McGladrey & Pullen
Certified Public Accountants

Fundamentals of Fair Value Measurement and Disclosures

National Professional Standards Group

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A. Introduction

This document discusses the authoritative guidance on how to measure fair value and the information about fair value measurements that must be disclosed in the financial statements. This guidance is included in Topic 820, "Fair Value Measurements and Disclosures," of the Financial Accounting Standards Board's (FASB) *Accounting Standards Codification*©™ (ASC or the *Codification*). The fair value measurement and disclosure guidance in the *Codification* is taking on increased importance as the FASB continues to require recognition and measurement at fair value in the financial statements in more and more situations. In addition, the fair value measurement guidance in the *Codification* continues to be important in the preparation of fair value measurements that are only disclosed in the notes to the financial statements. Many users of the financial statements consider these disclosures a critical element to better understand the entity's operations and financial position. Given the increasing importance placed on fair value measurements by users of the financial statements and the response to that importance by the standard setters, entities should focus on ensuring that they have the appropriate resources focused on their fair value estimation processes. As there are numerous complexities in measuring the fair value of many assets and liabilities in accordance with the fair value measurement and disclosure guidance in the *Codification*, it is becoming a necessity for entities to have valuation expertise, either on their internal accounting staff or via an external valuation expert.

The FASB released its *Codification* on July 1, 2009, at which point it became the single source of authoritative U.S. generally accepted accounting principles (GAAP), excluding guidance issued by the Securities and Exchange Commission (SEC) and the Governmental Accounting Standards Board. While the FASB's *Codification* includes much of the SEC's accounting guidance (e.g., SEC Staff Accounting Bulletins [SABs]), it is not considered the authoritative source for that guidance. The FASB's *Codification* was effective in the third quarter of 2009 for calendar year-end companies (for financial statements ending after September 15, 2009). For more information about the FASB's *Codification* refer to http://asc.fasb.org/ and McGladrey & Pullen's "Quick Reference Guide to the FASB Codification" (http://mcgladrey.com/Resource_Center/McGladrey_Pullen_Quick_Reference_Guide_FASB_Codification.pdf).

The FASB's *Codification* represents a topical reorganization of pre-existing U.S. GAAP. The pre-existing U.S. GAAP that was reflected in Topic 820 of the FASB's *Codification* upon its release included:

- FASB Statement No. 157, *Fair Value Measurements*;
- FASB Staff Position (FSP) No. FAS 157-1, *Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13*;
- FSP No. FAS 157-2, *Effective Date of FASB Statement No. 157*;
- FSP No. FAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active*;
- FSP No. FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*; and
- Emerging Issues Task Force (EITF) Issue No. 08-5, "Issuer's Accounting for Liabilities Measured at Fair Value with a Third-Party Credit Enhancement."

FSP FAS 157-4 was issued in April 2009 and superseded FSP FAS 157-3. For calendar year-end public companies, FSP FAS 157-4 was effective in the quarter ending June 30, 2009. Refer to FASB ASC 820-10-65-4 for additional information regarding the effective date and transition guidance provided for in FSP FAS 157-4. This FSP is discussed in detail in Questions D4-3, E2-1 and E2-2 later in this document.

Since release of the *Codification*, the FASB has issued two Accounting Standards Updates (ASUs) that affect the fair value measurement and disclosure guidance in the *Codification*. ASU 2009-05, *Measuring Liabilities at Fair Value*, is effective for the first reporting period beginning after August 27, 2009 (including interim periods). As such, for calendar year-end public companies, the guidance in this ASU was effective for the quarter beginning October 1, 2009. ASU 2009-05 is discussed in detail in Questions D7-4 through D7-7. ASU 2009-12, *Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*, is effective in the first reporting period ending after December 15, 2009 (including interim periods). As such, for calendar year-end public companies, the guidance in this ASU is effective for the period ending December 31, 2009. ASU 2009-12 is discussed in detail in Questions D10-1 through D10-4 and F-5.

This document discusses the fair value measurement and disclosure guidance in the FASB's *Codification* as of December 31, 2009. For ease of illustrating and discussing the fair value measurement and disclosure guidance included in the *Codification*, this document uses a question-and-answer format.

B. Purpose and Scope

B-1. What is the purpose of the fair value measurement and disclosure guidance included in the *Codification*?

