IASB Fair Value Measurements
Roundtable Summary

On November 2, 2009, the IASB held a roundtable at the FASB offices in Norwalk, CT to discuss its Fair Value Measurements exposure draft (ED). Roundtable participants consisted of a cross-section of representatives including auditors, financial statement preparers, valuation experts and industry. The notes below represent the roundtable observers' interpretations of the discussions.

The following issues were identified by the IASB staff for discussion during the roundtable:

Issue A –Fair value as an exit price
Issue B – Fair value of liabilities
Issue C – Fair value of non-financial assets and liabilities
Issue D – Fair value in inactive markets
Issue E – Fair value in emerging and transition economies
Issue F – Jurisdiction-specific issues
Issue G – US GAAP convergence

Due to time constraints, issues E and F were not discussed at this roundtable.

<u>Issue A- Fair value as an exit price</u>

When does a market-based exit price not reflect the present value of the expected future cash inflows and outflows from an asset or a liability?

For Issue A, the IASB staff began the discussion by indicating to roundtable participants the need to stay focused on the fact that the ED is centered around "how" to measure an asset or liability at fair value and not "when" to measure it.

Views expressed by participants relative to Issue A are summarized as follows:

- A participant indicated that a market-based exit price is relevant when markets are active. However, the participant questioned whether the measurement remains appropriate when markets are inactive and asserted that it is difficult to separate the "when" to measure question from the "how" to, especially when dealing with inactive markets. It was suggested that more debate needs to occur within the conceptual framework relative to inactive markets. Another participant questioned how an entity can get to a "market participant" view in an inactive market. In response to the challenges identified, certain participants responded that in the case of an inactive market, more significant judgments simply must be applied. It was noted that private equity has had to apply these types of judgments for some time now. Additionally, as it relates to disclosure, a participant (a preparer) found it interesting that disclosure rules do not specifically require that an entity declare that a market has been deemed inactive in determining the fair value.

- A participant suggested that a market-based exit price is relevant but may not be reflective of fair value when the asset is being used differently compared to how a market participant would use it. A discussion ensued regarding the assessment of the entity's own intent for the asset or liability.

Certain participants and the IASB staff emphasized that an entity's intent should not weigh into the determination of the fair value measurement.

- One participant indicated that while fair value as an exit notion is a sound foundation, in building the structure for the conceptual framework, use of common language to describe measurement attributes will be very important. In other words, as the IASB builds its tool kit of common definitions, it would be worthwhile to explore more specific, technical verbiage in the standards in describing the various types of measurement attributes (e.g., terms such as market-based entry value, market-based exit value, or settlement value).

<u>Issue B - Fair Value of Liabilities</u>

1. Can the principles of ASU No. 2009-5 be applied in practice in IFRSs? If not, why not?

In general, most participants could not think of significant reasons why the ASU could not work in practice in IFRS.

2. When might the fair value of a liability not be equal to the corresponding asset's fair value?

- Participants from the insurance industry had significant concerns with ASU 2009-05, in particular the concept of symmetry between assets and liabilities. Participants questioned whether restrictions are really already contemplated in the fair value measurement of a liability as indicated in paragraphs 820-10-35-16E and 16F, especially on day one, and whether it is truly the liability restriction being considered in the fair value measurement or is it really the restriction of an asset holder that is being built into the liability measurement. Participants indicated that there should be a proper debate regarding asset/liability symmetry.

- Participants from the insurance industry also indicated that differences could exist between an asset and liability when guarantees are involved (e.g., state guaranteed funds whereby the state will pay on behalf of the holder if the holder is not able to pay). Other participants agreed indicating that the fair value of a liability may not equal the corresponding asset's fair value when third party guarantees are involved as such guarantees would likely exist on the asset side of a transaction but not on the liability side.

- Participants indicated that there is reason to believe that the fair value of a liability may not be equal to the corresponding asset's fair value in situations when an entity is entering and exiting the transaction in different markets. Others responded that it depends on how an entity uses the bid-ask spread as to whether a difference will exist. In addition, a participant indicated that the second paragraph of ASU 2009-05 created a problem regarding liquidity risk.

<u>Issue C – Fair value of non-financial assets and liabilities</u>

1. What specific additional guidance is needed to measure the fair value of non-financial assets and liabilities?

2. Are any of the proposals in the exposure draft inconsistent with measuring the fair value of non-financial assets and liabilities?

Views expressed by participants relative to Issue C are summarized as follows:

- Participants expressed confusion regarding the application of highest and best use and the interplay with the unit of account. The example provided was that if one combines Asset A ($10) and B ($10) and both could be sold at their combined highest and best use for $30, what does an entity do with the $10 intrinsic value. Participants indicated that the guidance is not clear as to how the incremental value would be assigned, especially in situations where more than one depreciable asset is involved.

- The IASB staff indicated that an entity should value the two assets at the highest and best use and then allocate that value back to the individual asset/liability. Meanwhile, an IASB board member challenged the appropriateness of this allocation methodology.

