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In Focus

Accounting Standards Update No. 2011-04: *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*

Today, the FASB and the International Accounting Standards Board (IASB) issued their converged guidance on fair value measurement, which represents meaningful progress toward the stated goal of their Memorandum of Understanding to create a common set of high-quality global accounting standards.

The collective efforts of the Boards and their staff have resulted in common requirements for measuring fair value and for disclosing information about fair value measurements, including a consistent meaning of the term "fair value", which the Boards concluded would result in greater comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and IFRSs.

Why Is This Update Being Issued?

This Update represents the continued development of guidance related to fair value measurements in U.S. GAAP. Statement of Financial Accounting Standards No. 157, *Fair Value Measurements*, was issued in 2006 and has been amended by several FASB Staff Positions as well as several Accounting Standards Updates since being codified as Topic 820 in the *FASB Accounting Standards Codification*®.

The amendments in this Update are a result of the work of the FASB and the IASB to align their guidance with respect to fair value measurements and disclosures. The amendments generally represent clarifications to Topic 820, but also include some instances where a particular principle or requirement for measuring fair value or disclosing information about fair value measurements has changed. For many of the requirements, the Board does not intend for the amendments in this Update to result in a change in the application of the requirements in Topic 820. Furthermore, Topic 820 and IFRS 13, *Fair Value Measurement*, explain how to measure fair value. They do not require additional fair value measurements and are not intended to establish valuation standards or affect valuation practices outside of financial reporting.

Essential Elements

The amendments that clarify how to apply the existing fair value measurement and disclosure requirements in Topic 820 include the following:

- The concepts of highest and best use and valuation premise in a fair value measurement should be applied only when measuring the fair value of nonfinancial assets.
- Similar to comparable guidance for liabilities, the fair value of an instrument classified within a reporting entity's shareholders' equity should be measured from the perspective of a market participant that holds that instrument as an asset.
- For fair value measurements categorized within Level 3 of the fair value hierarchy, a reporting entity is required to disclose quantitative information about the unobservable inputs used in the measurements.

The amendments that change a particular principle or requirement for measuring fair value or disclosing information about fair value measurements include the following:

- Provided that certain criteria are met, a reporting entity that holds a group of financial assets and financial liabilities that exposes it to market risks and counterparty credit risk may apply an exception to the requirements in Topic 820, which permits the fair value of those financial instruments to be measured on the basis of the reporting entity's net risk exposure.
- Premiums or discounts may be applied in a fair value measurement to the extent that they are consistent with

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the unit of account and market participants would consider them in a transaction for the asset or liability. However, adjustments commonly referred to as blockage factors are not permitted in fair value measurements.

- A reporting entity must disclose the following information about fair value measurements:
  - For fair value measurements categorized within Level 3 of the fair value hierarchy:
    - The valuation processes used by the reporting entity.
    - A narrative description of the sensitivity of the fair value measurement to changes in unobservable inputs and the interrelationships between those unobservable inputs, if any.
  - The use of a nonfinancial asset if it differs from the highest and best use assumed in the fair value measurement.
  - For items that are not measured at fair value in the statement of financial position but for which the fair value is required to be disclosed, the level of the fair value hierarchy in which that measurement is categorized.

The Board continues to consider the unique application issues of U.S. GAAP to nonpublic entities as well as the relevance of certain information to the users of nonpublic entity financial statements. Since the fair value measurement guidance is about how to measure fair value rather than when to measure fair value, the Board concluded that the principles and concepts of Topic 820 are equally applicable to public and nonpublic reporting entities. However, the Board acknowledged that the relationship between costs and benefits related to certain disclosure requirements of this Update can differ depending on whether the reporting entity is a nonpublic entity. Accordingly, the Board concluded that certain disclosure requirements in this Update should not be required for nonpublic reporting entities, such as the requirement to disclose any transfers between Level 1 and Level 2 of the fair value hierarchy and the reasons for those transfers.

While we now have a converged definition of fair value and the measurement and disclosure requirements are aligned, some differences remain between U.S. GAAP and IFRSs:

- There are some different disclosure requirements about fair value measurements. The most significant difference is that IFRSs require a quantitative sensitivity analysis for financial instruments that are measured at fair value and categorized within Level 3 of the fair value hierarchy. U.S. GAAP does not require a quantitative sensitivity analysis disclosure.
- There are different requirements about whether, and in what circumstances, an entity with an investment in an investment company may use the reported net asset value as a measure of fair value.

When Will the Amendments Be Effective?

The amendments in this Update are to be applied prospectively. For public entities, the amendments are effective during interim and annual periods beginning after December 15, 2011. For nonpublic entities, the amendments are effective for annual periods beginning after December 15, 2011. Early application by public entities is not permitted. Nonpublic entities may apply the amendments in this Update early, but no earlier than for interim periods beginning after December 15, 2011.

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