Prior to the issuance of Statement 157 in September 2006, different standards provided different definitions of fair value. Statement 157 provided a common definition of fair value to be used across the wide spectrum of authoritative literature that required or permitted, in some manner, a fair value measurement attribute. These measures may have been referred to by a similar name such as market value or fair market value. To provide some consistency in the measurements made to comply with its definition, Statement 157 also provided a fair value measurement framework. To ensure that users of the financial statements understand the nature, extent, and effects of the fair value measurements used by an entity in its accounting, Statement 157 instituted a fairly extensive array of disclosure requirements related to fair value measurements. The definition, measurement and disclosure guidance included in Statement 157 has been incorporated primarily into the fair value measurement and disclosure guidance included in the *Codification*.

B-2. Does the fair value measurement and disclosure guidance in the *Codification* tell an entity when to use fair value?

No. The fair value measurement and disclosure guidance in the *Codification* does not require the use of fair value. If other guidance in the *Codification* tells an entity to use fair value for accounting purposes, then the fair value measurement and disclosure guidance in the *Codification* should be used to estimate that fair value (unless an exception to the scope of that guidance is provided [see Question B-4]). In essence, the fair value measurement and disclosure guidance in the *Codification* tells you what fair value is and how to estimate fair value, but not when to use fair value.

B-3. What are examples of situations in which the fair value measurement and disclosure guidance in the *Codification* is applicable?

Appendix D of Statement 157 (which was not carried forward into the FASB's *Codification*) listed over 60 standards that incorporated fair value measurements in one manner or another. A few examples of the assets, liabilities, or transactions whose accounting is affected by the fair value measurement and disclosure guidance in the *Codification* include:

- Debt and equity investment securities classified as trading or available-for-sale;
- Substantially all of the assets and liabilities acquired in a business combination;
- Many guarantee liabilities;
- Nonmonetary transactions;

- Contributions of services to a not-for-profit organization;
- Derivatives;
- Asset retirement obligations;
- Impairments of a long-lived asset or a group of long-lived assets; and
- Restructuring liabilities.

This list includes only a fraction of all the assets, liabilities, and transactions whose accounting is affected by the fair value measurement and disclosure guidance in the *Codification*.

B-4. Are there any situations in which the fair value measurement and disclosure guidance in the *Codification* is not applicable?

Yes. There is guidance in the *Codification* that requires use of fair value for accounting purposes, but for which the fair value measurement and disclosure guidance in Topic 820 of the C*odification* is not applicable. In other words, in limited situations, the *Codification* relies on guidance other than that in Topic 820 of the *Codification* for purposes of estimating fair value. These limited situations include:

- Accounting for share-based payment arrangements;
- Accounting for leases (unless the leases were acquired in a business combination);
- Determining vendor-specific objective evidence (VSOE) of fair value for purposes of accounting for revenue-related multiple-element arrangements; and
- Accounting for inventory.

In addition, there is guidance in the *Codification* that requires use of fair value for measurement purposes, but also provides a practicability exception to following that guidance. For example:

- An asset retirement obligation is recorded at fair value only if a reasonable estimate of fair value can be made. If a reasonable estimate of fair value cannot be made, then the asset retirement obligation is not recognized until the fair value can be reasonably estimated.
- Measurement of nonmonetary exchanges is based on recorded amounts if the fair value of neither the asset given up nor the asset received is determinable within reasonable limits.

The fair value measurement and disclosure guidance in the *Codification* does not affect these exceptions.

It is worth noting that changes have recently been made to the guidance included in FASB ASC 605-25, "Revenue Recognition – Multiple-Element Arrangements" (from EITF Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables"). The changes to this guidance result from the FASB's ratification of the consensus reached in EITF Issue No. 08-1, "Revenue Arrangements with Multiple Deliverables." Upon the effective date of the guidance included in the EITF issue, the terminology in the general multiple-deliverable arrangement guidance in the *Codification* will change from "fair value" to "selling price," which will help clarify the fact that the fair value measurement and disclosure guidance in the *Codification* is not applicable to the accounting for these multiple-deliverable arrangements. Upon its effective date, this EITF issue will bring other significant changes to the general multiple-deliverable arrangement guidance in the *Codification*. Refer to ASU 2009-13, *Multiple-Deliverable Revenue Arrangements*, and McGladrey & Pullen's fact sheet, "New Model for Multiple-Deliverable Revenue Arrangements Better Reflects Economics" (http://mcgladrey.com/Resource_Center/Articles/fact_sheets_available_new_revenue_recognition_guidance.html) for the changes brought about by EITF Issue 08-1 and the effective date of this guidance.

