Project **Fair Value Measurement**

Topic **Restrictions on the transfer of a liability**

Purpose of this paper

1. This paper addresses adjustments to reflect a restriction on the transfer of a liability measured at fair value.

2. This paper asks the boards to decide whether the fair value of a liability should be adjusted for the effect of a restriction on its transfer.

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

3. Both the IASB's exposure draft *Fair Value Measurement* and FASB Accounting Standards Codification Topic 820 (Fair Value Measurements and Disclosures) address how to reflect the existence of restrictions on the transfer of liabilities in a fair value measurement.

4. Paragraph 31 of the IASB's exposure draft states:

> A restriction on an entity's ability to transfer a liability to another party does not affect the fair value of the liability because the fair value of a liability is a function of the requirement to fulfil the obligation. A market participant transferee would be required to fulfil the obligation and would take that into account when determining the price it would demand to assume the liability from the entity. [footnote reference omitted]

5. Paragraph BC95 of the basis for conclusions explains the reason for the IASB's decision:

> The [IASB] concluded that a restriction on an entity's ability to transfer a liability does not affect the fair value of the liability. The fair value of a liability, unlike an asset, is not a function of

> marketability, but of performance. A market participant transferee will be required to fulfil the obligation (ie settle the obligation with the counterparty or otherwise fulfil the obligation) and would take that into account when determining the price it would demand to assume the liability from the entity. In other words, the market participant transferee, like the reporting entity, must perform to be relieved of the obligation.

6. Topic 820 also states that an entity does not adjust the fair value of a liability to reflect the existence of a restriction on its transfer, but in a slightly different way. Paragraphs 820-10-35-16E and 16F state:

> When estimating the fair value of a liability, a reporting entity shall not include a separate input or adjustment to other inputs relating to the existence of a restriction that prevents the transfer of the liability (see paragraphs 820-10-55-71 through 55-76). The effect of a restriction that prevents the transfer of a liability is either implicitly or explicitly already included in the other inputs to the fair value measurement. For example, at the transaction date, both the creditor and the obligor are willing to accept the transaction price for the liability with full knowledge that the obligation includes a restriction that prevents its transfer. As a result of the restriction already being included in the transaction price, a separate input or adjustment to an existing input into the fair value measurement of a liability is not required at the transaction date to reflect the effect of the restriction on transfer. Additionally, a separate input or adjustment to other inputs into the fair value measurement of a liability is not required at subsequent measurement dates to reflect the effect of the restriction on transfer.
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> In addition, there are two fundamental differences between the fair value measurement of an asset and a liability that justify different treatments for asset restrictions and for liability restrictions. First, restrictions on the transfer of a liability relate to performance under the obligation (that is, the reporting entity is legally obligated to satisfy the obligation and needs to do something to be relieved of the obligation), whereas restrictions on the transfer of an asset relate to the marketability of the asset. Second, virtually all liabilities include a restriction preventing the transfer of the liability, whereas most assets do not include a similar restriction. As a result, the effect of a restriction preventing the transfer of a liability would, theoretically, be consistent for all liabilities. However, the inclusion of a restriction preventing the sale of the asset typically results in a lower fair value for the restricted asset versus the nonrestricted asset, all other factors being equal.

Overview of comments received on the IASB's exposure draft

7. The invitation to comment for the IASB's exposure draft asked interested parties whether the proposed guidance for measuring the fair value of liabilities is appropriate. In particular, it asked whether the fair value of a liability would be affected by a restriction on an entity's ability to transfer the liability.

8. Some respondents agree with the conclusion that a restriction on the ability of the entity to transfer a liability would not affect the fair value of that liability because a market participant transferee, like the reporting entity, would have to perform or otherwise fulfil the obligation.

9. However, many respondents find the proposal unclear because it states that a restriction on an entity's ability to transfer a liability *does not affect* the fair value of the liability. They think the guidance should state that the value of a liability would be influenced by the existence of a restriction on its transfer and they prefer the wording in Topic 820 (see paragraph 6 above) because they think it better articulates the principle and think it would increase consistency in practice.

10. Some think restrictions on the transfer of a liability indicate that liabilities should not be measured at fair value, but rather at a settlement or fulfilment value.[1]

Staff recommendation

11. The staff recommends that the converged fair value measurement standard state that the fair value of a liability should not be adjusted for the effect of a restriction on its transfer for the reasons stated in Topic 820 and proposed in the IASB's exposure draft. This is because:

    (a) a market participant transferee would be required to fulfil the obligation and would take that into account when determining the price it would demand to assume the liability

[1] This is a 'when' issue and is outside the scope of this project. Agenda Paper 2G addresses the transfer notion for measuring the fair value of liabilities.

(b) the effect of a restriction is either implicitly or explicitly already included in the other inputs to the fair value measurement (at initial recognition and for subsequent measurement)

(c) the effect of a restriction preventing the transfer of a liability would, theoretically, be consistent for all liabilities.

12. If the boards agree with the staff recommendation, we will address the differences in wording in drafting.

Question 1 – Restrictions on transfer in a fair value measurement
Do you agree with the staff recommendation that the fair value of a liability should not be adjusted for the effect of a restriction on its transfer? If not, what do you propose and why?