Fair Value Measurement

Measurement in financial reporting has been a subject of debate in the last few years. This article discusses the new FAS 157 for Fair Value Measurement issued by FASB and also briefly looks at the existing Fair Value references in IAS / IFRS and Indian Accounting Standards.

There are different types of measurement attributes in financial reporting. These include historical cost, (e.g. cash and liabilities in general), modified historical cost (e.g. property, plant and equipment and receivables), fair values (derivatives and asset revaluations), and entity-specific value (impaired inventories and impaired property, plant and equipment).

In the recent years, there seem to be a perceived movement from 'historical cost', the traditional basis of measurement towards the 'fair value' basis. There have been debates and discussions on both the approaches and there are strong proponents of each basis of measurement. Proponents of fair value argue that the method of valuing assets and liabilities should be based on an 'economically satisfying' (read fair value) method instead of the traditional historical cost basis.

Reference, definitions and application of fair value is found in various pronouncements of United States Generally Accepted Accounting Principles (US GAAP), International Accounting Standards (IAS & IFRS) and Indian Accounting Standards (AS).

The use of fair value is not new. The old International Accounting Standards Committee used it, for example in IAS 22 on business combinations, originally issued in 1983. However, the notion of fair value was not much developed, and the old IAS used a number of different measurement approaches. In the United States however, the situation is different. The Financial Accounting Standards Board (FASB) has said that it believes fair value information is useful in making rational investment decisions. Fair value appears in a large number of US standards, and the FASB noted that differences in the guidance dispersed across these standards "created inconsistencies which added to the complexity of GAAP".

– CA. Shrikant Sortur

(The author is a member of the Institute as well as AICPA. He can be reached at shrikant_sortur@yahoo.com

FASB decided to issue a standard on fair value measurement, which would provide a single set of rules to be applied whenever other standards require the use of fair value. This was issued as an exposure draft in June 2004, and published in final form in September 2006 as the Statement of Financial Accounting Standard (SFAS) No.157 on 'Fair Value Measurements' (FAS 157)

Significance of FAS 157 for Indian Chartered Accountants

Fair Value Measurement Guidance is one of the Convergence Projects undertaken by the FASB of United States and IASB. IASB has said it will use FAS 157 as the exposure draft for a new International Financial Reporting Standard (IFRS) on Fair Value Measurement, and with which, logically, it should be thinking of converging. (IASB Work Plan - projected timetable as at 30 September 2006 estimates that the statement will be final by the year 2008)

ICAI is considering convergence to IFRS. A full convergence would mean adoption of IFRS in its full form. In any case AS are formulated on the basis of IAS/IFRS principles. Therefore, one could draw the conclusion that FAS 157 would be relevant to the Indian accounting professionals.

Statement of Financial Accounting Standard No.157 on 'Fair Value Measurements'

Introduction

Reference to 'Fair Value' is found in 67 pronouncements of FASB and Accounting Principles

Board (APB), which include Statements, Opinions, Interpretations and Technical Bulletins. This new standard (FAS 157) does not add to the assets or liabilities that are covered for fair value measurements, i.e. does not require any new fair value measurement, but instead provides the 'Measurement' framework for Fair Value. Twenty-eight pronouncements have been amended as a result of this standard. This statement codifies related guidance within GAAP.

The objective of the statement is to define fair value, establish a framework for measuring fair value, and expand disclosures about fair value measurements. Companies will need to adopt FAS 157 for financial statements issued for fiscal years beginning after November 15, 2007 (e.g., in 2008 for a calendar year-end company). The basic structure of listing the objective, scope, measurement, definitions is followed by Valuation techniques, Inputs, fair value hierarchy and disclosure requirements. A significant portion of the statement is taken up by the appendix that has the implementation guidance, present value techniques and the background information and basis for conclusions (which is a common feature for all SFAS).

Applicability

This standard is not applicable for:

i) Share based payment transactions (eg: APB No.25, FAS No.123 and FAS 123 (R))

ii) Accounting pronouncements that require or permit measurements that are similar to fair value but that are not intended to measure fair value, including the following:

   a. Standards that address revenue-recognition transactions that are measured based on vendor-specific objective evidence (VSOE) of fair value, including Statement of Position 97-2, Software Revenue Recognition, as modified by Statement of Position 98-9, Software Revenue Recognition, With Respect to Certain Transactions; EITF Issue No. 00-21, Revenue Arrangements with Multiple Deliverables; etc

   b. Accounting Research Bulletin No. 43, Chapter 4, "Inventory Pricing."

