Project **Fair Value Measurement**

Topic **Definition of fair value**

Purpose of this paper

1. This paper addresses the definition of fair value as an exit price and also considers whether the term 'fair value' should be replaced with another term that is more precise.

2. This paper asks the boards to:

   (a) reaffirm the definition of fair value as proposed in the IASB's exposure draft *Fair Value Measurement* and as required in FASB Accounting Standards Codification Topic 820 (Fair Value Measurements and Disclosures)

   (b) retain the term 'fair value'.

3. The boards have agreed to work toward publishing converged fair value measurement guidance. Although most of the focus will be on eliminating differences, the IASB needs to discuss some of the fundamental issues proposed in its exposure draft. One of those issues is the definition of fair value. The staff is asking the boards to discuss this topic jointly to ensure that a difference does not arise during the deliberations.

Definition of fair value in the IASB's exposure draft and Topic 820

4. The definition of fair value proposed in the IASB's exposure draft and in Topic 820 is:

> Fair value is 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.

5. The boards have already had detailed technical discussions on this topic in developing the IASB's exposure draft 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 between those two documents, the comments received on the IASB's proposals and feedback received about the implementation of Topic 820. 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.

Overview of comments received on the IASB's exposure draft

6. The invitation to comment for the IASB's exposure draft asked interested parties whether defining fair value as an exit price is appropriate. Furthermore, this topic was discussed at the round-table meetings.

Defining fair value as an exit price

7. Most of the comments received indicated that defining fair value as an exit price is appropriate in some circumstances.

8. However, many respondents question the application of an exit price for some assets and liabilities. Examples of when respondents think fair value (as an exit price) should not be used include the following:

   (a) an entity does not have the intention or the ability to sell the asset or transfer the liability

   (b) markets are not active (whether the market used to be active or has always been inactive)

[1] FASB Accounting Standards Codification Topic 820 codified SFAS 157.

(c) for specialised assets (eg specialised tangible assets) used in the operation of the business

(d) the market to buy an asset or incur a liability is different from the market in which the entity would sell the asset or transfer the liability

The exposure draft and Topic 820 explain how fair value (as an exit price) applies to each of these situations. For example, the guidance addresses the concern in (b) by providing guidance for Level 3 fair value measurements generally and when markets become less active. The guidance also addresses the concern in (c) through the description of the in-use valuation premise and the application of the replacement cost approach.

9. Some respondents think the use of fair value should depend on an entity's business model. That is, if an entity holds an asset that it intends to sell, it should measure that asset at fair value (as an exit price). But if an entity holds the same asset that it intends to hold indefinitely, it should measure that asset at something other than fair value because those respondents think that fair value is not relevant in those circumstances.

Replacing the term 'fair value'

10. Some respondents indicate that the term 'fair value' should be replaced with another term that more explicitly describes the measurement objective. As one respondent stated, narrowing the concept of fair value as a measurement basis means that the boards will need to have more concepts.

11. Given the proposed definition of fair value, many suggest that it be called 'current exit price'. Other suggestions include:

(a) market value (to emphasise that the objective is a market price)

(b) best price

(c) exchange amount or exchange value (to emphasise that it represents an exchange transaction)

(d) current value (to emphasise that it takes into account current conditions and information)

Staff recommendation

12. The staff recommends defining fair value as an exit price. This will result in consistency in application wherever fair value is used as it gives entities a common objective. If all entities have the same objective there will be greater comparability across entities and over time.

13. Furthermore, the exit price definition of fair value acknowledges that an entity can generate cash directly by selling an asset or transferring a liability, or indirectly by using the asset or fulfilling the obligation. As one respondent said, 'Every asset will finally be put to a use other than resale… [and as a result] every market price is finally based on an asset's use other than resale'. In other words, an exit price definition of fair value reflects an asset or liability's use within an entity's business.

14. The staff recommends that any concerns about using an exit price definition of fair value should be addressed in a scope assessment, to be discussed at a future IASB meeting. At this stage, the staff does not plan to ask the FASB to discuss the scope of a fair value measurement standard unless something comes to light indicating that the scope of Topic 820 needs to be changed.

15. The staff also recommends that the boards should retain the term 'fair value' for the following reasons:

    (a) people are used to using that term

    (b) although it might translate poorly in some languages (implying that any other value is 'unfair' although 'fair' in this context simply means unbiased toward either party to the transaction), it does not translate poorly in others

    (c) the emotive nature of an exit price will remain regardless of what it is called (ie those who do not agree with using fair value will still not agree with it even if it is called 'current exit price' or something else)

    (d) the term 'current exit price' is also an umbrella term and the distinction between price and value isn't always understood. For example, net realisable value (a current exit *value*) could be interpreted by some to be a current exit *price*.

Question 1 – Definition of fair value
Do you agree with the staff recommendation to define fair value as an exit price? The definition of fair value would be: ‘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’ If not, what do you propose and why?

Question 2 – Using the term ‘fair value’
Do you agree with the staff recommendation to retain the term ‘fair value’? If not, what do you propose and why?