Staff Paper

Project	**Fair Value Measurement**
Topic	**Transition Method and Effective Date**

Purpose of This Paper

1. This paper addresses the transition method and effective date for amendments to the guidance in Topic 820, Fair Value Measurements and Disclosures. Specifically, this paper asks the Board to determine:

    (a) The transition method for amendments to the measurement of fair value

    (b) The transition method for amendments to the disclosures of fair value measurements

    (c) Whether to include additional transition guidance

    (d) The effective date

    (e) Whether to permit early adoption of the amendments.

2. In October 2010, the FASB issued a Discussion Paper, *Effective Dates and Transition Methods*, to solicit information from constituents about the time and effort that will be required to implement anticipated new accounting and reporting guidance and when that guidance should become effective. Paragraph 4 of that Discussion Paper reads as follows:

> The FASB plans to make several targeted improvements to U.S. GAAP over the next year (fair value measurements and disclosure, for example). Those new requirements will include transition provisions and effective dates based on the FASB's assessment of them on a stand-alone basis. The FASB may reconsider and amend those decisions in light of the feedback it receives on this Discussion Paper.

3. At its March 2, 2011 meeting, the FASB tentatively decided to assess the effective date and transition methods for the fair value measurement project separately from the other major projects identified in the Discussion Paper.

Summary of the Transition Proposals

4. Proposed Accounting Standards Update, *Fair Value Measurements and Disclosures (Topic 820): Amendments for Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*, states that the proposed amendments would be effective at the beginning of the period of adoption. A reporting entity would recognize a cumulative-effect adjustment in beginning retained earnings in the period of adoption if, in a fair value measurement, a difference of an item recorded at fair value as a result of applying the amendments in the proposed Update (that is, a limited retrospective transition) exists. A reporting entity would be required to provide additional proposed disclosures upon adoption (that is, prospectively).

5. In deliberating the proposed Update, the Board rejected other transition methods, such as full retrospective transition. Retrospective transition methods provide the most useful information; however, the Board concluded that full retrospective application would be impracticable to apply for some of the amendments in the proposed Update because reporting entities would be required to take into account with hindsight what inputs would have been appropriate in prior periods. The Board concluded that it would be difficult for some reporting entities to make such restatements and that the benefits would not justify the costs.

6. As proposed, the amendments that the Board believes would change a particular principle or requirement for measuring fair value or disclosing information about fair value measurements will include a link to the transition guidance in the final Update. Amendments that are insignificant in nature and that the Board believes would not change practice will not be linked to the transition guidance and will become effective immediately upon the issuance of a final Update.

Overview of Comments Received

Transition

7. The Questions for Respondents accompanying the proposed Update asked constituents whether they agreed that limited retrospective transition should be required for the proposed amendments.

8. Nearly all respondents agreed that the proposed amendments would not result in a significant change in current practice. Many respondents agreed that limited retrospective transition would be appropriate and noted that full retrospective adoption would be impracticable. Some constituents noted that a cumulative-effect adjustment to beginning retained earnings in the year of adoption would provide transparency of the effect of the amendments on the reporting entity.

9. Some respondents did not agree with the proposed guidance for limited retrospective transition. Those respondents noted that prospective transition is more consistent with prior transition guidance for fair value measurements in U.S. GAAP. A few respondents suggested that any adjustments required as a result of the proposed amendments should be considered a change in accounting estimate within the associated valuation techniques and treated as such in the period of initial adoption (that is, prospective transition and no cumulative adjustment to opening retained earnings).

10. The proposed Update did not include a link to the transition guidance for the proposed amendments that the Board believes would not change current practice. The Questions for Respondents also asked constituents to identify proposed amendments that should be linked to transition guidance (if not already).

11. Most constituents agreed with the proposed amendments that the Board believes would not change practice and did not suggest any additional amendments that should be linked to the transition guidance. However, a few constituents noted that while the proposed amendments are consistent with current practice, the following paragraph should be linked to the transition guidance:

820-10-30-6 If another Topic requires or permits a reporting entity to measure an asset or a liability initially at fair value and the transaction price differs from fair value, the reporting entity shall recognize the resulting gain or loss in earnings unless that Topic specifies otherwise.