Measurement & Its Explanation

FAS 157 defines fair value as "Fair value is 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"

While the words may have a similar tone to past definitions, on closer observation we can find some key differences. First and foremost is the fact that the definition is based on an 'Exit' price (price that would be received to 'Sell' an asset) and not an entry price (price at which an asset would be bought) regardless of whether the entity plans to hold or sell the asset.

Contrast this with the present definition under IAS / IFRS and Indian Accounting Standards "Fair Value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arms length transaction." The words 'exchanged' in this definition can either be an 'exit' price or an 'entry' price. FAS 157 specifically defines price to be an exit price.

A brief discussion on the terminology and definitions in FAS 157 that helps us understand follows:

The objective of fair value measurement is to determine ***"the price"*** that would be received to sell the asset or paid to transfer the liability at the measurement date i.e. an Exit Price. Application of the exit price to an Asset or Liability would depend on the ***'Unit of Account'*** i.e. Either as stand alone (for example, a financial instrument or an operating asset) or as a group of assets and /or liabilities (for example, an asset group, a reporting unit, or a business) determined in accordance with other applicable accounting standards.

Orderly Transaction: is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (for example, a forced liquidation or distress sale).

The Principal (or Most Advantageous) Market is a new concept that is being introduced by FAS 157. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. *Principal market* is the market in which the reporting entity would sell the asset or transfer the liability with the greatest volume and level of activity for the asset or liability. *The most advantageous market* is the market in which the reporting entity would sell the asset or transfer the liability with the price that maximizes the amount that would be received for the asset or minimizes the amount that would be paid to transfer the liability.

Determining the appropriate market is done from the perspective of the company, thereby allowing for differences among companies and the markets in which those companies transact. For example, the principal market for a manufacturing company that enters into an interest rate swap is the "retail" market for swaps, while the principal market for an investment bank is the "wholesale" market for swaps. FAS 157 specifies that if there is a principal market for the asset or liability, the price in that market should be used to measure fair value even if the price in a different market is potentially more advantageous at the measurement date. The Board concluded that in most cases, the principal market would represent the most advantageous market and did not want to require a company to continuously evaluate multiple prices for an asset or a liability in order to determine the most advantageous market. Therefore, the price from the most advantageous market should be used only when there is no principal market for the asset or liability.

Note: *Transaction Costs vs. Transportation Costs: The price in the principal or most advantageous market should not be adjusted to reflect transaction costs (example: a commission or a fee that a broker charges). The price should, however, be adjusted to reflect transportation costs if the location of the asset or liability that is being measured is a characteristic of that asset or liability (example: the cost of transporting a physical-commodity from its current location to the market).*

'Market Participants' are buyers or sellers in

the "Principal" (or "the most advantageous") market for the asset or liability. The market participants should be (a) Unrelated (b) Knowledgeable about factors relevant to the asset or liability and the transaction; (c) Able to transact (i.e., have the legal and financial ability to do so); and (d) Willing to transact (i.e., motivated but not forced or otherwise compelled to transact).

Measurement Date: The measurement date, as specified in each accounting standard requiring or permitting fair value measures, is the "effective" valuation date. Accordingly, a valuation should reflect only facts and circumstances that exist on the specified measurement date so that the valuation is appropriate for a transaction that would occur on that date.

Application to Assets: The fair value measurement assumes the asset's highest and best use by the market participants. The company's intended use of an asset is not necessarily indicative of the highest and best use as determined by a market participant; therefore, the fair value measure is not an entity-specific measure that reflects only the company's expectations for the asset. For example, a company's management may intend to operate a property as a parking lot, while market participants would consider a Storage facility as the highest and best use of the property. In that case, the property's fair value measure should be based on the property's use as a Storage Unit.

The highest and best use of the asset establishes the valuation premise used to measure the fair value of the asset. Namely, Fair value In-Use and Fair Value In-Exchange.

- **Fair value in-use:** The highest and best use of an asset is in-use if the asset would provide maximum value to market participants principally through its use with other assets as a group. That may be the case for an operating (non-financial) asset that provides maximum value principally through its use in combination with all (or some) of the other operating assets of the company as a group. In that case, the fair value of the asset group is determined using the in-use valuation premise. FAS 157 clarifies that even in a situation where the in-use valuation premise is applicable, the fair value measure is still a market-based measure determined based on the use of the asset by market participants, not a value determined based solely on the use of the asset by the company (i.e., it is not an entity-specific measure).
- **Fair value in-exchange:** The highest and best use of an asset is in-exchange if the asset would provide maximum value to market participants principally on a stand-alone basis. That may be the case for an asset that provides maximum value separate and apart from the other assets of the company.

