agenda Paper 2D (IASB)/3D (FASB) addresses the valuation of financial instruments.

3. This paper asks the boards:

   (a) to clarify that the in-use valuation premise assumes that an asset within an asset group is sold individually

   (b) to confirm that market participants are assumed to have the complementary assets *and complementary liabilities* necessary to utilise the asset within an asset group

   (c) to consider whether to retain the terms 'in-use' and 'in-exchange'.

4. The boards have already had detailed technical discussions on this topic in developing the IASB's exposure draft *Fair Value Measurement* and FASB Statement of Financial Accounting Standards No. 157 *Fair Value Measurements* (SFAS 157).[1] As a result, the meeting will focus on analysing the differences

[1] Topic 820 codified SFAS 157.

between those two documents, the comments received on the IASB's proposals and feedback received about the implementation of 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 *Fair Value Measurement* 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 the highest and best use of an asset establishes the valuation premise, which may be either in-use or in-exchange.

6. Both documents describe the asset to be:

   (a) 'in-use' if the asset would provide maximum value to market participants principally through its use in combination with other assets and liabilities as a group (as installed or otherwise configured for use)

   (b) 'in-exchange' if the asset would provide maximum value to market participants principally on a stand-alone basis.

7. The in-use valuation premise assumes that market participants will use the asset in combination with other assets or liabilities, and that those assets [and liabilities in the IASB's exposure draft] are available to those market participants. Such assets and liabilities are referred to as 'complementary' assets and liabilities. The IASB extended the concept of 'complementary assets' to liabilities because an asset might be used in combination with other assets or with other assets and liabilities (eg within a division or a business).

8. Assumptions about the highest and best use of the asset shall be consistent for all the assets of the group within which it would be used.

9. The IASB's exposure draft states that both the in-use valuation premise and the in-exchange valuation premise assume that the asset is sold individually, ie not as part of a group of assets or a business. Topic 820 does not explicitly state this,

although the staff believes that the FASB's intent with the guidance in Topic 820 is consistent with the IASB's exposure draft. Paragraphs 14-23 below describe the rationale for the assumption that the asset is sold individually. Neither document provides guidance on the appropriate grouping of assets for determining what is an 'asset group'.

Overview of comments received on the IASB's exposure draft

10. The invitation to comment for the IASB's exposure draft asked interested parties whether the proposed guidance for the in-use and the in-exchange valuation premise is appropriate.

11. Many respondents agree with the proposals and find the further explanation (ie that the asset is sold individually in both valuation premises and that market participants also have 'complementary liabilities') to be helpful.

12. However, some respondents have the following concerns:

    (a) they do not agree with the 'clarification' that the asset is sold individually in the in-use valuation premise because assets typically are sold as a group, not individually

    (b) there is confusion about the terms 'in-use' and 'in-exchange' because both relate to the use of an asset and both are sold in exchange transactions. They suggest using different terminology that better articulates the objective of the valuation premise (and reduces the confusion about the relationship between the in-use valuation premise and value in use in IAS 36 *Impairment of Assets*). Suggested terms include:

In-use	**In-exchange**
'use dependently with other assets'	'use independently'
'measure the asset as part of a group of assets'	'measure asset on a standalone basis'
'in business operations'	'not part of operations'

Staff analysis and recommendation

13. The highest and best use of an asset determines its valuation premise (see Agenda Paper 2A (IASB)/3A (FASB) for a discussion of the highest and best use concept). Because assumptions about the highest and best use of the asset must be consistent for all the assets within the group, they must also have the same valuation premise. For example:

    (a) if the highest and best use of a parcel of commercial land with a factory on it is to convert it to residential land and demolish the factory, the land is in-exchange and the rest of the assets in the asset group must be in-exchange

    (b) if the highest and best use of a parcel of commercial land with a factory on it is the current use, the land is in-use and the rest of the assets in the asset group must be in-use.

Why assume that the asset is sold individually?

14. The IASB's exposure draft proposes that the in-use valuation premise assumes that the entity sells the subject asset (on its own) to a market participant that has the complementary assets and liabilities necessary to manage or operate that asset (that is, they have the rest of the assets in the asset group, and they are just lacking this particular asset).

15. Consider the following example to explain why the IASB included this proposal:

    > An entity operates an oil refinery. One of the asset groups is comprised of 3 assets: a pipe with a machine on both ends of the pipe. The pipe was designed to fit these machines and is not suitable for another purpose. The entity wants to measure the fair value of the pipe.

16. The in-use valuation premise in the IASB's exposure draft would say that the pipe is valued assuming that market participant buyer has the 2 machines necessary to operate the pipe—it does not need to buy the pipe plus the 2 machines. The in-exchange valuation premise is not relevant here because the

value of the pipe standalone is a scrap value. No one would be able to use it without the 2 machines.

17. The in-use valuation premise assumes that the individual asset's value is measured in the context of its use with other assets as a group. Because the market participant buyer has the complementary assets to manage or operate it, the value of the individual asset is the same regardless of whether you consider it as part of a group or on its own.

