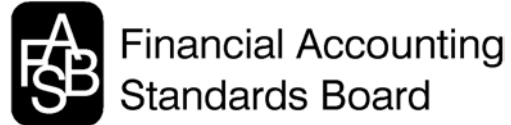


MINUTES



To: Board Members
From: Nesta (ext. 330)
Subject: Minutes of the May 7, 2003 Board Meeting **Date:** May 9, 2003
cc: Bielstein, Leisenring, Petrone, Smith, Swift, Polley, Bossio, Munro, Pinson, MacDonald, Tamulis, Manders, Wilson, Cropsey, Lott, T. Johnson, Slayton, McKenna, McIntosh, Thompson, Mahoney, FASB Intranet, Sutay, Gabriele

Topic: Fair Value—Definition and Measurement

Basis for Discussion: Memorandum dated April 16, 2003

Length of Discussion: 1:15 p.m. to 2:15 p.m.

Attendance:

Board members present: Crooch, Foster, Herz, Schieneman, Schipper, Trott, Wulff

Board members absent: None

Staff in charge of topic: Munro and Pinson

Other staff at Board table: Bielstein, Leisenring, Bossio, MacDonald, Cropsey, Nesta

Outside participants: None

Summary for ACTION ALERT:

The Board discussed issues relating to fair value measurements in situations including, but not limited to, a business combination. The Board decided to:

1. Refine the definition of fair value to refer to “the amount for which an asset or liability could be exchanged in a current transaction between knowledgeable,

unrelated willing parties when neither party is acting under compulsion” and provide related guidance clarifying that:

- The objective of a fair value measurement is to estimate the single exchange price at which willing parties would agree to transact
 - The estimate should not be adjusted for transaction costs
 - Marketplace participants are hypothetical willing parties—sellers and buyers that have utility (a need) for the item and are both willing and able to transact, having the legal and financial ability to do so
 - The definition of *fair value*, as refined, is consistent with the definition of *fair market value* in IRS Rev. Rule 59-60.
2. Specify that in estimating the fair value of nonfinancial assets, a “going concern or in-use” valuation premise should be used for those assets that are held and used and an “in-exchange” valuation premise should be used for those assets that are classified as held for sale.
3. Clarify the fair value hierarchy to emphasize the general principle that fair value estimates should be determined based on the result of valuation techniques that maximize market inputs and minimize entity-specific inputs by:
- Incorporating a reference market notion, referring to “the market to which the entity has reasonable access that would yield the most advantageous price for an item”
 - Clarifying that the reference market should be used as a basis for determining both the price and unit of accounting for the item
 - Emphasizing the preference for multiple valuation techniques consistent with a market, income and, if applicable, cost approach for Level 3 fair value estimates.

In addition, the Board has directed the staff to perform additional work on the application of the proposed guidance to liabilities and to further define certain terms used.

[All Board members agreed]

Matters Discussed and Decisions Reached:

Ms. Munro stated that the focus of the April 16, 2003 memorandum was on measuring the fair value of assets and, if the Board agreed with that paper's conclusions, the staff would further study the application of the fair value measurement guidance to liabilities. She added that if the Board agreed with the staff's proposed guidance, the staff would request the Board to determine how the proposed guidance would interact with current FASB projects, such as the Business Combinations—Purchase Methods Procedure as well as a potential overall fair value measurement project.

Ms. Munro stated that the definition of fair value was the first issue for discussion. She noted that the staff was proposing several refinements to the definition (see attached handout).

The Board decided to refine the definition of fair value to refer to “the amount for which an asset or liability could be exchanged in a current transaction between knowledgeable, unrelated willing parties when neither party is acting under compulsion” and provide related guidance clarifying that:

- The objective of a fair value measurement is to estimate the single exchange price at which willing parties would agree to transact
- The estimate should not be adjusted for transaction costs
- Marketplace participants are hypothetical willing parties—sellers and buyers that have utility (a need) for the item and are both willing and able to transact, having the legal and financial ability to do so
- The definition of *fair value*, as refined, is consistent with the definition of *fair market value* in IRS Rev. Rule 59-60.

Mr. Foster asked whether the use of exchange price would preclude the use of the exit price to determine fair value. The staff noted that there has been confusion over the notions of entry and exit prices and their relationship with an exchange price when measuring fair value. The staff asserted that the exchange price for the buyer and seller is the same in the same market for the same unit of

accounting and that when estimating fair value, one may consider both observable entry and exit prices.

Ms. Schipper noted that the terms *transaction costs*, *exchange*, and *willing* need to be explained in greater detail in the proposed guidance because none of those terms have an agreed-upon meaning. The staff agreed to clarify the meaning of those terms.

Mr. Pinson stated that the next issue for the Board to address was the need to specify a valuation premise for purposes of fair value measurement. The staff recommended that the Board specify that in estimating the fair value of nonfinancial assets, a “going concern or in-use” valuation premise should be used for those assets that are held and used and an “in-exchange” valuation premise should be used for those assets that are classified as held for sale.

