Thursday, June 9, 2011 • Financial Reporting

A Single Fair Value !!!

James P. Catty, MA, CPA/ABV, CA·CBV, CVA, CFA, CFE

President, Corporate Valuation Services Limited

501-707 Eglinton Avenue West Toronto ON M5N 1C8 Canada

Chairman, International Association of Consultants, Valuators and Analysts

- Please set pagers, cell phones, etc. on vibrate mode or turn them off.
- Please complete and hand in the Presenter Evaluation forms.
- Don’t forget to complete your CPA Attestation Form. Add your Membership Number (located on your name badge) and sign it. Keep the white copy for your records. Turn in the yellow copy at the Registration Desk.

Thursday, June 9, 2011 • Financial Reporting

A Single Fair Value

James P. Catty,

MA, CPA/ABV, CA·CBV, CVA, CFA, CFE

A Single Fair Value

- In this presentation, I deal with Fair Value in the two main accounting languages:
  - Generally Accepted Accounting Principles - GAAP - in the United States
  - International Financial Reporting Standards – IFRS - in the rest of the world

  - Now, they are identical

A Single Fair Value

- Due to time constraints we deal only with
  - A Single Fair Value
  - The common Framework for determining Fair Value

A Single Fair Value

- FASB and IASB started to converge their disparate regimes in 2002.
- This was difficult because
  - Driven by the US legal system GAAP has rules - lots and lots of them.
  - Reflecting European traditions IFRS has principles and not nearly as many.

Principles = Judgment = Litigation?

A Single Fair Value

- 13 May 2011 was a momentous day for Valuators.
- FASB issued a 331 page document "Fair Value Measurement (Topic 820), Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRSs".

A Single Fair Value

- Now there is a single FAIR VALUE concept for GAAP and IFRS.
- The same FRAMEWORK is applied.
- Affects almost everyone in the expanding financial world - except some users of national accounting standards.
- Many of those are planning to converge

A Single Fair Value

ASC 820 Amended and IFRS 13 *Fair Value Measurement* - What do they say?

1. A common definition for a market-based, not entity-specific measurement.

"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"

A Single Fair Value

2. An established Framework for measuring Fair Value - discussed in detail later.
3. Enhanced disclosures about such measurements.

- This presentation will not deal with disclosures. They are Management's or Auditors' jobs using our information.

A Single Fair Value

- Fair Value is a market-based exit price.
- Fits with definitions of assets and liabilities:
  - Assets result in cash inflows
  - Liabilities result in cash outflows
- Entities recognize and measure assets and liabilities.

A Single Fair Value

ASC 820A and IFRS 13 - What is the effect?

<u>For the United States</u>

- Changes in wording but not significant in principles for determining Fair Value or applying ASC 820.
- Elimination of highest and best use concept for financial assets.

A Single Fair Value

ASC 820A and IFRS 13 - What is the effect?

- Changes in the meaning of “instruments classified in a reporting entity’s shareholders equity” – shares etc. issued in Business Combination.
- A requirement to reveal quantitative information about unobservable Level 3 inputs.

A Single Fair Value

ASC 820A and IFRS 13 - What is the effect?

- New provisions for financial assets and liabilities managed as a portfolio.
- Guidance on application of premiums and discounts.

EFFECTIVE DATE: 15 December 2011

Early adoption prohibited

A Single Fair Value

ASC 820A and IFRS 13 - What is the effect?

<u>For the rest of the world</u>

- Revised definition of Fair Value.
- Eliminating the willing seller notion.
- New framework for its measurement.
- Different common disclosures.

A Single Fair Value

ASC 820A and IFRS 13 - What is the effect?

- Improved consistency in changes of procedures under:
  - 5 International Financial Reporting Standards.
  - 10 International Accounting Standards.

A Single Fair Value

- Introduction of Fair Value hierarchy.
- In other words – it is mainly a new ball game moving from Canadian to US football rules.