In other words, the asset is separable or substitutable with other equivalent assets (for example, some financial assets).

Application to Liabilities: For a liability, a fair value measure assumes that the liability is transferred to a market participant at the measurement date and that the nonperformance risk relating to the liability is the same before and after its transfer. Nonperformance risk refers to the risk that the obligation will not be fulfilled, and therefore, affects the value at which the liability is transferred. Nonperformance risk includes but may not be limited to a company's own credit risk. Accordingly, liability remeasurements at fair value should reflect the effect of changes in the company's credit standing. The fair value measure of a liability is not affected by how a company intends to settle the liability.

Note: *This is already being termed as a controversial provision since entities are required to take into account the effect of changes in their own credit standing when they measure one or more liabilities at fair value.*

The next part of FAS 157 lists out the Valuation Technique, Inputs to Valuation Techniques and the Fair Value Hierarchy. Each of these is seen in brief:

Valuation Techniques:

SFAS 157 identifies three approaches to Valuation Techniques (i.e. for estimating exit prices):

a) **Market approach:** uses "prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities." Valuation techniques include market multiples and matrix pricing.

b) **Income approach:** uses valuation techniques to convert future amounts (for example, cash flows or earnings) to a single present amount (discounted). The measurement is based on the value indicated by current market expectations about those future amounts. Valuation techniques include present value techniques; option-pricing models, such as the Black-Scholes-Merton formula and lattice models; and the multi-period excess-earnings method.

c) **Cost approach:** uses current replacement cost. i.e. is based on the amount that currently would be required to replace the service capacity of an asset often referred to as current replacement cost. The approach assumes that the fair value would not exceed what it would cost a market participant to acquire or construct a substitute asset of comparable utility, adjusted for obsolescence.

In all cases, companies should measure fair value by using a valuation technique (or a combination of valuation techniques) that is appropriate in the company's given circumstances and for which sufficient data is available. When multiple valuation techniques are used to measure fair value, the company should evaluate and weigh, as appropriate, the results to determine a single best fair value measure.

The evaluation and weighting process should not be mechanical and requires a significant amount of professional judgment. Valuation techniques used to measure fair value should be applied consistently. However, it is appropriate to change a valuation technique or its application if the change will result in a measure that better represents fair value for instance, a change in a particular technique's weighting when multiple valuation techniques are used. A change in valuation technique might also be warranted as new markets develop, new information becomes available, and valuation techniques improve. Revised valuations resulting from a change in the valuation technique or its application are accounted for as changes in accounting estimates in either (1) the period of change, if the change affects that period only, or (2) the period of change and future periods, if the change affects both.

Inputs to Valuation Techniques:

SFAS 157 defines "inputs" into various valuation techniques, as "the assumptions market participants would use in pricing the asset or liability, including assumptions about risk." Inputs are of two types, observable or unobservable:

A) Observable inputs: are inputs that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the reporting entity.

Markets in which inputs might be observable for some assets and liabilities (e.g., financial instruments) include the following: a) Exchange Market: for example, the New York Stock Exchange, the Mumbai Stock Exchange, b) Dealer Market Dealer markets exist for assets and liabilities, such as financial instruments, commodities, and physical assets, c) Brokered Market: In a brokered market, brokers attempt to match buyers with sellers, do not stand ready to trade for their own account and do not use their own capital to hold an inventory of the items for which they make a market and d) Principal-to-Principal Market: No intermediary. Often, very little information about these transactions is publicly available.

B) Unobservable inputs: are inputs that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances.

The standard specifically requires that the valuation techniques used to measure fair value should maximize the use of observable inputs and minimize the use of unobservable inputs.