- In regards to the reference market, a participant agreed that the most advantageous market was better than the principal market concept. However, the participant questioned what to do when an entity transacts in multiple markets and indicated that US GAAP seems to be a bit clearer in this regard.

- A participant from the agriculture industry indicated that agricultural assets definitely have a different highest and best use depending on intent and timing in the lifecycle of the asset (e.g., In determining the fair value of fish, does an entity assume that the fish will grow to a certain size? How does one factor into the analysis that the variation in size can impact the potential use by a market participant?) The participant indicated the need for a hierarchy related to highest and best use to put all of the notions into play.

- A participant indicated that it is rare that the highest and best use of a commodity is something other than its actual current use in its current form. For example, should an entity with crude oil look to all of the different potential uses of that oil (e.g., refined oil, gasoline, electricity through oil burning plants) and only add conversion costs to derive different potential fair values when there is a market for crude oil? It was recommended that the requirement to measure the fair value of a commodity assuming its highest and best use by market participants be eliminated. This revision would be consistent with the reasoning for exclusion of financial assets from the highest and best use requirement.

Issue D – Fair value in inactive markets

Is the proposed guidance sufficient for measuring fair value when markets have become inactive (when they previously were active)? If not, what additional guidance do you think is necessary?

Views expressed by participants relative to Issue D are summarized as follows:

- A participant indicated that FSP No. 157-4 helped to clarify whether a market is inactive; however, it did not provide much clarity with regards to the determination of when a market is orderly. As such, it can be difficult to conclude that a transaction is not orderly.

- Another participant questioned how to determine whether a transaction is "orderly" in the case where a market was active and has become less active. In a related discussion, another participant questioned how long a market has to be inactive or have a decreased level of volume before it's considered the new norm.

- One participant indicated that as a preparer, the entity believes in fair value measurement and routinely uses FSP No. 157-4 and the IASB Expert Advisory Panel paper to assist in applying its judgments. Another participant indicated that, yes, while the FASB guidance is a reminder to apply professional judgment, entities should be careful in applying the Expert Advisory Panel paper as its guidance is harsher than FSP No. 157-4. That is, in the participant's view, the Expert Advisory Panel paper makes it very difficult to move away from transaction price and contains wording differences that may not yield the same result as FSP. No. 157-4 when applied.

- A participant recommended to the IASB staff that the language in the Expert Advisory Panel paper and the ED be aligned and not handled as two separate documents in order that wording differences not create differences in practice.

<u>Issue E – Fair value in emerging and transition economies</u>

1. What proposals in the exposure draft are not applicable to emerging and transition economies? Why are they not applicable?

2. What specific additional guidance is needed?

This issue was not discussed during the meeting.

<u>Issue F – Jurisdiction-specific issues</u>

Are there measurement considerations specific to your jurisdiction that the exposure draft does not seem to have contemplated? If so, what are they?

This issue was not discussed during the meeting.

<u>Issue G - US GAAP convergence</u>

1. Aside from the reference market and blockage factors, would you expect there to be a numerical difference between a fair value calculated using the proposals in the exposure draft and a fair value calculated using the Topic 820?

2. Have you learned anything from applying Topic 820 that the IASB should consider when finalising an IFRS on fair value measurement guidance?

Views expressed by participants relative to Issue G were as follows:

- Participants were concerned that the ED does not clearly address whether the unit of valuation can be different from the unit of account. For example, participants cited the need for further clarification in regards to the valuation premise for financial instruments, in particular whether to measure fair value at the individual instrument level versus focusing on the instruments as a group (e.g., how to handle master netting arrangements related to financial instruments).

- Participants indicated that the prohibition on using blockage factors for Level 1 securities is troubling as a market participant would take into account the blockage. Participants indicated that for private equity, a block can achieve a higher market value but that concept is not being allowed in the ED. As a result, private equity firms are not achieving the highest and best use due to these contradictions that exist.

- Participants indicated that the accounting treatment for the recognition of day 1 gains and losses could cause a difference. That is, the proposed amendments to paragraph D32 to IAS 39 paragraph AG 76(b) result in a gain or loss being deferred if the criteria in IAS 39 AG76(a) are not met. One participant indicated that for transactions in which unobservable inputs are utilized in a valuation model, the valuation model generally should be calibrated (either through the inputs or through valuation adjustments) such that model value equals the transaction price at initial recognition.

- The market participant definition was cited as a difference compared to US GAAP. As indicated by a participant, this definition is problematic because it implies that the market participant has access to entity-specific information that is not publicly available. For example, assume the reporting entity has access to "insider" information about the item being measured. In that case, the proposed definition of "knowledgeable" assumes that the market participant has access to the same "insider" information even though that information is not available in the market which does not seem realistic. This turns the definition of a "market participant" into an entity-specific concept. It does not acknowledge that the entity would possess details that it cannot divulge to the market.

- Participants indicated that the ED requires very different disclosures compared to US GAAP, especially when you considered the new guidance on improving fair value disclosures that the FASB has undertaken. It was suggested that the FASB and IASB work to resolve the disclosure differences as it is difficult to assess comparability when different information is disclosed.