EFFECTIVE DATE: 1 January 2013

Early adoption allowed

A Single Fair Value

- The Fair Value framework of ASC 820 and IFRS 13 has six Stages:
    1. Determine Unit of Account
    2. Evaluate Valuation Premise
    3. Assess the Principal Market
    4. Establish Most Advantageous Market
    5. Select Valuation Methods
    6. Estimate Fair Value

A Single Fair Value

Stage 1 – Determine Unit of Account

- What is actually being valued?
- A stand alone item, a group of related items such as an operating plant, a business, a technology or even a liability.

A Single Fair Value

Examples:

- Loan portfolio (Financial)
- Office building (Physical)
- Operating plant (Physical)
- Brand (Intangible)
- Single publicly traded share (Financial)
- Reporting or cash generating unit (Financial)

A Single Fair Value

- Value is based on the level of aggregation or disaggregation in applicable GAAP or IFRS.
- Must reflect the item's characteristics:
  - Condition
  - Location
  - Restrictions on sale or use

A Single Fair Value

Stage 2 – Evaluate Valuation Premise

- Physical and Intangible Assets are based on the highest and best use by market participants.
- May differ from management's intensions or even existing use.
- Example: a restaurant that market participants consider the highest and best use is a parking lot – that establishes Fair Value.

A Single Fair Value

Highest and best use of an item:

<u>In-combination</u>

- Physical or intangible asset provides maximum value to market participants principally as part of a group of assets.
- Even when in combination, Fair Value is still market-based considering facts and circumstances.

A Single Fair Value

- May apply to a single unit of account, such as a reporting or cash generating unit, if the underlying items are used together.
- Applies when combining multiple units.

Stand Alone

- Provides maximum value principally as an individual item.

A Single Fair Value

Market Participants

- Concept is a key element of Fair Value ensuring it is market based not entity specific.
- Similar to but not the same as the willing buyers and willing sellers of Fair Market Value.

A Single Fair Value

- Buyers and sellers in the relevant markets are:
  - Independent of the entity and each other.
  - Knowledgeable with a reasonable understanding of the item and transaction using all available information including usual and customary due diligence.
  - Able to enter into a hypothetical sale.
  - Willing to deal – motivated but not forced or otherwise compelled.

A Single Fair Value

- In identifying candidates management should consider factors specific to the item, the market and entities with whom the firm would transact.
- Profile potential candidates.
- Specific entities need not be identified.

A Single Fair Value

- Usually the process is straightforward due to general knowledge of potential buyers.
- Sometimes management must make assumptions about the type of market participant that might be interested.

A Single Fair Value

- With the exit market determined, market participants' assumptions for each valuation premise are developed.
- Interaction between the valuation premise and the appropriate market is iterative.

A Single Fair Value

Restricted Assets

- Certain items on sale or transferability.
- Fair Value reflects any discount a market participant might require.
- Depends on their transferability.
- Example: land is donated to a not-for-profit organization subject to contract restrictions on its use.

A Single Fair Value

- Contractual restrictions not legally transferred on sale are then specific to the organization and another owner could use the property based on its zoning.
- They do not affect the Fair Value as they are not considered by market participants.
- Reflect restrictions if legally transferred.

A Single Fair Value

Interaction of Unit of Account & Valuation Premise

- Unit of account is what is being valued.
- Individual units of account are aggregated to achieve highest and best use.
- Groupings, from market participants' perspectives reflect an entity's access to the market.
- A single unit of account can be included in only one group.

A Single Fair Value

- Consider different groupings in the appropriate market for a higher value.
- Disaggregation determines the Fair Value of a unit of account based on individual sale of its components.
- Applies if a sale maximizes the value if the entity has access to the relevant markets.

A Single Fair Value

- Exercise caution estimating Fair Values using disaggregation.
- An item be so valued when a strong fact pattern supports market participants disaggregation to maximize returns.
- If an item is customarily sold at a level below the full unit of account, transactions in such markets may be indications of value.

A Single Fair Value

Existing Form

- Item is valued in current condition.
- Transformation or value adding activity is deducted.
- When applying aggregation and disaggregation the ultimate valuation must relate solely to the unit of account.