C. Unit of Account

C-1. What is meant by "unit of account"?

The phrase "unit of account" refers to the level at which the accounting for an asset or liability occurs. For example:

- Depreciation is often calculated for each individual operating asset.
- The allowance for doubtful accounts may be determined for each individual customer account or for pools of similar customer accounts.
- Goodwill impairment is measured at the reporting unit level.

In some cases, the authoritative literature defines the unit of account (e.g., goodwill impairment). In other cases, more judgment may need to be exercised in determining the appropriate unit of account (e.g., depreciation and allowance for doubtful accounts).

C-2. What unit of account is the fair value measurement and disclosure guidance in the *Codification* applied to?

As discussed in Question B-2, other authoritative literature, and not the fair value measurement and disclosure guidance in the *Codification*, tells you when to use fair value for accounting purposes. As such, the unit of account to which this guidance is applied is dictated by the other authoritative literature that requires use of fair value. If that other authoritative literature requires you to value a single asset at fair value, then that single asset is the unit of account. If that other authoritative literature requires you to value a group of assets at fair value, then that group of assets is the unit of account. Refer to Question D10-1 for discussion of the unit of account used to measure the fair value of an alternative investment.

D. Fair Value Definition

D1. Basics

D1-1. What is the definition of fair value?

FASB ASC 820-10-20 (from paragraph 5 of Statement 157) defines fair value as "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."

D1-2. Does the definition of fair value only apply to assets and liabilities and not to items within stockholders' equity?

No. While the definition of fair value does not make reference to items within stockholders' equity, that definition is still used to measure items within stockholders' equity that are required to be measured at fair value. In other words, the definition does not apply exclusively to measuring assets and liabilities at fair value.

D2. Exit vs. Entry Price

D2-1. Does the fair value measurement and disclosure guidance in the *Codification* rely on an exit price or entry price notion for purposes of measuring fair value?

The fair value measurement and disclosure guidance in the *Codification* relies on an exit price notion to measure fair value. In the case of measuring the fair value of an asset, this is made evident in the definition by focusing on the "price to sell" instead of the "price to buy." In the case of measuring the fair value of a liability, this is made evident in the definition by focusing on the "price paid to transfer" instead of the "price paid to settle."

In some cases, the entry price and exit price for a particular asset or liability may be the same while in other cases, there may be differences between the entry price and exit price for the asset or liability. For example, an entry price and exit price for a particular asset or liability would likely differ if the transaction that is the source of the entry price

and (or) exit price: (a) is between related parties; (b) occurs under duress; (c) includes special terms, concessions or rights; and (or) (d) involves multiple assets or liabilities. In addition, the entry price and (or) exit price could be affected by synergies (see Question D5-2).

D3. Market Participant Perspective

D3-1. Is an entity-specific or market participant perspective used when measuring fair value?

Fair value must be measured from the perspective of market participants. The perspective of a market participant is paramount in the determination of fair value. The entity's own perspective or intentions should not factor into the measurement of fair value. In some cases, the entity may need to form assumptions during the fair value estimation process. While these are the entity's assumptions, they should still be based on the perspective of market participants (i.e., be the same as those assumptions that would be made by market participants).

D3-2. What characteristics must a market participant possess?

A market participant must be unrelated to the reporting entity and be willing and able to enter into the hypothetical transaction involving the asset or liability whose fair value is being measured. A market participant must also be sufficiently knowledgeable about the asset or liability whose fair value is being measured.

D3-3. When measuring the fair value of an asset, can the entity's expected use of the asset form the basis for the measurement?

No. When measuring the fair value of an asset, its highest and best use from the perspective of a market participant should form the basis for the measurement. Highest and best use essentially means assuming the use of the asset that will maximize its value to a market participant. In determining the highest and best use of an asset, any physical, legal or financial limitations or restrictions with respect to the asset should be taken into consideration. The highest and best use of an asset from a market participant's perspective may not be the same as the entity's expected use of the asset.

For example, an entity may hold a financial asset with a defined maturity date. Current market prices for that financial asset may seem artificially low, particularly if the holder of the instrument does not intend to sell the investment. However, the entity's intent and ability to hold the instrument until maturity or a market recovery should not be taken into consideration when determining the fair value of the financial asset. This is because the fair value of the financial asset should represent the price at which the entity would be able to sell the financial asset to market participants in an orderly transaction ***on the measurement date***. Use of this perspective to measure fair value does not allow for consideration of the entity's intentions to hold the financial asset until maturity or until a market recovery.

