IFRS
FASB

IASB/FASB Joint Meeting
Week commencing 14 March 2011

IASB Agenda reference **2A**

FASB Agenda reference **28A**

Staff Paper

Project	**Fair value measurement**
Topic	**Effective date of an IFRS on fair value measurement**

Purpose of this paper

1. At its 2 March meeting, the IASB decided to assess the effective date and transition methods for fair value measurement separately from the other major projects identified in the Request for Views *Effective Date and Transition Methods* (see Agenda Paper 3C for that meeting).

2. Consequently, this paper asks the IASB to determine:

   (a) the effective date of an IFRS on fair value measurement; and

   (b) whether to permit early application of the IFRS.

3. The staff will not be asking the Board to discuss the transition requirements for an IFRS on fair value measurement. The Board received very few comments on the proposed transition requirements and the comments received were supportive of the proposal (including the comments received on the Request for Views). Appendix 1 contains the transition requirements proposed in the exposure draft *Fair Value Measurement*.

Summary of the proposals

4. The exposure draft proposed permitting early application of the IFRS on fair value measurement. It did not propose an effective date. The exposure draft stated:

> 62 A entity shall apply this [draft] IFRS for annual periods beginning on or after [date to be inserted after exposure]. Earlier application is permitted. If an entity applies the [draft] IFRS for an earlier period, it shall disclose that fact.

Overview of comments received

5. This section summarises the comments received on the exposure draft. Agenda Paper 3B from the 2 March 2011 meeting summarises the comments received on the Request for Views.

6. Although the exposure draft did not specifically seek comments on this issue, a few respondents commented on the proposal to permit early application or provided input on the effective date for the IFRS on fair value measurement.

7. For example, one respondent suggested that the effective date should allow enough time to assess any practical issues that might arise in measuring the fair value of non-financial assets and liabilities.

8. In the staff's discussions with entities in emerging and transition economies, those entities suggested that the effective date should allow enough time so that they can put the necessary systems in place to measure fair value and to capture the information necessary to provide the related disclosures.

Staff analysis and recommendation

9. The IFRS on fair value measurement will be a major new standard. However, it will not require any new fair value measurements and it will not fundamentally change many of the requirements for measuring fair value or for disclosing

information about fair value measurements. In many respects, the new IFRS will use different words to articulate the concepts already present in IFRSs today.

10. In addition, it is possible that some may inadvertently start applying the revised fair value measurement concepts before the standard is effective because:

    (a) The FASB published Statement of Financial Accounting Standards No. 157 *Fair Value Measurements* (SFAS 157) (now in Topic 820) in 2006. Because SFAS 157 has been in the public domain for many years now and has formed the basis for the IASB's discussions about fair value measurement, many people refer to its requirements when describing fair value, even under IFRSs.

    (b) IFRS 7 *Financial Instruments: Disclosures* uses terminology that was introduced by SFAS 157.

11. The following sections analyse the measurement and disclosure changes to current IFRSs.

Measurement

12. The following guidance already exists in some form in IFRSs:

    (a) the description of 'knowledgeable, willing parties in an arm's length transaction' is similar to the new definition of market participants and how they enter into transactions;

    (b) the description of an active market uses different words but is not expected to change the determination of whether a market is active;

    (c) potential valuation techniques (eg the market, income and cost approaches) will be the same, but will be articulated consistently in the new standard;

    (d) the requirement to maximise the use of observable inputs and minimise the use of unobservable inputs when measuring fair value will remain unchanged;

(e) the requirement to consider the characteristics of an asset or a liability when measuring its fair value is sometimes implicit in IFRSs today, and will be explicit in the new standard;

(f) the ability to measure the fair value of financial instruments on a net basis when there are offsetting market risks is permitted in IFRSs today, although that practice will be articulated differently in the new standard;

(g) the requirement that fair value reflects the highest and best use of an asset is implicit in IFRSs today, and will be explicit in the new standard;

(h) the treatment of transaction costs in a fair value measurement will be unchanged;

(i) the inclusion of transport costs in a fair value measurement will be unchanged; and

(j) the concept of defensive value for assets acquired in a business combination is in IFRSs today, and the new standard will provide additional guidance for measuring defensive value.