A Single Fair Value

Highest and Best Use

- Applies to Physical and Intangible Assets
- Gives greatest return for Market Participants and is:
  - Physically possible
  - Legally permissible
  - Financially feasible

A Single Fair Value

Physically possible

- Account for characteristics that market participants would consider when pricing the asset – location, condition of a fleet.

A Single Fair Value

Legally permissible

- Accounts for restrictions that market participants would consider when pricing the asset - zoning regulations applicable to a property.

A Single Fair Value

Financially Feasible

- Account for the return (income or cash flow) market participants would require considering the costs of converting the asset to that use.

A Single Fair Value

- Determined from market participants perspective even if the entity intends a different one.
- The use is presumed to be the highest and best unless market or other factors suggest a different one by market participants would maximize its value.

A Single Fair Value

Defensive Assets

- An entity may intend to not actively use an asset according to its highest and best use to protect its competitive position.
- It may prevent others from using it.
- Fair Value is still determined by its highest and best use by market participants.

A Single Fair Value

Example - Unit of Account Loan Portfolio

- Mutual Bank is estimating the fair value of its loan portfolio.
- It has access to both the individual loan and securitization markets.
- The bank has historically sold a majority of its loans through securitizations.

A Single Fair Value

- Management determines the individual loan market is not its principal one.
- A portfolio of individual loans is often aggregated and “transformed” into securities through a “true sale” of the entire portfolio to a trust that undertakes subsequent distributions (sales) of beneficial interests to investors (disaggregation).

A Single Fair Value

- Fair value is focused on the actual item being valued not on what it may become.
- Depending on facts and circumstances, it may be reasonable to incorporate assumptions and input a market price by working backward from a downstream outcome.

A Single Fair Value

Stage 3 - Assess the Principal Market

- Determine potential markets, their participants and valuation premises, consider which are accessible.
- Consider several potential markets in each.
- Assume the principal market is the most advantageous with no opposing evidence.

A Single Fair Value

- A valuator may need to estimate prices in multiple markets and consider all valuation premises.
- If there is a principal market stages three and four can be expedited.
- An entity cannot incorporate potentially more advantageous markets into Fair Value when it has a principal market.

A Single Fair Value

- Principal market is that representing a majority of the volumes.
- If it regularly buys or sells a particular item in a single market that is the one.
- Usually it is the most advantageous.
- Continuous evaluation of multiple prices and markets is not necessary to determine the most advantageous.

A Single Fair Value

Financial Market Prices

- Recent increases in mortgage defaults and turmoil in credit markets have raised questions – are market prices for some financial items Fair Value?
- Orderly transactions in a normal and customary manner are not "forced" sales.

A Single Fair Value

- With no market transactions or observable trading valuators rely on other market inputs:
  - credit spreads on similar securities or ratings
  - apply judgment
  - make informed estimates

A Single Fair Value

Market Selection

- The principal or most advantageous market is determined from the perspective of the entity to allow for those with more than one activity.
- An entity’s different reporting (GAAP) or cash generating (IFRS) units may transact in different markets.
- Each unit individually considers its markets.

A Single Fair Value

- Not all entities have access to the same markets.
- Items sold in a number of them.
- Different markets have different prices.
- Participants in each vary.
- Inaccessible markets may be considered in a hypothetical transaction but are not a principal or most advantageous market.

A Single Fair Value

Stage 4 – Establish Most Advantageous Market

- A single entity can have several Fair Values for identical or similar items depending on the relevant units and their markets.
- Each considers the appropriate facts and circumstances following the Framework, irrespective of another unit's holdings of identical or similar items.

A Single Fair Value

Transaction and Transportation Costs

- Prices are not adjusted for transaction costs - those are not attributes, merely incremental specific expenses, that differ by nature.
- Considered in assessing net proceeds for the most advantageous market.

A Single Fair Value

- Location is a characteristic of an item (such as inventories) therefore Fair Value includes transportation costs.
- Moving a physical item to market is part of establishing Fair Value.