D3-4. How did the valuation of defensive intangible assets change when Statement 157 was issued?

A defensive intangible asset is defined in FASB ASC 350-30-20 as "[a]n acquired intangible asset in a situation in which an entity does not intend to actively use the asset but intends to hold (lock up) the asset to prevent others from obtaining access to the asset." One example of a defensive intangible asset is a trade name acquired in a business combination that the buyer does not intend to use or sell. The buyer does not intend to use the trade name because the buyer wants to use its own, existing trade name and the buyer does not intend to sell the trade name because the buyer does not want one of its competitors to have access to the trade name. Prior to the effective date of Statement 157, some believed that the buyer's intention with respect to the trade name should have been taken into consideration when estimating its fair value. Because the buyer intended to figuratively put the trade name on a shelf and not use it, some believed that translated into a fair value of zero. In other words, the buyer does not plan on getting any value from the name by using it or selling it, therefore, it must not have any value. The fair value measurement and disclosure guidance in the *Codification* dispels this logic and makes it clear that: (a) a market participant's perspective should be used when estimating the fair value of an asset and (b) the highest and best use of the asset should form the basis for estimating the fair value of an asset. It is highly unlikely that following these principles would result in the trade name discussed earlier having a fair value of zero. The highest and best use of

the asset to a market participant would likely be something other than putting the trade name on a shelf (i.e., using or selling it). But, even if a market participant's highest and best use of the trade name was putting it on a shelf, its value would still not be zero. In other words, there is value in not allowing others to use the asset. Under the business combination guidance in the *Codification*, the fair value determined in accordance with the fair value measurement and disclosure guidance in the *Codification* is the amount reflected for the trade name intangible asset in the accounting for the business combination.

Additional guidance on accounting for defensive intangible assets can be found throughout FASB ASC 350-30, "Intangibles—Goodwill and Other – General Intangibles Other Than Goodwill." The guidance in the *Codification* on accounting for defensive intangible assets is effective for those defensive intangible assets acquired in annual reporting periods beginning December 15, 2008 or later (which is consistent with the effective date of the business combination guidance in the *Codification*).

D4. Orderly Transactions

D4-1. What is an orderly transaction?

An orderly transaction is one that has not been forced. A distressed sale is not an orderly transaction and neither is a forced liquidation. In addition, FASB ASC 820-10-20 (from paragraph 7 of Statement 157) indicates that "[a]n 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…."

D4-2. For purposes of being considered an orderly transaction, how long must a transaction be exposed to the market?

There is no bright line for how long a transaction must be exposed to the market to be considered orderly. In general, the longer the period that a transaction is exposed to the market, the more likely it is that the exposure was sufficient for purposes of concluding that the transaction was orderly. However, the nature of the transaction and the market in which the transaction occurred must be taken into consideration when determining whether the transaction was exposed for a sufficient period of time. For example, the sale of an equity security classified as trading that has a ready market may only need to be exposed to the market for a matter of minutes or hours to be considered orderly. In contrast, the sale of a building with unique features such as a cold storage warehouse may need to be exposed to the market for several months or more to be considered orderly.

D4-3. Can orderly transactions occur in a distressed market?

Yes. The fact that a distressed ***sale*** is not an orderly transaction does not mean that a transaction that occurs in a distressed ***market*** is not an orderly transaction. Whether a transaction occurring in a distressed market is orderly or not orderly requires the exercise of judgment and the consideration of all relevant facts and circumstances. The question of whether a transaction in a distressed market represents a distressed sale has gotten significant attention given the recent economic environment. Because prices in certain markets and trading volumes in certain securities fell (or fluctuated) so dramatically, the question arose as to whether transactions occurring in those markets were distressed sales. The fact that a transaction occurs in a distressed market does not automatically make the transaction itself a distressed sale (and, therefore, a disorderly transaction that is not representative of fair value).

As discussed in the "Introduction," FSP FAS 157-4 was issued in April 2009. This FSP provided guidance on the circumstances under which a transaction may be viewed as not orderly. This guidance is included primarily in FASB ASC 820-10-35-51E through 51F. Under this guidance, the circumstances under which a transaction may be viewed as not orderly include:

- Inadequate exposure to the market such that "usual and customary" marketing activities did not take place;

- Only a single market participant was focused on by the seller during the "usual and customary" marketing period;
- The seller has filed for bankruptcy (or is close to doing so) or has been placed under receivership (or is close to having such done);
- Regulatory or legal requirements forced the seller into the transaction; and
- The transaction price falls outside the range of prices for transactions occurring in the same timeframe for the same or similar item.