Fair Value Hierarchy:

To increase consistency and comparability in fair value measurements and related disclosures, the fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. Level 1 is the highest priority and Level 3 the lowest. The details of which are as follows:

Level 1 inputs are "quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date"

Eg: Quoted price (unadjusted) in an active market. Say, Company 'A' common stock / share traded and quoted on the New York Stock Exchange / Mumbai Stock Exchange

Level 2 inputs are "inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either

directly or indirectly. Level 2 inputs include the following:

a) Quoted prices for similar assets or liabilities in active markets

b) Quoted prices for identical or similar assets or liabilities in markets that are not active that is, markets in which (i) there are few transactions for the asset or liability; (ii) the prices are not current; (iii) price quotations vary substantially either over time or among market; or (iv) little information is publicly available

c) Inputs other than quoted prices that are observable for the asset or liability (for e.g., interest rates and yield curves observable at commonly quoted intervals, volatilities, prepayment speeds, and default rates)

d) Inputs that are derived principally from or corroborated by other observable market data through correlation or by other means (market corroborated inputs)

Eg: i) Company 'Y' common stock / share traded and quoted only on an inactive market in an emerging country. ii) A privately placed bond / debenture of 'XY' whose value is derived from a similar 'XY' bond / debenture that is publicly traded.

Level 3 inputs are "unobservable inputs for the asset or liability. Therefore, unobservable inputs shall reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability. Unobservable inputs shall be developed based on the best information available in the circumstances, which might include the reporting entity's own data. In developing unobservable inputs, the reporting entity need not undertake all possible efforts to obtain information about market participant assumptions. However, the reporting entity shall not ignore information about market participant assumptions that is reasonably available without undue cost and effort. Therefore, the reporting entity's own data used to develop unobservable inputs shall be adjusted if information is reasonably available without undue cost and effort that indicates that market participants would use different assumptions."

Eg: i) Shares of a privately held company whose value is based on projected cash flows. ii) A long dated commodity swap whose forward price curve, used in valuation model, is not directly observable or correlated with observable market data.

Fair Value of an Asset or Liability - Initial Recognition

Some of the accounting standards require that an asset or a liability be initially recognized at fair value. A company should determine whether the 'transaction price' represents the fair value of the asset or the liability at initial recognition. In simple terms, the question is whether the 'exchange price' is to be recognized as the 'Fair Value'. If an asset is acquired or a liability is assumed in an exchange transaction, the transaction price represents the price that was paid for the asset or that was received to assume the liability (i.e., the entry price). In contrast, the fair value of the asset or the liability represents the price that would be received for the asset or paid to transfer the liability (i.e., the exit price). Conceptually, those two prices are different. Companies do not necessarily sell or otherwise dispose of assets at the prices that they paid to acquire them. Similarly, companies do not necessarily transfer a liability at the price that they received to assume the liability. In some situations, the transaction price will equal the exit price and, therefore, represent the fair value of the asset or liability at initial recognition.

FAS 157 cite four instances that might indicate that the transaction price does not represent fair value. The said instances are helpful in determining the fair value at initial recognition, but not necessarily all-inclusive. The reporting entity should consider factors specific to the transaction and to the asset or the liability. The four instances when the transaction price might not represent the fair value of an asset or liability at initial recognition are:

i) The transaction is between related parties

ii) The transaction occurs under duress or the seller is forced to accept the transaction price because of some urgency

iii) The unit of account represented by the transaction price is different from the unit of account for the asset or the liability that is measured at fair value. (For e.g., say, the transaction price includes transaction costs)

iv) The market in which the transaction occurs is different from the principal (or most advantageous) market in which the reporting entity would sell or otherwise dispose of the asset or transfer the liability.

Disclosures

The reporting entity needs to disclose information so as to enable the users of financial statements to assess the inputs used to develop those measurements. Towards that objective the reporting entity needs to disclose for each interim and annual period separately for each major category of assets and liabilities:

I. For Recurring Fair Value Measurements:

a. The fair value measurements at the reporting date

b. The level within the fair value hierarchy in which the fair value measurements in their entirety fall, segregating Level 1, Level 2 and Level 3

c. For fair value measures using Level 3 inputs, a reconciliation of the beginning and ending balances including total gains and losses (realized and unrealized) for the period is required, except for derivative assets and liabilities, which may be presented net.

d. In annual periods, companies should disclose the valuation techniques used to measure fair value and include a discussion of changes in the techniques employed, if any.