13. Clearly the biggest difference relates to the definition of fair value as an exit price rather than as a neutral exchange amount. However, the Board has concluded that in many cases there will not be a difference in the resulting fair value measurement when the transaction to buy and to sell an asset or to settle or to transfer a liability would take place in the same market.

14. Furthermore, in the project to amend IFRS 3 *Business Combinations*, the Board asked valuation practitioners to assess where there might be differences in fair value if fair value were to be defined as an exit price rather than as a neutral exchange amount. Those valuation practitioners found that for most assets acquired in a business combination, they would reach the same conclusion about fair value. However, the case study did not encompass all assets and liabilities

that could exist in a business combination. The valuation practitioners indicated that there might be a difference in fair value under each definition for:

(a) liabilities when there is a difference between the amount to settle with the counterparty and the amount to transfer to a third party; and

(b) assets for which there is a defensive value.

See IFRS 3.BC246–BC251.

15. There could also be the following differences:

(a) differences from referring to the principal market for an asset or a liability (or in the absence of a principal market, the most advantageous market). IFRSs are not consistent when referring to the market on which to base a fair value measurement. For example, IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 9 *Financial Instruments* refer to the most advantageous market, whereas IAS 41 *Agriculture* refers to the most relevant active market (the market in which the entity expects to enter into transactions). Many other IFRSs do not refer to any particular market.

(b) differences in the bid-ask spread guidance. IAS 39 requires the use of bid prices for assets and ask prices for liabilities. The fair value measurement standard will state that an entity is to select the point within the bid-ask spread that best represents fair value in the circumstances. If an entity selects a point other than the bid price for assets or the ask price for liabilities under the fair value measurement standard, there could be a difference in fair value.

Disclosure

16. With respect to disclosures, entities must already provide information about fair value measurements, such as:

(a) the methods and significant assumptions used in the measurement; and

(b) whether the measurement was determined by reference to observable prices or recent market transactions.

17. In addition, many standards already require a reconciliation from opening to closing balances for all fair value measurements, not only for those that are categorised within Level 3 of the fair value hierarchy. A few standards also require information about the sensitivity of the measurement to changes in significant inputs.

18. The biggest change with respect to disclosures (for non-financial assets and liabilities) will result from applying the fair value hierarchy. That change only relates to non-financial assets and liabilities because the Board amended IFRS 7 in March 2009 to introduce a three-level fair value hierarchy and to require more detailed information about fair value measurements categorised within Level 3 of the fair value hierarchy. Furthermore, paragraph 27 of IFRS 7 requires an entity to disclose the assumptions applied in measuring fair values of each class of financial instruments, which is consistent with the quantitative disclosure of significant inputs used in Level 3 fair value measurements.

FASB approach to effective date in SFAS 157

19. The FASB issued SFAS 157 in September 2006. For financial assets and liabilities, SFAS 157 became effective for financial statements issued for fiscal years beginning after 15 November 2007 (approximately 14 months after publication). For non-financial assets and liabilities, the FASB delayed the effective date by one year, giving entities just over two years to apply the new requirements.

20. Agenda Paper 2B (FASB agenda paper 28B) addresses the effective date of the amendments to Topic 820 resulting from the joint fair value measurement project.

Staff recommendation

21. The staff recommends that:

(a) the effective date of an IFRS on fair value measurement should be **1 January 2013**, which is nearly two years after the date when the standard will be issued (which is expected to be in April 2011). This would give entities (including those in emerging and transition economies) time to analyse the requirements and to make any necessary systems changes.

(b) early application should be permitted, in conformity with the proposal in the exposure draft. This would allow entities to apply the measurement and disclosure requirements as soon as practicable, thereby improving comparability in measurement and transparency in disclosures. This would also improve comparability with entities applying US GAAP.

Question 1
Does the IASB agree with the staff recommendations in paragraph 21? If not, what do you propose and why?

Appendix 1

1. The exposure draft *Fair Value Measurement* proposed the following transition requirements:

> 63 This [draft] IFRS shall be applied prospectively as of the beginning of the annual period in which it is initially applied.
>
> 64 The disclosure requirements of this [draft] IFRS need not be applied in comparative information provided for periods before initial application of the [draft] IFRS.

2. Those proposals are consistent with those required by SFAS 157.