A Single Fair Value

Example – Market Selection

- Ascendo Corp identifies that a certain item of equipment is impaired.
- The charge depends on its Fair Value.
- Identical items sold in three markets: retail wholesale or auction.
- None is the principal market because it does not regularly trade in equipment.

A Single Fair Value

- There is no principal market therefore Fair Value is based on the most advantageous.
- The one with the highest net proceeds.

	Retail	Wholesale	Auction
	$	$	$
Price	10,000	9,700	9,500
Transportation Costs	(200)	(300)	(150)
Fair Value	9,800	9,400	9,350
Transaction Costs	(500)	nil	(450)
Net Proceeds	9,300	9,400	8,900

A Single Fair Value

- Fair Value then is the wholesale (most advantageous) market figure.
- Different transaction costs change the conclusion.

	Retail	Wholesale	Auction
	$	$	$
Fair Value	9,800	9,400	9,350
Transaction Costs	(300)	-	(200)
Net Proceeds	9,500	9,400	9,150

A Single Fair Value

- Here the most advantageous market is the retail.
- It yields the highest net proceeds ($9,500).
- Fair Value is now $9,800 not $9,400.

A Single Fair Value

No apparent exit market

- Determine the characteristics of hypothetically buyers - strategic or financial.
- Identify assumptions they use to price the item.

A Single Fair Value

- Construct a notional market based on the entity’s assumptions about what buyers take into account negotiating a purchase.
- Key considerations are specific location, condition, assumed market growth, expected depreciation, availability of certain synergies and appropriate risk premium.

A Single Fair Value

Stage 5 – Select Valuation Methods

- Use any method under one of the standard valuation approach – market, income and cost.
- Consider them all.
- Select methods where market participants' assumptions can be obtained without undue cost and effort.

A Single Fair Value

Market Approach

- Prices and other relevant information from market transactions involving identical or similar items, such as business interests.
- Ranges of market multiples, such as Price Earnings Ratios (PER) derived from comparables.

A Single Fair Value

- Select appropriate level within the range based on qualitative and quantitative factors to the situation.
- Matrix pricing is commonly used to price liabilities (as assets) by relying on their relationships (spreads) to quoted (benchmark) prices.

A Single Fair Value

Intangible Asset

- No exit market - no market participants.
- Cannot use Market Approach.
- Selling price to market participants does not work.
- MUST apply Income or Cost Approach whichever is more suitable.

A Single Fair Value

Select theoretical market participants - strategic or financial buyers.

- Valuator chooses the most likely strategic - usually pay more.
- When the auditor questions the decision - how do we prove it is correct?

A Single Fair Value

- We cannot prove that a strategic buyer is the most logical market participant nor can the auditor demonstrate the opposite.
- The auditor will likely be conservative, choose a financial buyer that pays less with lower goodwill.
- There will be trouble and arguments.

THE AUDITOR ALWAYS WINS.

A Single Fair Value

Income Approach

- Converts future amounts (cash flows or earnings) for either the next year (capitalization) or a projected period (discounting) to a single value.
- Indicates market participants current expectations about future activities.

A Single Fair Value

- Includes present value techniques and option pricing models as well as multi-period excess earnings.
- Use the method appropriate to the specific facts and circumstances.

A Single Fair Value

Discounted Cash Flows

- Key method from the perspective of market participants.
- Requires supportable:
  - Projections of future cash flows
  - Expectations of possible variations in amount and timing (scenarios)

A Single Fair Value

Discount Rate

- Based on risk-free rates for same durations as cash flows.
- Risk premiums due to:
  - Nature of item (equity risk)
  - Industry features
  - Specific entity characteristics
  - Other factors considered by market participants

A Single Fair Value

Incorporating Risks in Cash Flows

- Adjustments reflecting systematic (non-diversifiable) risk can be made to the projected cash flows or the discount rate.
- Adjusting expected cash flows to reflect systematic risk is very difficult.

A Single Fair Value

- Discount rate applied to cash flows is often the weighted-average cost of capital required by a marketplace participant.
- Option pricing models are part of this approach.

