



SFAS No. 157

Fair Value Measurements

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SFAS 157 – Overview

- What the standard is
- Scope
- Why the standard was issued
- When the standard is effective
- Key concepts
- Examples
- Recent developments



SFAS 157 – What

- Defines fair value
- Provides a framework for measurement of fair value in GAAP
- Applies to accounting pronouncements that require or permit fair value measurements
- Does not require any new fair value measurements



SFAS 157 – Scope

- Examples of pronouncements affected:
 - SFAS 87, Employers' Accounting for Pensions
 - SFAS 107, Disclosures about Fair Value of Financial Instruments
 - SFAS 115, Accounting for Certain Investments in Debt and Equity Securities
 - SFAS 133, Accounting for Derivative Instruments and Hedging Activities
 - SFAS 141, Business Combinations
 - SFAS 142, Goodwill and Other Intangible Assets
 - SFAS 144, Accounting for the Impairment or Disposal of Long-Lived Assets



SFAS 157 – Scope, cont'd

- Exclusions to SFAS 157:
 - SFAS 123 (revised 2004), Share-Based Payments
 - Pronouncements that are based on vendor-specific objective evidence (VSOE) of fair value, such as SOP 97-2, Software Revenue Recognition
 - ARB 43, Chapter 4, Inventory Pricing



SFAS 157 – Why

- Previously, there were different definitions of fair value
- Guidance for the application of those definitions was limited
- Dispersed among the many pronouncements that require or permit fair value
- Addressed the need for consistency and comparability of fair value measurements and for expanded disclosures



SFAS 157 – When Effective

- Applicable for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years
- For calendar companies, it will be effective the quarter ended March 31, 2008
- Generally to be applied prospectively, with some limited exceptions that require beginning of the year application.



SFAS 157 – Key Concepts

- Definition of fair value
- Principal (or most advantageous) market
- Market participants
- In-use versus in-exchange
- Valuation
- Fair value hierarchy
- Disclosures
- Examples



Fair Value

“ 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, cont'd

Clarifies several key points:

- Fair value is an exit price whereas the transaction price is an entry price
- An exit price in the principal (or most advantageous) market in which the issuer would transact
- Fair value is a market-based measurement, not an entity-specific measurement
- The exit price objective applies regardless of the issuer's intent and/or ability
- Fair value contemplates an actual sale of an asset or transfer of a liability, not a transaction to offset risks



Market

- Assumption that the transaction occurs in the principal market for the asset or liability
- If no principal market, then the seller would select the most advantageous market
- Principal market would hold over most advantageous even if that results in lower fair value
- Price shall not be adjusted for transaction costs
- Price would include transport costs



Market

- Market A offers \$26 for an asset, less \$3 in transaction costs for net \$23
- Market B offers \$25 for the same asset, less \$1 in transaction cost for net \$24
- If Market A is the principal market, then fair value is \$26.
- If there is no principal market, then fair value is \$25 because Market B offers higher value



Market Participants

- Market participants are buyers and sellers in the principal (or most advantageous) market for the asset or liability
 - They are independent of the issuer
 - They are knowledgeable
 - They are able to transact
 - They are willing to transact



Market Participants, cont'd

- Specific market participants do not need to be identified to apply SFAS 157
- The issuer should be able to identify the characteristics that distinguish market participants for the asset or liability



In-use / In-exchange

- Fair value is based on “highest and best use” of the asset by market participants
- Highest and best use by a market participant may differ from actual or current use of the issuer
- Highest and best use is based on “in-use” or “in-exchange”



In-use / In-exchange, cont'd

In-use considerations:

- Provides maximum value through its use in combination with other assets as a group
- Fair value is based on price to be received assuming that the asset would be used with other assets as a group and that those other assets would be available to market participants



In-use / In-exchange, cont'd

In-exchange considerations:

- Provides maximum value on a stand-alone basis
- Fair value is based on price to be received in a current transaction on a stand-alone basis



In-use / In-exchange, cont'd

An asset group consists of Asset A and Asset B and uses billing software, Asset C

	Strategic buyer (in-use)	Financial buyer (in-exchange)
Asset A	\$360	\$300
Asset B	260	200
Asset C	30	100
Total	\$650	\$600

Sum of highest amounts would suggest a fair value of \$720. However, the issuer must select the \$650 as in-use represents the highest fair value for asset group.



