Project	**Fair Value Measurement**
Topic	**Replacing the term fair value**

Purpose of this paper

1. This paper follows from Agenda Paper 2A, which considers whether 'fair value' should be replaced with another term. This paper is in response to concerns raised about retaining the term 'fair value'.

Background

2. In Agenda Paper 2A, the staff 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*.

3. Some have found those arguments unconvincing. For example:

   (a) an important plain English rule is to avoid jargon or a specialised vocabulary. Using the term 'fair value' when we mean 'current exit price' breaks that fundamental rule.

   (b) the term 'fair value' contributes to confusing definitional and scope issues. Many of the commentators on the IASB's exposure draft arguing for changes in the definition of fair value were really arguing against the use of a current exit price in some circumstances. Replacing the term 'fair value' with 'current exit price' will untangle those two issues.

   (c) the need to define other current measurement bases (eg current entry price) is not a reason not to retain a potentially vague and commonly misunderstood term like fair value.

   (d) although people are used to using the term fair value, they use the term to mean different things, contributing to confusion and misunderstanding. For example, in the concepts project, the boards have decided to discontinue using the long-standing, commonly-used, and commonly misused and misunderstood term 'reliability'.

   (e) confusion between the notions of 'price' and 'value' can be alleviated in the basis for conclusions. The purpose of the basis for conclusions is to explain such differences to facilitate common understanding.

Why the IASB has decided (so far) to retain the term 'fair value' in its fair value measurement project

4. The IASB considered replacing the term fair value with a term that more explicitly describes the measurement objective, eg 'current exit price' in the deliberations leading up to the publication of the IASB's exposure draft *Fair Value Measurement*. The IASB completed a standard-by-standard review to determine whether the intended measurement basis for each use of the term fair value was a current exit price. Some (board members and others) were

concerned that in some cases the IASB or its predecessor might have intended a current entry price measurement objective.

5. The IASB's standard-by-standard review took over six months to complete. The process included the project team's assessment, other project teams' input, director review, external review (including the accounting firms), board advisor review and finally the board discussion.

6. For the standard-by-standard review, the IASB defined current entry price as:

> The price that would be paid to buy an asset or received to incur a liability in an orderly transaction between market participants (including the amount imposed on an entity for incurring a liability) at the measurement date.

7. To the extent that the IASB or its predecessor did not intend a current exit price measurement objective, the IASB considered whether to use the terms 'current exit price' and 'current entry price' in the relevant circumstances. This raised the question of whether the IASB would need to provide measurement guidance for a current entry price as well.

8. After completing the standard-by-standard review, the IASB concluded that a current entry price and a current exit price will be equal when they relate to the same asset or liability on the same date in the same form in the same market.[1] Therefore, the IASB considered it unnecessary to make a distinction between a current entry price and a current exit price in IFRSs with a market-based measurement objective (ie fair value), and decided to define fair value as a current exit price.

9. The staff found during the standard-by-standard review that although people say they would prefer an entry price at initial recognition, they actually prefer the transaction price (or cost), not the market-based current entry price defined above. Because determining whether the transaction price is an appropriate

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[1] The basis for conclusions accompanying the exposure draft notes that some have questioned the assertion that entry and exit prices are equal in those situations, citing bid-ask spreads as a potential difference between entry and exit prices in the same market. In reaching its conclusion, the IASB acknowledged that such a difference could exist but attributed any such difference to transaction costs, which are not included in the price when measuring fair value.

measurement basis was outside the scope of this project, the staff did not address this in the standard-by-standard review or in the scope assessment.

Implications of replacing the term 'fair value'

10. The staff thinks the boards need to consider fully the implications of replacing the term fair value with 'current exit price', 'current exit value' or some other term before making a decision, particularly because the boards are also likely to need to introduce a 'current entry price' in some situations (eg at initial recognition).

11. Although in developing the exposure draft the IASB has concluded that current entry prices and current exit prices will in most cases be the same, in some cases the terminology will be awkward. For example, the business combination standards would state, 'The acquirer shall measure the identifiable assets acquired and the liabilities assumed at their acquisition-date current exit prices'. The boards would need to include a description of why the measurement basis for the acquisition (entry) is an exit price and whose exit price we mean (is it the acquirer's or a market participant's exit price or is it the seller's exit price?).

12. In addition, the boards would need to consider what to do with, for example, the term 'fair value through profit or loss'. Presumably at initial recognition it would be 'current entry price through profit or loss'. For subsequent measurement it would be 'current exit price through profit or loss'. When referring to it generally it would be 'current entry price or current exit price through profit or loss'.

13. The staff thinks that the process for replacing the term 'fair value' would need to consider what the standards would look like if the term 'fair value' never existed. That is, when developing a particular standard, would the IASB/FASB have used 'current entry price' or 'current exit price' instead? The staff thinks it is likely they would have used both.

14. Given that, what would the scope of the fair value measurement project be had the term 'fair value' never existed? The project probably would have entailed

providing guidance for both (and possibly other) current value measurement bases, and a reconciliation between each of them.

15. The staff thinks that the right answer is to replace the term fair value with more descriptive terms. However, the boards need to decide if it should be done in the fair value measurement project. Perhaps this could be done as part of a project that would provide measurement guidance for all current value measurement bases or in the measurement phase of the conceptual framework project.

16. Such an exercise would require the boards to:

    (a) perform a thorough analysis of the use of the term 'fair value' in existing literature,

    (b) determine the appropriate measurement basis for each use (eg an entry notion, an exit notion or something else) and

    (c) develop guidance for new measurement bases (eg 'current entry price').

17. The IASB staff performed (a) in the standard-by-standard review. The standard-by-standard review only considered the intention of the IASB or its predecessor at the time each standard was written. The standard-by-standard review did not question whether an exit price was an appropriate measurement basis for each standard ((b) above) except to the extent that it considered whether the measurement objective in each standard was consistent with the proposed definition of fair value. This was the basis of the scope assessment.