This list is not all-inclusive nor does every circumstance on the list need to exist to conclude that a transaction is not orderly. In determining whether a transaction is not orderly, the entity must consider "information that is available without undue cost and effort." Said differently, an entity does not have to undertake exhaustive information-gathering efforts in this regard. It is presumed, however, that an entity would be able to determine whether a transaction is orderly if the entity is a party to the transaction.

The conclusion as to whether a transaction is not orderly is based on the weight of the evidence evaluated by the entity. After evaluating the weight of the evidence, the entity should reach one of the following conclusions about the transaction, which has the corresponding effect on whether (and, if so, how) the transaction price should be used in the fair value estimation process:

Conclusion about the Weight of the Evidence	Effect on Fair Value Estimation Process
Transaction is not orderly	Little, if any, regard should be given to that transaction price in the fair value estimation process
Transaction is orderly	Must consider that transaction price in the fair value estimation process; how the transaction price is considered depends on a number of factors including: • What is the size of the transaction? • How comparable is the subject of the transaction to the item being measured? • How close did the transaction occur to the measurement date?
Evidence is insufficient to conclude that transaction is orderly or is not orderly	Must consider that transaction price in the fair value estimation process; however, it does not have to be considered determinative of fair value nor should the entity place as much weight on this transaction price in the fair value estimation process as it would place on a price for a transaction that is determined to be orderly.

In referring to the use of the transaction price in the fair value estimation process, it is important to note that the process may need to include the estimation of a market risk premium, which is meant to compensate an investor for taking on additional risk caused by the uncertainty inherent in the cash flows of an asset or liability. Some of these additional risks relate to nonperformance and (or) liquidity. The amount of the market risk premium varies based on the level of uncertainty inherent in the cash flows. The market risk premium, together with the risk-free rate of return (i.e., the rate of return on a risk-free investment [e.g., rate of return on a U.S. treasury security]), comprise the expected return on an asset. If a market participant would require a risk premium, then the fair value estimation process should reflect an appropriate risk premium (see Question E2-3). Transaction prices may provide reference points for determining the appropriate risk premium.

D5. Valuation Premise

D5-1. What does it mean to use an "in use" valuation premise vs. an "in exchange" valuation premise?

The fair value of an asset is based on either an "in use" or "in exchange" valuation premise. An entity must determine whether the highest and best use of an asset is "in use" or "in exchange." If the maximum value of an asset is tied to its use in a group of assets, then the most appropriate valuation premise is "in use." It is common to use this valuation premise when determining the fair value of a tangible asset, such as a piece of equipment. If the maximum value of an asset would come from selling the asset on a standalone basis, then the most appropriate valuation premise is "in exchange." It is common to use this valuation premise when determining the fair value of a financial asset.

D5-2. Should synergies be incorporated into the expected cash flows used to value an asset?

Synergies should only be incorporated into the expected cash flows used to value an asset if those synergies are available to most market participants. If the synergies are unique to one party, then they should not be incorporated into the expected cash flows.

D6. Principal vs. Most Advantageous Market

D6-1. If there is more than one market in which an asset could be sold or a liability transferred, which market should be used to estimate the fair value of the asset or liability?

If a principal market for the asset or liability exists, then that market should be used for purposes of measuring fair value. If a principal market does not exist, then the most advantageous market should be used. Attributes of a principal market include the highest volume of transactions involving the asset or liability as well as the highest level of activity. The most advantageous market for an asset is the one that brings the highest price for the asset. The most advantageous market for a liability is the one that requires the lowest transfer price. The valuation of a privately-held entity will typically use the most advantageous market given the lack of a principal market for the entity's securities. The concept of "most advantageous market" does not necessarily mean an active market in the traditional sense. For example, when estimating the fair value of a privately-held entity or a portion of its business (such as a reporting unit), the most advantageous market can be thought of in the context of the question: "Who would I sell this asset to?"

Consider a situation in which the entity identifies both a principal market and a most advantageous market for purposes of determining the fair value of an asset. The fair value measurement using information from the principal market is $10,000 and the fair value measurement using information from the most advantageous market is $11,000. The fair value that should be used is the one from the principal market (i.e., $10,000) even though that fair value is less than the fair value from the most advantageous market (i.e., $11,000).