Valuation

Valuation techniques shall include:

- Market approach
- Income approach
- Cost approach



Valuation, cont'd

Market approach:

- Uses prices and other relevant information generated by market transactions
- Involves identical or comparable assets or liabilities
- Often uses market multiples derived from a set of comparables



Valuation, cont'd

Income approach:

- Converts future amounts (cash flow or earnings) to a single present amount (present value)
- Measurement shaped by market expectations
- Includes present value techniques, option pricing models and multi-period excess earnings method



Valuation, cont'd

Cost approach:

- Based on current replacement cost
- Requires adjustment for obsolescence
- Obsolescence is more than just depreciation, it includes:
 - Physical deterioration
 - Functional obsolescence
 - Economic obsolescence



Valuation, cont'd

Other considerations for valuation include:

- Fair value measurement is the point within a range that is most representative of fair value
- Valuation techniques shall be consistently applied; revisions shall be accounted for as a change in accounting estimate
- The use of observable inputs shall be maximized and unobservable inputs shall be minimized



Fair Value Hierarchy

- | | |
|---------|--|
| Level 1 | Quoted prices in active markets for identical assets or liabilities (unadjusted); no blockage factors (P x Q) |
| <hr/> | |
| Level 2 | Other observable input; includes quoted prices for similar assets or liabilities (adjusted) and market-corroborated inputs |
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| Level 3 | Unobservable inputs; entity's own assumptions about market participant assumptions, including assumptions about risk, developed based on the best information available (subject to cost-benefit constraints); might include issuer's own data |



Fair Value Hierarchy, cont'd

- Prioritizes inputs to valuation techniques used to measure fair value
- Determines the nature of required disclosures
- Level at which measurement is disclosed is based on lowest level of input that is significant to overall fair value measurement



Disclosures

- Measurement required on a recurring basis:
- Level of hierarchy used
 - Reconciliation of beginning and ending balances for Level 3, including:
 - Total gains and losses in income and OCI
 - Purchases, issuances and settlements
 - Transfers in and out of Level 3
 - Amount of total gains and losses recognized in earnings for unrealized gains and losses in Level 3 for assets and liabilities held at reporting date
 - Valuation techniques used to measure fair value and any changes from prior period



Disclosures, cont'd

- If measurement is performed on a non-recurring basis:
- Level of hierarchy used
 - If Level 3, a description of the inputs and the information used to develop the inputs
 - Valuation techniques used to measure fair value and any changes from prior period



Examples

Fair value measurements by level:

(Dollars in 000's)

Fair value as of December 31, 2008:

Description	12/31/2008	Level 1	Level 2	Level 3
Trading securities	\$115	\$105	\$10	\$ -
Available-for-sale securities	75	75	-	-
Derivatives	60	25	15	20
Venture capital investments	10	-	-	10
Total	\$260	\$205	\$25	\$30



Examples, cont'd

For recurring fair value measurements using Level 3 inputs:

(Dollars in 000's)

Level 3 Fair Value Measurements

	Derivatives	Venture Capital Investments	Total
Beginning balance	\$ 14	\$ 11	\$ 25
Total gains and losses included in:			
Earnings	11	(3)	8
OCI	4	-	4
Purchases, issuances and settlements	(7)	2	(5)
Transfers in/out of Level 3	(2)	-	(2)
Ending balance	\$ 20	\$ 10	\$ 30
Change in unrealized gains and losses in earnings relating to assets still held	\$ 7	\$ 2	\$ 9



Examples, cont'd

For non-recurring fair value measurements:

(Dollars in millions)

Fair Value Measurements Using:

	Year Ended 12/31/2008	Level 1	Level 2	Level 3	Total Gains (Losses)
Long-lived assets held and used	\$75	\$ -	\$75	\$ -	\$(25)
Goodwill	30	-	-	30	(35)
Long-lived assets held for sale	26	-	26	-	(15)
					<u>\$(75)</u>



Recent Developments

- FASB Staff Position No. FAS 157-1 posted February 14, 2008
- Addresses issues associated with lease classification and measurement under FAS 13
- Scope exception is limited to FAS 13 and does not apply to leases accounted for under FAS 141R




Recent Developments

- FASB Staff Position No. FAS 157-2 posted February 12, 2008
- Provides delayed effective date for certain assets and liabilities.
- Does not apply to entities that have issued interim or annual financial statements that include the application of the measurement and disclosure provisions of FAs 157



Summary

- Establishes a consistent framework for the application of fair value under GAAP
- Provides a market-based definition of fair value
- Creates a fair value hierarchy
- Provides for expanded disclosures
- Effective for fiscal years beginning after December 15, 2007, and interim periods within


Questions

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