

IASB staff draft on fair value measurement

What you need to know

- ▶ The staff draft is for information purposes only. The IASB is not seeking comments.
- ▶ Our *Supplement to IFRS outlook issue 43: Fair value measurement – proposals for a new standard* provides background on the proposed *Fair Value Measurement* standard (the May 2009 ED) and can be found at www.ey.com/ifrs.
- ▶ Additional information about the FASB's Proposed Update can be found in our *Hot Topic: FASB proposes amendments to converge fair value guidance* available at www.ey.com/us.
- ▶ Additional information about the IASB's June 2010 ED can be found in our *Supplement to IFRS outlook issue 77: Limited re-exposure of fair value measurement disclosures* at www.ey.com/ifrs.

The International Accounting Standards Board (IASB) posted a staff draft (the staff draft) of the proposed standard *Fair Value Measurement* to its website on 19 August 2010. The proposed standard *Fair Value Measurement* will establish a single source of guidance for all fair value measurements, when fair value is required or permitted by IFRS. The staff draft reflects the tentative decisions to date of the US Financial Accounting Standards Board (FASB) and the IASB (the Boards) regarding how to measure fair value. As described below, this staff draft might be useful for those IFRS constituents wishing to interact with the IASB on the proposed *Fair Value Measurement* standard, or those planning for their eventual adoption of the standard when it is issued.

How does this working draft fit into the joint project on *Fair Value Measurement*?

This staff draft is a part of the IASB's *Fair Value Measurement* project to provide a single source of guidance on **how** to measure fair value, when fair value is required or permitted by IFRS. One of the IASB's objectives for issuing this proposed IFRS is to reduce complexity and improve consistency in application when measuring fair value. As part of this project, the IASB also hopes to enhance disclosures about fair value to help users assess the valuation techniques and inputs used to measure fair value. The IASB's proposals do not change **when** an entity is required to use fair value.

The IASB also hopes to increase convergence with US GAAP. The *Fair Value Measurement* project is included in the Memorandum of Understanding between the Boards. In 2006, the FASB issued its fair value guidance and in May 2009, the IASB issued its exposure draft *Fair Value Measurement* (the May 2009 ED). Although the May 2009 ED was largely consistent with US GAAP, certain IASB proposals differed from US GAAP, where the IASB felt its changes would improve upon existing guidance.

In their comments on the May 2009 ED, many constituents stressed the importance of converged guidance for measuring fair value. In October 2009, the IASB and FASB agreed to develop common guidance on how to measure fair value and the related disclosure requirements, when IFRS or US GAAP (as applicable) requires or permits such measurement. As a result, in June 2010, the IASB issued a limited re-exposure draft *Measurement Uncertainty Analysis Disclosure for Fair Value Measurements* (the June 2010 ED). In June 2010, the FASB issued an exposure draft of a proposed Accounting Standards Update *Amendments for Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRS* (the Proposed Update) that is intended to converge US GAAP with IFRS.

The staff draft is for information purposes only. The IASB is not seeking comments thereon. This staff draft reflects all of the tentative decisions to date resulting from the Boards' deliberations following the issuance of the IASB's May 2009 ED, including those tentative decisions that are included in the FASB's Proposed Update, and the tentative decisions proposed in the IASB's June 2010 ED. Together the Boards will consider the responses to the FASB's Proposed Update, which is nearly identical to this staff draft. The FASB will accept comments on its Proposed Update from IFRS constituents (which should be submitted by 7 September 2010). The Boards expect to issue a common fair value measurement standard in early 2011.

2006	2007	2008	2009	2010	2011
<p>September 2006 FASB issued SFAS 157 (now codified in ASC 820 <i>Fair Value Measurements and Disclosures</i>)</p> <p>November 2006 IASB published discussion paper (using SFAS 157 as starting point)</p>		<p>October 2008 Expert Advisory Panel report published (Measuring and disclosing the fair value of financial instruments in markets that are no longer active)</p>	<p>May 2009 IASB published exposure draft</p> <p>November – December 2009 IASB roundtable meetings</p>	<p>June 2010 FASB published Proposed Update and IASB published limited re-exposure draft</p> <p>September 2010 Comment periods end</p> <p>October 2010 – January 2011 Redeliberation</p>	<p>Early 2011 IASB and FASB plan to issue common IFRS and US GAAP fair value measurement standards</p> <p>IASB plans to publish educational material</p>

How does this working draft compare to current IFRS and the May 2009 ED?