D6-2. Should transaction costs be taken into consideration when determining which market provides the most advantageous price?

Yes. As discussed earlier, if a principal market does not exist, then the most advantageous market should be used to measure fair value. In determining which market provides the most advantageous price, transaction costs should be taken into consideration. However, as discussed in Question D9-1, transaction costs should not be reflected in the fair value measurement itself.

D6-3. Is the principal market or, in its absence, the most advantageous market, determined from the perspective of a market participant or the entity itself?

The principal or most advantageous market is determined from the perspective of the entity and not the market participant. There may be markets that a market participant has access to that the entity itself does not have access to. The entity should only consider the markets that it has access to when identifying the principal or most advantageous market.

D7. Measuring Liabilities

D7-1. Under what circumstances are liabilities measured at fair value?

Liabilities are measured at fair value in many different circumstances. If an entity elects to use the fair value option to account for a financial liability, then such liability is initially and subsequently measured at its fair value in the financial statements. Unrealized gains and losses related to the periodic change in the fair value of the liability are reported in earnings. Other circumstances under which a liability is initially measured at fair value in the financial statements include:

- Recognition of an asset retirement obligation;
- Recognition of a restructuring liability; and
- Recognition of many liabilities acquired in a business combination.

Another example of a situation for which determining the fair value of a liability may be necessary involves Step 1 of the goodwill impairment test when the valuation approach first measures enterprise value, then reduces that value by the fair value of the liabilities.

In addition, fair value-related disclosures are required for many financial liabilities that are not recognized at fair value in the entity's financial statements (e.g., the entity's debt). The fair value measurement guidance in the *Codification* should be used to estimate the fair value disclosed for these financial liabilities. Refer to Question F-3 for additional discussion.

D7-2. When determining the fair value of a liability, is it safe to assume that the price to transfer the liability is the same as the price to settle the liability?

No. The price to transfer the liability assumes that the liability continues, whereas the price to settle the liability assumes that the liability has been extinguished. Fair value for a liability is based on the price to transfer the liability, not the price to settle the liability. As discussed further in the next question, this approach may produce a result with which some may not be comfortable.

D7-3. Is the credit risk of the entity taken into consideration when determining the fair value of one of its liabilities?

Yes. The fair value of a liability should take the credit risk of the entity into consideration. In other words, if there is a risk that the entity will not satisfy the obligation, that risk should be reflected in the price that would be paid to transfer that liability. This approach may have some counter-intuitive consequences with which some may not be comfortable. Consider a situation in which debt with a face value of $500,000 is accounted for at fair value. The fair value of the debt determined in accordance with the fair value measurement and disclosure guidance in the *Codification* is $450,000. The fair value of the debt is below its face value because there has been a decline in the entity's credit standing. In adjusting the debt to reflect its fair value, a gain of $50,000 would be recognized. While counter-intuitive, recognizing a gain upon a decline in an entity's credit standing is an acknowledged potential outcome of accounting for debt at fair value. To continue with this example, assume that in a subsequent period, the entity's credit standing rebounds and the fair value of the debt determined in accordance with the fair value measurement and disclosure guidance in the *Codification* is $500,000. In that situation, a loss would be recognized and attributed to a rise in the entity's credit standing. This result is also counter-intuitive, but again an acknowledged potential outcome of accounting for debt at fair value.

Another concern arises when accounting for an entity's debt at fair value when that fair value is less than its face value. This concern centers on whether a reader of the financial statements fully understands that the entity is still obligated to pay the face amount of the debt even though it has recorded a lesser amount on its balance sheet. Providing adequate disclosures in the financial statements to highlight this treatment and its results is essential.

D7-4. How does an entity estimate the amount at which it would be able to transfer one of its liabilities, particularly when its own credit risk must be taken into consideration?

This question has received a significant amount of attention given the lack of market information on transfer prices for entity-specific liabilities. There is little market information available because contractual or other legal restrictions often prevent the transfer of such liabilities.