12. For paragraph 820-10-30-6, one constituent noted that Topic 820, as currently written, is clear in stating that the transaction price does not necessarily equal fair value at initial recognition, but does not explicitly address how to account for any differences. That constituent proposes linking paragraph 820-10-30-6 to the transition guidance because that paragraph clearly states that any difference between the transaction price and fair value should be recognized as a gain or loss in earnings (unless another Topic specifies otherwise).

Effective Date

13. The Questions for Respondents in the proposed Update asked constituents how much time would be needed to prepare for and implement the amendments.

14. Most respondents noted that except for the measurement uncertainty analysis disclosure, the proposed amendments would not take a significant amount of time to implement because they agreed with the Board that the proposed amendments would not represent a significant change in current practice. Most respondents noted that, if the measurement uncertainty analysis disclosure (as proposed) would be required, they would need at least one year from the issuance of a final Update to prepare for and implement the amendments. Some respondents suggested that the proposed amendments should be effective at the first period beginning after the final Update is issued if the measurement uncertainty analysis disclosure is not included. A few respondents suggested a period of six months to prepare for and implement the amendments.

15. A few respondents suggested that significant time may be needed to implement the proposed amendments. However, those respondents also stated that the proposed amendments would result in a significant change to current practice.

16. Many respondents suggested aligning the effective date for the final Update on fair value measurements with the effective date for the final Update on financial instruments because the measurement uncertainty analysis would not be required for certain assets, as stated in the proposed Update, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*. As part of its redeliberations, the Board has tentatively rejected the proposed measurement uncertainty analysis disclosure. The disclosure requirements that were tentatively added as a result of the redeliberations on that uncertainty analysis disclosure are currently not linked to any other of the FASB's pending Updates.

Considerations for Nonpublic Entities

17. The Questions for Respondents in the proposed Update asked constituents whether any of the proposed amendments should be different for nonpublic entities.

18. In general, respondents stated that the proposed amendments related to the application of the principles and concepts of fair value measurement should not be different between nonpublic entities and public entities. Differences in the definition of fair value or the considerations made in measuring fair value may, in fact, lead to what are ultimately different measurement bases with inconsistent information for users. On the other hand, the Board did consider the different needs of users of nonpublic entity financial statements when making its decisions on disclosure requirements for certain fair value measurements. Some respondents noted that the proposed amendments should not apply to nonpublic entities, but those respondents' concerns were primarily related to the cost of implementing the proposed measurement uncertainty analysis disclosure or the question of *when* fair value should be used as opposed to *how* fair value should be measured. Outside of the context of the proposed measurement uncertainty analysis disclosure, significant concerns about the effective date were not raised.

Staff Analysis and Recommendation

19. Similar to most respondents, the staff thinks that the proposed amendments will not result in a significant change in the application of the guidance in Topic 820. If adjustments to fair value measurements do result from the proposed amendments, the staff thinks that the potential that these adjustments are any more significant than the adjustments made for prior FSPs or Accounting Standards Updates is small. Appendix A shows the amendments issued for Statement 157 and Topic 820 and the transition methods for each. Historically, changes resulting from updates to the guidance for fair value measurements have been treated prospectively as changes in accounting estimate. Although there was not pervasive opposition from respondents to the limited retrospective transition method in the proposed Update, the staff thinks that the prospective transition method that has been used in almost all other amendments to fair value measurement guidance in the past is similarly appropriate for the guidance in the final Update.

Certain Disclosures about Fair Value Measurements Classified within Level 3 of the Fair Value Hierarchy

20. In the proposed Update, the measurement uncertainty analysis disclosure would be required for all Level 3 fair value measurements unless another Topic specifies that such a disclosure would not be required for a specific asset or liability. However, the Board tentatively decided not to require the measurement uncertainty analysis disclosure (as proposed). Instead, the Board tentatively decided to require the following information about Level 3 fair value measurements:

    (a) A quantitative disclosure of the unobservable inputs and assumptions used in the measurement

    (b) A description of the valuation processes in place

(c) A discussion of the sensitivity of the fair value to changes in unobservable inputs and any interrelationships between those inputs that magnify or mitigate the effect on the measurement.