A Single Fair Value

Cost Approach

- Based on the amount that currently required to replace the service capacity of an item (current replacement cost).
- Assumes Fair Value does not exceed what a market participant would pay to acquire or construct a substitute item of comparable utility, adjusted for condition.

A Single Fair Value

- Requires estimating deductions for:
  - <u>Functional Deterioration</u>: The loss in value resulting from a relative inability of the asset to fulfill its intended purpose.

A Single Fair Value

– Technological Obsolescence: Occurs when a new process is introduced that significantly lowers operating expenses or improves quality.

– Physical Decline: Reflects that for older equipment, even when well maintained and retaining full functionality, spare parts and trained technicians may be difficult and expensive to obtain.

A Single Fair Value

- – Economic Deprivation: Drop-offs due to economic or market factors.
- Replacement cost method includes product improvements and new materials.

A Single Fair Value

Application of Valuation Techniques

- The Framework does not prescribe which valuation techniques should be used and does not prioritize among them.
- Those chosen should be appropriate in the circumstances.
- Choice is affected by the availability of relevant inputs and their relative reliability.

A Single Fair Value

- In some cases one method may provide the best indication of Fair Value.
- In most circumstances several are desirable.
- When reconciling them frequently one or more are less relevant as a result of limited data or the type of asset.

A Single Fair Value

- Due to underlying assumptions all results may not be equally representative of Fair Value.
- When multiple techniques are used evaluate and weigh the results to develop a range of possible conclusions.

A Single Fair Value

- Fair Value is the most representative point within that range under the circumstances.
- Techniques for each type of asset should be consistently applied.
- It is appropriate to change them or their application if the new result better represents Fair Value.

A Single Fair Value

- Fair Value revisions, from modifications in techniques or changed applications, are changes in accounting estimates that affect current and future reporting periods.

A Single Fair Value

Fair Value Hierarchy

- Three levels of inputs.
- Distinguishes between those observable from market data - more objective - and those unobservable - more subjective.
- Inputs are market participants' assumptions for pricing decisions including measures of risks.

A Single Fair Value

- Level 1 Inputs
  - Quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity can access at the measurement date.
  - Examples: quoted prices for items that trade frequently in volume on a major exchange or dealer market.

A Single Fair Value

- Level 2 Inputs
  - Inputs other than quoted prices included in Level 1 that are directly or indirectly observable.
  - <u>Examples</u>: interest rate and yield curves at commonly quoted intervals, implied volatilities or credit spreads.

A Single Fair Value

- Level 3 Inputs
  - Anything unobservable or requiring major adaptation.
  - <u>Examples</u>: projected cash flows of an entity or reported past real estate transactions in a different municipality requiring adjustments for time, size and location.

A Single Fair Value

- The lowest significant input determines the position of the entire measurement.
- Assessing the importance of a particular input requires judgment.
- Determining which amounts are based on Level 3 inputs is essential as certain disclosures are only required for them.

A Single Fair Value

Observable Inputs

- Fair Values maximize observable inputs regardless of the approach.
- Determination can require significant judgment.

A Single Fair Value

- Include:
  - Prices or quotes from exchanges or dealer markets with sufficient liquidity and activity.
  - Proxy market data proven highly correlated with a logical economic relationship to the item being valued.

A Single Fair Value

Allocation of Adjustments

- Certain valuation adjustments – for credit or liquidity risks - are normally determined for a portfolio.
- Must be attributed to individual units of account for financial reporting.
- Use reasonable, practical, consistent policy.

A Single Fair Value

Observable Data

- <u>Non proprietary</u>: from external sources available to and regularly used by participants in the relevant market / product sector as basis for transactions or verifying quotations.
- <u>Readily available</u>: market participants can obtain for a reasonable fee.

A Single Fair Value

- Regularly distributed: available in a timely manner for pricing decisions - verify no changes between intervals render some data meaningless.

A Single Fair Value

- Multiple independent sources: obtainable from more than one provider. For financial instruments - broker quotes and pricing services.