18. Furthermore, if the market participant buyer buys the entire asset group, it seems that the complementary assets assumption is not necessary because the market participant buyer is buying the complementary assets along with the subject asset.

19. Because the market participant buyer has the necessary complementary assets, it will not pay more for the asset being measured (eg the pipe) because of goodwill or other intangible assets that have been attributed to it (because it already has those assets available to it). However, the market participant might pay for these other assets if it buys a group of assets (because it does not have the other assets in the asset group, including goodwill).

20. In a business combination an entity sells the asset group (business) to a market participant that has the corporate assets necessary to effect the business combination (and the staff thinks that corporate assets are not complementary assets). In a business combination, the market participant buyer would recognise the goodwill and the separately identifiable intangible assets that were part of the asset group. In an actual business combination those are recognised as separate assets via the purchase price allocation. However, IFRS 3 *Business Combinations* (revised in 2008) and FASB Accounting Standards Codification Topic 805 (Business Combinations) require an entity to measure the fair value of each individual asset and liability; it is no longer an allocation of the purchase price.

21. However, if a actual business combination has not actually taken place, the market participant buyer cannot recognise the internally generated goodwill and intangibles (eg trade name or customers) that might be part of the asset group

hypothetically acquired. So if the market participant buyer pays for the asset group, it must not recognise any synergies or other intangibles in the asset group—it can only measure the part of the asset group that relates to the assets that would be recognised.

22. There is a difference between the synergies of the *assets working together* (ie the value of an asset in the context of its operation with other assets in the group) and synergies of the *business* (which give rise to goodwill, eg management know-how related to all asset groups).

23. The difference between in-use and in-exchange is not related to whether the asset's fair value is measured on its own or not, but whether the asset derives value from being used with other assets within a group or not.

24. The staff recommends that a converged fair value measurement standard state that both the in-use valuation premise and the in-exchange valuation premise assume that the asset is sold individually, ie not as part of a group of assets or a business.

Question 1
Do the boards agree with the staff recommendation in paragraph 24? If not, what do you propose and why?

Does a market participant buyer have both the complementary assets and the complementary liabilities?

25. As stated above, the IASB's exposure draft proposes that market participants have the necessary complementary assets and complementary liabilities to operate the asset in the in-use valuation premise. This is because the IASB noted that an asset might be used in combination with other assets or with other assets and liabilities (eg within a division or a business).

26. The staff recommends that the concept of complementary assets be extended so that the in-use valuation premise assumes that market participants also have complementary liabilities.

Question 2
Do the boards agree with the staff recommendation in paragraph 26? If not, what do you propose and why?

Should the terminology be changed?

27. The term ‘in-use’ is well-understood in the valuation of tangible assets such as machinery and equipment. Furthermore, the terms ‘in-use’ and ‘in-exchange’ are now being used practice for those applying Topic 820 (in the US and elsewhere).

28. Although the terms might be confusing to some, it will be difficult to change them now and the suggested terms for replacing them to-date are not improvements.

29. The staff thinks there are two possible approaches.

    (a) **Approach 1:** spend the effort (in a converged fair value measurement standard and in the basis for conclusions, as well as through outreach) explaining what the terms mean rather than changing the terminology. For example, we should make it clear that:

        (i) both the in-use and in-exchange valuation premises assume the asset is ‘used’ (that is, held for some purpose)

        (ii) the in-exchange valuation premise assumes the asset is used on a standalone basis

        (iii) both the in-use and in-exchange valuation premises assume the asset is sold to a market participant who will use the asset in-use or in-exchange.

    (b) **Approach 2:** remove the terms ‘in-use’ and ‘in-exchange’ altogether. Instead, a converged fair value measurement standard would describe the objective. For example:

        In place of the in-use valuation premise:

        The highest and best use of the asset might provide maximum value to market participants principally through its use in

> combination with other assets and liabilities as a group (as installed or otherwise configured for use). If the highest and best use of the asset is to use it in combination with other assets and liabilities as a group, the fair value of the asset is measured on the basis of the price that would be received in a current transaction to sell the asset assuming that the asset would be used with other assets and liabilities as a group and that those assets and liabilities (complementary assets and liabilities) would be available to market participants. Assumptions about the highest and best use of the asset shall be consistent for all of the assets of the group within which it would be used.
>
> *In place of the in-exchange valuation premise:*
>
> The highest and best use of the asset might provide maximum value to market participants principally on a stand-alone basis. If the highest and best use of the asset is to use it on a stand-alone basis, the fair value of the asset is the price that would be received in a current transaction to sell the asset to market participants who would use the asset on a stand-alone basis.

30. Approach 2 more directly achieves the clarifications stated in paragraph 29(a)(i)-(iii).

31. Therefore, the staff recommends Approach 2. That is, a converged fair value measurement standard would describe the objective and would not use the terms ‘in-use’ and ‘in-exchange’.

Question 3
Do the boards agree with the staff recommendation in paragraph 31? If not, what do you propose and why?