21. Each of the disclosures listed in paragraph 20 represent new disclosure requirements. Although they generally reflect information that is likely to be currently available to reporting entities, the refinement and assimilation of that data into financial statements may require time. Specifically, with respect to the disclosure requirements described in subparagraphs 20(a) and 20(c), a reporting entity may have to revisit its determination of class of assets or liabilities and develop systems to efficiently capture the required information. Therefore, the staff thinks that additional time may be required to implement those new disclosure requirements.

22. The new disclosure requirement described in subparagraph 20(b) is intended to convey information about the valuation process used by the reporting entity for fair value measurements that are categorized within Level 3 of the fair value hierarchy. The staff thinks that this additional requirement to provide a narrative disclosure about a reporting entity's valuation process would not necessitate additional time to implement in excess of the effective date for the overall Update.

Considerations for Nonpublic Entities

23. The staff expects a final Update to be issued in April 2011 and understands that the typical education cycle for new accounting guidance for nonpublic entities occurs in the late summer or early fall. The staff thinks that there is sufficient time to incorporate materials about the incremental changes to Topic 820 into the curriculum of those fall training sessions so that the amendments can be understood and implemented during the first calendar quarter of 2012. The staff further thinks that nonpublic entities, and public entities alike, should have an extended amount of time to prepare for certain amendments to Topic 820 related to specific new disclosure requirements. However, some staff members think that the effective date should be the same for all of the disclosures described in

paragraph 20 of this memo, rather than just those in subparagraphs 20(a) and 20(c).

Staff Recommendation

24. The staff recommends that the amendments to Topic 820 be applied prospectively as of the beginning of the fiscal year in which the guidance is initially applied and that revisions resulting from a change in valuation technique or its application should be accounted for as a change in accounting estimate.

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

25. The staff recommends that prospective application of the disclosures should be required in the final Update.

Question 2
Do you agree with the staff recommendation in paragraph 25? If not, what do you propose and why?

26. The staff does not think that a significant change in current practice would result from the application of paragraph 820-10-30-6 and recommends no additional transition guidance in the final Update.

Question 3
Do you agree with the staff recommendation in paragraph 26? If not, what do you propose and why?

27. The staff recommends that the guidance in the final Update should be effective for public and non-public entities for fiscal years beginning on or after December 15, 2011, subject to the exception discussed in Question 5, below.

Question 4
Do you agree with the staff recommendation in paragraph 27? If not, what do you propose and why?

28. The majority of staff members recommend that for all entities disclosures (a) and (c) in paragraph 20 be effective for interim and annual periods ending on or after December 15, 2012 while disclosure (b) in paragraph 20 would be effective for years beginning after December 15, 2011 including interim disclosures within those years. Those who support this recommendation accept the argument that for disclosures (a) and (c) a reporting entity may have to revisit its determination of class of assets or liabilities and develop systems to efficiently capture the required information justifying the later effective date. However, they believe it would not require significant time or effort to disclose item (b) since the entity is putting into words the processes that it is currently following.

29. Other staff recommend that for non-public entities all three new disclosures should be effective at the same time; for annual periods ending on or after December 15, 2012 and for interim and annual periods thereafter. The primary reason they support the first annual period is because of how many non-public entities learn and apply new standards. For interim reporting, entities often follow the disclosures that were included in the previous year end's audited financial statements. Many small to mid sized private companies do not have the internal resources to learn about and adopt a standard for the first time for interim financial statements.

Question 5
Which recommendation do you support or is there another alternative the staff should pursue?

30. The staff recommends permitting early adoption of the guidance in the final Update.

Question 6
Do you agree with the staff recommendation in paragraph 30? If not, what do you propose and why?

Appendix A

Amendments to Fair Value Measurement Guidance	
FSP/Codification Update	**Transition Method**
FSP FAS 157-1, *Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13*	Full retrospective
FSP FAS 157-2, *Effective Date of FASB Statement No. 157*	Prospective
FSP FAS 157-3, *Determining Fair Value of a Financial Asset When the Market for That Asset Is Not Active*	Prospective
FSP FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*	Prospective with disclosure of change, if any
Update No.2009-05, *Fair Value Measurements and Disclosures (Topic 820): Measuring Liabilities at Fair Value*	Prospective with disclosure of change, if any
Update No. 2009-12, *Fair Value Measurements and Disclosures (Topic 820): Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*	Prospective with disclosure of change, if any
Update No. 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements*	Prospective