A Single Fair Value

- Transparent: reliable sources provide the data that participants in a particular product / market use to deal.
- Verifiable: users are able to contact the supplier for verification.

A Single Fair Value

Market-Based

- <u>Reliable</u>: actual market parameters subject to periodic testing and control; offers ability to review sources of data before using it.

A Single Fair Value

- Based on consensus within observable ranges: multiple sources of comparable data within a reasonably narrow range demonstrate a market consensus; one source should verify another.

A Single Fair Value

- Source actively involved in the market: data originates from an active participant for the relevant product in the applicable market.

A Single Fair Value

- <u>Supported by market transactions</u>: Although data need not be traced directly to a “live” or “perfectly offsetting” deal there should be evidence that it is drawn from actual transactions or used to price real trades.

A Single Fair Value

- Broker quotes should be from known organizations that reliably quote prices at which based on their substantial experience, actual transactions can be executed.

A Single Fair Value

- If the entity is a retail customer without access to the wholesale market its quoted prices are not Level 1 inputs.
- Available inputs may affect the choice of valuation technique.

A Single Fair Value

- When Level 1 inputs are available, a market method often provide better evidence of Fair Value than an income method.

A Single Fair Value

- A practical expedient exists for portfolios of large numbers of similar assets (such as debt securities) for which quoted prices in active markets are available but not readily accessible.
- It allows Level 2 measurements by an alternative method (matrix pricing) provided that it reasonably replicates actual transactions.

A Single Fair Value

Subsequent Events

- Fair Value reflects facts and circumstances existing on the specified date as well as events before, or reasonably foreseeable on that date.

A Single Fair Value

- Significant situations (principal transactions, brokered trades or announcements) may occur after the close of a market (say, over a weekend) but before the measurement date.
- Confirm they are representative before using.

A Single Fair Value

- Establish and apply a consistent policy for identifying and incorporating such events.
- Measurements using entity adjusted quoted prices are Level 2.

A Single Fair Value

Offsetting Credit Risks

- Removal of the in-combination premise for financial assets creates problems in valuing items managed as portfolios.
- ASC 820 and IFRS 13 now provide specific guidance for those with offsetting market or counterparty credit risks.

A Single Fair Value

- Allows measuring Fair Values using prices for the net position
- Applies to derivatives not considered financial assets or liabilities.
- Example: entities may apply this guidance when an interest rate risk is being managed for a group of assets and liabilities.

A Single Fair Value

- Used only when:
  - Entity manages the group on net exposures to risks based on documented strategies.
  - Management is given information of net risk exposures that are managed consistently.
  - Assets and liabilities within the group are reported at Fair Value.

A Single Fair Value

- When criteria are met entities are required to measure the Fair Value of the group by applying the figure within the bid-ask spread that is most representative under the circumstances of an exit price for the overall portfolio.

A Single Fair Value

- If there is a legally enforceable right to offset assets and liabilities on a counterparty’s default (such as a netting agreement) adjustments should be made to the net exposure to reflect the counterparty’s credit risk.
- The unit of account remains the individual item.

A Single Fair Value

- Presentation requirements remain the same therefore netting is permitted only when existing criteria are met.
- Fair Values based on net risk exposure are prohibited for financial assets and liabilities with available Level 1 inputs.

A Single Fair Value

Stage 6 - Estimate Fair Value

- The use of “blockage discounts” is prohibited for all assets.
- They relate to the size of the holding (shares or automobiles) in relation to the volume of trading in the reference market.

A Single Fair Value

- This forbidden concept is frequently seen in the real world - increased supply reduces prices.
- Therefore price multiplied by quantity equals Fair Value.
- A block purchased at a premium shows a Day One loss.

A Single Fair Value

- If unit of account is a complete holding discounts or premiums that market participants might apply are allowed for:
  - Limited voting rights
  - Lack of marketability (DLOM)
  - Premiums for degree of control - more for 68% (super majority) than 51%, increases for 80% (tax consolidation in US) and 100%.

