

### The FASB and the IASB Are Joining Forces to Converge Fair Value Accounting

At their joint meeting this past Thursday, February 18<sup>th</sup>, the FASB and IASB made new strides in improving fair value accounting. The Boards discussed fair value accounting for both financial and nonfinancial assets. Two topics were discussed: measuring the fair value of financial instruments and the use of premiums and discounts in a fair value measurement. Both topics ended up with decisions that could further tighten fair value measurements and improve their “fidelity” to real-world market values.

### Measuring the Fair Value of Financial Instruments

The Boards tentatively decided that the concepts of 1) highest and best use and 2) valuation premise are relevant only for nonfinancial assets and **not for financial assets or liabilities**. This is likely because these concepts apply more to “hard assets” than financial instruments. For example, ‘valuation premise’ refers to whether an asset should be valued based on whether its highest and best use is with other assets as a group or on a standalone basis. While one might argue that a single financial instrument is worth more in a group than by itself, or vice versa, the Boards’ view seems to be that it’s impracticable to apply these concepts to individual, or a portfolio of, financial instruments.

The Boards tentatively decided to describe certain valuation adjustments that companies might be required to make due to the fact that other market participants would make such adjustments. These adjustments were described in the IASB’s Expert Advisory Panel report, *Measuring and Disclosing the Fair Value of Financial Instruments in Markets That Are No Longer Active*, released in October 2008:

“If a valuation technique is used to measure fair value, the valuation model is periodically calibrated to observable market information to ensure that the model reflects current market conditions and to identify any potential deficiencies in the model. As market conditions change, it might be necessary either to change the models used or to make additional adjustments to model valuations. (...) Valuation adjustments include, for example, model deficiencies highlighted through calibration of the model, liquidity adjustments and credit adjustments. Adjustments are not appropriate if they adjust the measurement away from fair value, for example for conservatism.”

This decision, if turned into a proposal which is ultimately accepted, may lead to a further tightening of financial instrument valuation practices and a **renewed focus on exit value** for a specific security in a fund or financial instrument on a company’s books on the reporting date. This convergence effort is almost certainly in response to abuses: where, for example, the “best use” value of a security is much more aspirational in nature than the actual, present-time exit value.

### Premiums and Discounts

The Boards tentatively decided:

1. To clarify what a ‘blockage factor’ is for an individual instrument and to distinguish how it’s different from other adjustments such as a lack of marketability discount
2. To completely prohibit the application of a blockage factor
3. To specify that **fair value in Levels 2 and 3 should consider other premiums and discounts that market participants would consider** at the unit of account set forth in the relevant standard (except for a blockage factor)

The Boards will continue their discussion of fair value accounting at their March joint meeting, including whether the fair value of financial instruments within a portfolio should consider offsetting risk positions, including credit risk and market risk.

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