

# Alert

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## FASB Delays Issuance of Fair Value Measurements Statement

### Plans new guidance on valuing nonfinancial assets and liabilities

*“The new project will result in the issuance of a FASB staff position (FSP), with an exposure draft scheduled for the third quarter of 2006 and a final document by year end.”*

Amid concerns over implementation of the *Fair Value Measurements* standard, the FASB decided at its June 28 meeting to add a new fair value-related project to its agenda. The new project arises from concerns about the apparent diversity in practice under existing accounting standards for business combinations and impairment. Specifically, the FASB is expected to address the use of entity-specific assumptions rather than market participant assumptions to measure the fair value of nonfinancial assets and nonfinancial liabilities under Statements 141, *Business Combinations*, 142, *Goodwill and Other Intangible Assets*, and 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*.

The new project will result in the issuance of a FASB Staff Position (FSP), with an exposure draft scheduled for the third quarter of 2006 and a final document by year end. The Board has not confirmed a release date for the final *Fair Value Measurements* standard but has said that its issuance is pending, subject to the Board's deliberations in the related FSP.

#### MARKET PARTICIPANT ASSUMPTIONS

The *Fair Value Measurements* standard is expected to require that fair values be based on the perspective of a "market participant." Consideration of the market participant's viewpoint in fair value estimates is not new; the use of market-participant assumptions is provided for in Statements 141, 142, and 144. For example, when determining fair value in the context of an impairment, both Statements 142 and 144 provide for the use of market participant assumptions when that information is "available without undue cost and effort." Otherwise, an entity's own assumptions may be used. The Board believes that diversity in practice has arisen because some practitioners are defaulting to entity-specific assumptions on the presumption that market participant assumptions are not available without undue cost and effort whenever there are no quoted market prices.

Since there has been much redeliberating by the FASB regarding the original *Fair Value Measurements* exposure draft, we thought it would be helpful to review the main principles that are expected to be contained in the final statement.

#### DEFINITION OF FAIR VALUE

The new statement will include a single definition of fair value which will provide the basis for measuring fair value in financial reporting. Fair value is expected to be defined as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date."

#### FAIR VALUE HIERARCHY

The Board proposed in the ED a "fair value hierarchy" to rank the reliability of inputs used in a valuation approach to estimate fair value. The final standard will also include a hierarchy that,

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while different from the initial proposal, continues to focus on the reliability of the inputs to the valuation model. The hierarchy takes on practical importance because it is likely that the type of disclosures and perhaps even the accounting for assets and liabilities measured at fair value will vary depending on which level's inputs were used.

*“Importantly, the proposed FSP could affect current accounting standards which require fair value measurements...”*

The final standard is expected to identify three levels for the hierarchy. The first - and highest - level will refer to quoted prices for identical assets or liabilities in an active market. When those prices are not available, the second - or middle - level will base fair value estimates on observable inputs that a market participant would use. If observable inputs are not available, the third - and lowest - level will require the use of unobservable inputs. However, the objective of fair value remains the same and thus even unobservable inputs will need to incorporate the assumptions a market participant would use in developing an exit price.

### VALUATION APPROACHES

The final standard is expected to state that valuation techniques consistent with the market approach, income approach and/or cost approach should be used to estimate fair value. Selection of a valuation method, or multiple valuation methods, will depend on the nature of the item being valued as well as the availability of data. For example, the final standard is expected to indicate that a single valuation technique may be appropriate when valuing an asset or liability for which quoted prices in an active market for an identical item are available. In contrast, multiple valuation techniques may be appropriate when valuing a reporting unit.

Valuation specialists are required by professional valuation standards and practices to consider all three approaches, but they may choose not to apply one of the approaches, particularly if the results of the approach would not be relevant, or if the data needed to employ the approach is not available. A valuation expert exercises judgement in deciding which approaches to use and in "weighing" the various value conclusions in order to select the most appropriate value.

### IMPLICATIONS

The *Fair Value Measurements* standard is expected to be effective for fiscal years beginning after November 15, 2007. While there is no indication as to when the proposed FSP would become effective, the changes in the proposed FSP could be effective before that date. Importantly, the proposed FSP could affect current accounting standards which require fair value measurements, including the allocation of purchase price in a business combination and impairment of goodwill and other long-lived assets. In addition, the FSP could affect convergence with IASB standards. The FASB will consider how the FSP project could impact these areas. For more information about fair value measurements, contact your Valuation Research representative or Greg Barber at (415) 277-1802. **VR**

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