A Single Fair Value

Conclusion

- The result of the market determination process and the application of appropriate valuation methods is Fair Value.
- When the conclusion applies to an asset group valued in-combination the total must be allocated to each component based on the specific facts and circumstances.

A Single Fair Value

Example - GAAP Impairment Test

- Superior Products Company is performing Step 1 of its annual GAAP impairment test of goodwill.
- This has been allocated between two reporting units.

A Single Fair Value

- It is performed for each reporting unit which is the unit of account.
  - Evaluation of the potential markets and market participants indicated each individual unit may be sold separately.
  - Combining them provides the highest value to market participants.
  - There is no principal market for either.

A Single Fair Value

- Management concludes that the in-combination provides the maximum value from the view of market participants.
- The unit of account is the individual reporting unit.

A Single Fair Value

- Two potential situations – stand alone (sold individually) or in-combination (sold together).
- Indications of value:
  - Stand alone – sale of individual units for $80 million and $120 million – total $200million.
  - In-combination – sale together for $220 million.

A Single Fair Value

- The additional $20 million realized from aggregating the reporting units has to be allocated to the units of account.
- Usually on the basis of relative individual amounts.

A Single Fair Value

	Unit A	Unit B	Total $million
Individual Value	80	120	200
Increase due to aggregation	8	12	20
Fair Value	88	132	220

A Single Fair Value

Effect of method on classification of inputs

- Methods should be selected based on the facts and circumstances regardless of the classification of available inputs.
- An entity is required to use methods appropriate in the circumstances and for which inputs are available without undue cost.

A Single Fair Value

- Models are frequently used to value certain assets such as derivatives.
- They may be used for asset retirement obligations.
- The level of such conclusions are determined by their inputs not the methodology or the details of the model.

A Single Fair Value

- Complex models may be used to develop forward curves and other inputs inextricably linking the models and inputs.
- A model does not automatically result in a Level 3 fair value.
- A standard model used to calculate a value with only observable inputs is likely Level 2.

A Single Fair Value

- To the extent that adjustments or interpolations are made, the measurement may become Level 3.
- A proprietary model with unobservable inputs is Level 3.

A Single Fair Value

Non-actively traded financial instrument

- Valued by a proprietary model.
- Broker provides a quoted price.

A Single Fair Value

- If the model does not include management's assumptions for adjustments, inputs, etc. measurement may be Level 2.
- If forward price curve is developed because the term exceeds the period of observable inputs - or otherwise adjusts the observable data - the conclusion is Level 3.

A Single Fair Value

Ongoing Differences

- Day One gains and losses
  - Under GAAP use of unobservable data to measure Fair Value permits immediate recognition of Day One gains and losses.

A Single Fair Value

- IFRS prohibits immediate recognition of unrealized gains and losses based on the difference between transaction price and Fair Value.

A Single Fair Value

- Under certain conditions ASC 820 allows entities to measure Fair Value of certain investments at Net Asset Values (NAV).
- Includes investment in entities substantially similar to those specified in ASC 946, *Financial Services – Investment Companies.*

A Single Fair Value

- IFRS has no current guidance on investment companies.
- As NAV is not consistently defined or calculated everywhere, IASB decided to not adopt a similar concept.

A Single Fair Value

Sensitivity Analyses

- Responding to the financial crises, IASB expanded disclosure requirements to help users understand the valuation techniques and inputs used to develop Fair Value measurement and their effects.

A Single Fair Value

- Sensitivity disclosures continues to be required for financial assets and liabilities under IFRS 7 *Financial Instruments: Disclosures.*

A Single Fair Value

- Level 3 required disclosures:
  - Quantitative information about the significant unobservable inputs used.
  - Qualitative information about their sensitivity to changes in unobservable inputs including a description of any interrelationship between them.

A Single Fair Value

- Nearly everything is converged but differences remain:
  - GAAP - no sensitivity analysis for Level 3 financial instruments.
  - Includes a practical expedient for measuring certain alternative investments (hedge funds, private equity, real estate) in an investment company without easily determined Fair Value.