II. For Non Recurring Fair Value Measurements: (Point b & d remains the same as required by Recurring Fair Value Measurement disclosure.) Instead of a & c above the difference is as follows:

a. The fair value measurements recorded during the period and the reasons for the measurements

b. For fair value measurements using significant unobservable inputs (Level 3), a description of the inputs and the information used to develop the inputs

Quantitative disclosures should be presented using a tabular format and are required in all interim and annual periods. Quali-

tative disclosures about the valuation techniques used to measure fair value are required in all annual periods. FAS 157 encourages companies to combine the fair value measurement disclosures with the fair value disclosures required under other accounting standards (e.g., FAS 107), if practicable.

Fair Value under International Accounting Standards

Let us now see the Fair Value concept under International Accounting Standards (IAS) and how FAS 157 and the convergence project are impacting the same.

'Fair Value' is defined and referenced in various IAS / IFRS. (See Table 1 for the listing). Specific definition in various standards (e.g.: IAS 16,17,18,19,20,21,22, 33, 38, 40, 41 etc) is as follows:

Fair Value: "is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arms length transaction." In some of the standards there are alternative measurement that can be taken for fair value (e.g.: IAS 38 Para 9 (b) states "The revalued amount should be the fair value of the asset" and IAS 26: Para 32 "In the case of marketable securities fair value is market value"). In fact IFRS 3, Business Combinations prescribes a number of alternatives that can be used as fair value which includes estimated value, present value, current replacement cost, depreciated replacement cost, selling price less the costs of disposal plus a reasonable profit allowance etc.

IAS / IFRS currently do not have a single hierarchy that applies to all fair value measures. Instead individual standards indicate preferences for certain inputs and measures of fair value over others and lacks consistency.

In a meeting of IASB in December 2005, (exposure draft of FAS 157 was already issued) The staff of IASB presented a paper identifying and comparing the differences between the definitions of fair value in the FASB's draft Fair Value Measurements (FVM) standard to the definition in IFRS. This comparison was meant to assist the Board in concluding whether or not to replace the current IFRS definition of fair value with the FVM standard definition.

In a subsequent meeting in May 2006 the Board concurred with the Staff view that the revised definition of fair value (i.e. FASB's definition of fair value is FAS 157) is substantively similar to the one tentatively approved by the IASB in December 2005. Based on that, the IASB agreed that the revised definition is consistent with the measurement objective. In the same meeting, the Board agreed with the staff's conclusion that the FAS 157 Fair Value Hierarchy is consistent with the principles in IFRS and represents an improvement over the disparate and inconsistent guidance currently in IFRS.

There have been issues and debates on this subject within the board and its constituents. The big ones being on 'Price', the 'exit' price notion and also about market etc. IASB has said it will use FAS 157 as the exposure draft for a new International Financial Reporting Standard (IFRS) on Fair Value Measurement to be published next year, with changes and references to IFRS standards instead of the US GAAP. The objective will be to invite comments on possible issues that would arise in adopting FAS 157 principles into the new IFRS. Indications are that the divergences will be bare minimal, if any. Therefore IFRS would have the same measurement criteria, Valuation techniques and Fair Value Hierarchy as set out in FAS 157.

Fair Value under Indian Accounting Standards

Indian Accounting standards (AS) are formulated on the basis of IAS / IFRS. Fair value measurement is required by many of the standards, some of the standards define Fair value while in some others it is referenced.

We look at the Fair Value definition in AS in brief:

Table 1: International Accounting Standards that require fair value measurement

A. The following standards were noted as requiring assets or liabilities to be measured at fair value in certain circumstances:

1. IAS 11 - Construction Contracts
2. IAS 16 - Property, Plant and Equipment
3. IAS 17 - Leases
4. IAS 18* - Revenue
5. IAS 19 - Employee Benefits
6. IAS 20 - Accounting for Government Grants and Disclosure of Government Assistance
7. IAS 26 - Accounting and Reporting by Retirement Benefit Plans
8. IAS 33 - Earnings per Share
9. IAS 36 - Impairment of Assets
10. IAS 38 - Intangible Assets
11. IAS 39 - Financial Instruments: Recognition and Measurement
12. IAS 40 - Investment Property
13. IAS 41 - Agriculture
14. IFRS 1 - First-time Adoption of International Financial Reporting Standards
15. IFRS 2* - Share-based Payment
16. IFRS 3 - Business Combinations
17. IFRS 5 - Non-current Assets Held for Sale and Discontinued Operations

** For IAS 18 and IFRS 2 the measurement objective listed therein is not consistent with FAS 157 and hence being excluded from the scope for 'now'. (may change based on deliberations)*