The IASB believes that most of the tentative decisions included in this staff draft are consistent either with the proposals in the May 2009 ED, or with current requirements in IFRS. Therefore, the IASB decided that it was unnecessary to re-expose the full contents of the proposed standard.

However, the IASB concluded that a limited re-exposure was necessary with respect to the measurement uncertainty analysis disclosures, which resulted in the issuance of the June 2010 ED. The measurement uncertainty disclosures proposed in the June 2010 ED are reflected in this staff draft.

Is US GAAP converging with IFRS?

The FASB's Proposed Update includes amendments to clarify the existing principles in US GAAP to make the converged guidance more understandable to constituents (particularly to those constituents that would be applying this guidance for the first time). The main areas that the FASB proposes to add or clarify are:

- ▶ The concepts of 'highest and best use' and 'valuation premise' are relevant only for non-financial assets
- ▶ The criteria that must be met for an entity to use a 'portfolio approach' to measure the fair value of financial assets and liabilities
- ▶ The guidance for measuring the fair value of an instrument classified within shareholders' equity
- ▶ The circumstances in which a premium or discount could be applied when measuring fair value and the prohibition against applying a blockage factor
- ▶ The objective of a fair value measurement is to determine the price for a sale of the individual asset that is being measured (based on its unit of account), regardless of whether the asset or liability is used by itself or together with other assets

- ▶ The concepts related to determining the principal market
- ▶ The measurement uncertainty disclosures

Even though one of the objectives of this joint project is to converge IFRS and US GAAP on **how** to measure fair value when that measurement is required, certain differences between IFRS and US GAAP related to fair value will remain even after the Boards' respective standards are finalised.

For example, the Boards decided not to address the issue of recognising 'day one gains and losses,' because they believe this is an issue of 'when' and not 'how' to measure fair value. It is hoped that this issue will be discussed as part of the Boards' projects on financial instruments.

The IASB also decided against providing a practical expedient to measure certain investments at net asset value (NAV). Given that IFRS does not currently have accounting requirements that are specific to investment companies and there are different practices for calculating NAV globally, the IASB determined it would be difficult to prescribe the circumstances under which such a practical expedient could be applied.

In addition, other differences remain between US GAAP and IFRS on **when** to use fair value.

When and how would the proposals become effective?

No effective date has yet been proposed for this standard. The Boards indicated that they expect to issue a common fair value measurement standard in early 2011.

The new standard would be applied prospectively, and new disclosures required would only be provided for periods beginning after the effective date. Comparative disclosures for periods prior to the effective date would not be required.

What is the business impact?

For financial instruments, the proposals in the staff draft are generally consistent with the existing requirements of IFRS and the guidance issued by the Expert Advisory Panel. However, the extension of the disclosure requirements to financial assets for which fair value is only disclosed (but which are not measured at fair value in the statement of financial position), and to non-financial assets and liabilities measured at fair value (e.g., some investment property measured at fair value, some biological assets) might result in significant changes to processes and procedures for determining fair value, and providing the required disclosures.

In addition, while the requirement to determine fair value by reference to market participants is not new, the specific requirements relating to highest and best use, and the principal market, may require companies to re-evaluate their processes and procedures for determining fair value. Entities that maintain portfolios of financial instruments will also need to carefully consider the proposed requirements of the new standard, and how these proposals may affect the entity's current practice for measuring fair value of such financial instruments.

In addition, the requirement to consider the correlation between unobservable inputs when assessing whether different unobservable inputs would have significantly changed fair value might require management to re-evaluate the processes and procedures for determining fair value and the information that is accumulated for disclosures. If adopted as proposed, management will need to determine which unobservable inputs are correlated with each other and the effect of that correlation on fair value.

Comments are due on both the FASB's Proposed Update and the IASB's June 2010 ED by 7 September 2010.

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