The Board agreed with the staff recommendation. Board members noted that the guidance will help eliminate confusion that exists between valuation experts and accountants in applying current valuation guidance found in accounting standards. The Board has asked the FASB staff, when drafting this guidance, to emphasize that “in-use” as a valuation premise is not to be confused with the term “value in use” that is currently used in both FASB and IASB literature.

Mr. Pinson then stated that the staff proposed clarifying the fair value hierarchy to emphasize the general principle that fair value estimates should be determined based on the result of valuation techniques that maximize market inputs and minimize entity-specific inputs (see attached handout, Item 3 a-c).

The Board decided to clarify the fair value hierarchy to emphasize the general principle that fair value estimates should be determined based on the result of valuation techniques that maximize market inputs and minimize entity-specific inputs by:

- Incorporating a reference market notion, referring to “the market to which the entity has reasonable access that would yield the most advantageous price for an item”
- Clarifying that the reference market should be used as a basis for determining both the price and unit of accounting for the item
- Emphasizing the preference for multiple valuation techniques consistent with a market, income and, if applicable, cost approach for Level 3 fair value estimates.

Mr. Wulff stated that he believes if an entity cannot corroborate a fair value measurement using multiple valuation techniques then the measurement is not sufficiently reliable and the entity should use historical cost to measure the asset.

Mr. Pinson noted that in some circumstances involving unique intangible assets only the income approach can be used. The staff noted that the issue of sufficient reliability of fair value measurements would be further studied. Mr. Wulff also noted that the staff should consider further clarifying the definition of “similar” when applying the fair value measurement hierarchy.

Ms. Munro also noted that the Board’s decision merely clarifies the current fair value hierarchy and would not impose any additional costs on financial statement preparers or auditors.

Ms. Munro stated that the last issue for the Board to address was the interaction of the clarifying guidance with other agenda projects, such as the Business Combinations—Purchase Method Procedures as well as a potential overall fair value measurement project.

The Board noted that the interaction of this proposed guidance with the Replacement of Statement 107 project should also be considered. The Board decided to discuss at a future meeting whether to issue the above guidance as part of a broader fair value measurement project (currently the staff expects that the objective and scope of that project will be discussed at the June 4, 2003 FASB Board meeting). In the short term, the Board believes that the above decisions should be incorporated into the Exposure Draft for the Business Combinations—Purchase Method Procedures project.

The Board and staff also noted that the staff of the Canadian Accounting Standards Board (AcSB) is addressing similar issues in the IASB research project on measurement and that the Board's decisions are largely consistent with the working conclusions discussed at the April 2003 National Standard Setters meeting.

Follow-up Items:

The Board directed the staff to:

1. Perform additional work on the application of the proposed guidance to liabilities.
2. Further clarify the definition of "exchange." The staff plans to specifically address whether the notion of exchange includes the settlement of a liability as they further study the application of this guidance to liabilities.
3. Further define the term "willing". Specifically, the FASB staff plans to address whether it is necessary for the definition to include both the term "willing" and "when neither party is acting under compulsion."
4. Define what types of costs are considered transaction costs.

General Announcements:

None

Business Combinations—Fair Value

At its May 7, 2003 meeting, the Board will discuss issues relating to fair value measurements in situations including, but not limited to, a business combination. Specifically:

1. The Board will discuss whether to refine the definition of fair value to refer to “the amount for which an asset or liability could be exchanged in a current transaction between knowledgeable, unrelated willing parties when neither party is acting under compulsion,” further clarifying that:
 - a. The objective of a fair value measurement is to estimate the single exchange price at which willing parties would agree to transact
 - b. The estimate should not be adjusted for transaction costs
 - c. Marketplace participants are hypothetical willing parties—sellers and buyers that have utility (a need) for the item and are both willing and able to transact, having the legal and financial ability to do so
 - d. The definition of *fair value*, as refined, is consistent with the definition of *fair market value* in IRS Rev. Rule 59-60.
2. The Board will discuss whether to specify a valuation premise as a basis for developing a fair value estimate for nonfinancial assets and, if so, whether to specify a “going concern or in-use” premise for those assets that are held and used and an “in-exchange” premise for those assets that are classified as held for sale.
3. The Board will discuss whether to clarify the fair value hierarchy to emphasize the general principle that fair value estimates should be determined based on the result of valuation techniques that maximize market inputs and minimize entity-specific inputs as follows:
 - a. Incorporate a reference market notion, referring to “the market to which the entity has reasonable access that would yield the most advantageous price for an item”
 - b. Clarify that the reference market should be used as a basis for determining both the price and unit of accounting for the item
 - c. For Level 3 fair value estimates, emphasize the preference for multiple valuation techniques consistent with a market, income and, if applicable, cost approach.
4. The Board will discuss the interaction of the clarifying guidance referred to above with other agenda projects, including:
 - a. Business combinations—purchase method procedures
 - b. An overall fair value measurement project; specifically, whether to issue the guidance in a proposed Statement issued in that project (the Board will discuss the objective and scope of that new project at a future meeting).