B. Standards that require fair value measurement by reference to another standard

A. IAS 2 - Inventory

B. IAS 21 - The Effects of Changes in Foreign Exchange Rates

C. IAS 27 - Consolidated and Separate Financial Statements

D. IAS 28 - Investment in Associates

E. IAS 31 - Interests in Joint Ventures

F. IAS 32 - Financial Instruments: Presentation and Disclosure

G. IFRS 4 - Insurance Contracts

H. IFRS 7 - Financial Instruments

C. Standards that do not require fair value measurement

i. IAS 1 - Presentation of Financial Statements

ii. IAS 7 - Cash Flow Statements

iii. IAS 8 - Accounting Policies, Changes in Accounting Estimates and Errors

iv. IAS 10 - Events After the Balance Sheet Date

v. IAS 12 - Income Taxes

vi. IAS 14 - Segment Reporting

vii. IAS 23 - Borrowing Costs

viii. IAS 24 - Related Party Disclosures

ix. IAS 29 - Financial Reporting in Hyperinflationary Economies

x. IAS 30 - Disclosures in the Financial Statements of Banks and Similar Financial Institutions

xi. IAS 34 - Interim Financial Reporting

xii. IAS 37 - Provisions, Contingent Liabilities and Contingent Assets

xiii. IFRS 6 - Exploration for and Evaluations of Mineral Reserves

The most often used definition has the exact wording that exist in IAS / IFRS as of now. *AS 19 On Leases, AS 20: Earnings per share & AS 26, Intangible Assets* define "Fair Value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction." The same definition is used with the additional wordings of "Under appropriate circumstances, market value or net realisable value provides an evidence of fair value" in *AS 13: Accounting for Investments & AS 29: Provisions, Contingent Liabilities and Contingent Assets. However, in AS 14: Accounting for Amalgamations the wording* 'Or a liability settled' is missing from the regular definition.

Other standards use reference / alternatives for Fair Value measurements in AS 2, AS 11,AS 28 etc.

Example: AS 11: Accounting for the effects of changes in Foreign Exchange Rates

Para 7 (c) non-monetary items other than fixed assets, which are carried in terms of fair value or other similar valuation, e.g. net realizable value, denominated in a foreign currency, should be reported using the exchange rates that existed when the values were determined (e.g. if the fair value is determined as on the balance sheet date, the exchange rate on the balance sheet date may be used);

From the above, one can observe that Indian AS do not list a uniform fair value definition and measurement criteria. So the question would be, will Indian Accounting follow FAS 157 and proposed IFRS Fair Value measurement criteria at some point in time?

Indian Accounting Standards (AS) are formulated on the basis of the IFRSs. Changes to AS are made to consider among others, the state of economic environment in the country and the legal and regulatory framework prevailing in the country. ICAI has set up an 11-member task force to examine the issues involved in full convergence to IFRS. Full convergence would involve adoption of IFRS in the same form as issued by the IASB. At present, practical difficulties, legal and regulatory implications would be the major roadblocks to overcome.

What are also relevant are the economic environment, business practices and lack of appropriate market measures in comparison to other countries (read United States and certain European countries) to the Fair Value Measurement criteria that can be adopted by India. In fact member countries within Europe also will find it very difficult to implement the new standard.

In the Indian context, it would be appropriate to quote the Past President of ICAI, Sri T.N.Manoharan from his presentation at OECD on the topic "International Standards and Practices for Accounting, Audit and Non-financial Disclosures". The challenges that would be faced for fair value would be "The markets of many economies such as India normally do not have adequate depth and breadth for reliable determination of fair values." Another relevant point that was made was "Till date, no viable solution of objective fair value measures is available." This sums up the present situation in the Indian context.

Conclusion

Valuing tangible and intangible assets at fair value could be difficult and time-consuming. Current financial accounting standards, however, require the use of estimates every day; for example, the allowance for doubtful accounts, contingent liabilities, projected pension obligations, and goodwill impairment. It is not a significant leap to require companies to provide some measurement of the fair market value of both tangible and intangible assets, even if this information is reported only in the footnotes. In the Indian context, what would be pertinent is how 'exit' price, markets, and inputs are readily and appropriately available to make the measurement is what is to be seen.

FAS 157 has set the ball rolling on this highly debated subject. IASB has picked up that ball, now the question is whether the Indian Accountant also becomes a part of the play. Eventually it will happen in one form or the other. It would make sense to gear ourselves with the change that FAS 157 will bring. ❐