As discussed in this document's "Introduction," the FASB provided guidance on measuring the fair value of liabilities in ASU 2009-05. Under the guidance in the ASU, when estimating the fair value of a liability, the first thing that the entity should consider is whether a quoted price in an active market is available for the exact same liability. If so, then that price should be used in measuring the fair value of the liability. In most cases, however, such information will not be available for entity-specific liabilities and the entity will need to use a valuation technique. The valuation technique may incorporate the quoted price of: (a) the exact same liability when that liability is traded as an asset; (b) a similar liability; or (c) a similar liability when that liability is traded as an asset. It may also be appropriate to use other valuation techniques, provided that the techniques are consistent with the overall definition of fair value. Examples of other valuation techniques that may be appropriate to use in measuring the fair value of a liability are: (a) a present value technique; (b) a market approach based on the amount the entity would pay to transfer the exact same liability; or (c) a market approach based on the amount the entity would receive to enter into the exact same liability.

Similar to other fair value measurements, use of "relevant" observable inputs should be maximized in any given valuation technique while use of unobservable inputs should be minimized in any given valuation technique (see Question E2-1).

ASU 2009-05 is effective for the first reporting period beginning after August 27, 2009 (including interim periods). An entity can early adopt the guidance in the ASU only if it has not yet issued the financial statements in which it wishes to adopt the guidance. The effects of the change are reflected as a change in accounting estimate. To the extent the guidance in the ASU results in a change in the valuation technique or inputs for a liability, the entity should disclose that fact and quantify the effects of the change.

D7-5. If an entity is restricted (i.e., prohibited) from transferring its own liability, how should that restriction be taken into consideration in determining the fair value of the liability?

If an entity is restricted from transferring a liability, a separate or explicit adjustment to reflect such restriction should ***not*** be made in the fair value estimation process. The theory behind not making a separate or explicit adjustment for the restriction is that the effects of the restriction are already reflected in other inputs used in the fair value estimation process. How the restriction is "already" reflected in the fair value estimation process depends on the approach used to measure the fair value of the liability. For example, assume an entity measures the fair value of a liability using a market approach that incorporates the amount the entity would receive to enter into the exact same liability (see Question D7-4). Because the exact same liability is being used in the fair value estimation process, reflecting a separate adjustment for the restrictions on the transfer of the liability would essentially double-count the effects of the restriction.

D7-6. If the quoted price for the exact same (or a similar) liability when that liability is traded as an asset is used to measure the fair value of a liability, under what circumstances would it be necessary to make adjustments to the quoted price of the asset?

A debt instrument traded as an asset is an example of a situation in which the fair value of a liability (i.e., the debt) may be measured using the quoted price for the exact same liability when that liability is traded as an asset (i.e., the quoted price of purchasing the debt as an investment). When being used to measure the fair value of a liability, it may be appropriate to adjust the quoted price of the liability when it is traded as an asset (i.e., the quoted price of the corresponding asset). Two questions that should be considered in this regard include:

- *Does the quoted price of the corresponding asset relate to the same or a similar liability?* If the quoted price relates to a similar liability, it would likely be necessary to make an adjustment to reflect the difference(s) between the liability being measured and the similar liability being used for fair value measurement purposes.
- *Is there a difference between the unit of account for the corresponding asset and the unit of account for the liability being measured?* For example, if the unit of account for the corresponding asset includes the effect of a third-party credit enhancement, an adjustment to the quoted price for that corresponding asset would be necessary as the effects of the third-party credit enhancement should not be reflected in the fair value of the liability being measured.

Note that these are not the only questions that should be considered when determining whether an adjustment to the quoted price of a corresponding asset is appropriate. Other adjustments may be necessary depending on the facts and circumstances, such as if there has been a significant decrease in the volume and level of activity for the corresponding asset (see Question E2-2).

D7-7. What constitutes a Level 1 fair value measurement for a liability?

Question E2-1 discusses the levels within the fair value hierarchy. Based on the definition of a Level 1 input, the quoted price in an active market for the exact same liability clearly represents a Level 1 fair value input. In addition, if the exact same liability is traded as an asset in an active market, the quoted price for that corresponding asset also represents a Level 1 fair value input provided that an adjustment to the quoted price for that corresponding asset is not necessary (see Questions D7-6 and E2-2). Once the entity determines that it is necessary to make an adjustment to the quoted price for the corresponding asset (e.g., because the unit of account for the asset is different from the unit of account for the liability), the quoted price for the corresponding asset would no longer be considered a Level 1 fair value input.

D8. Measuring Assets with Restrictions

D8-1. If the use of an asset is restricted, should that restriction be taken into consideration in measuring the fair value of the asset?

It depends on whether the restriction would transfer to a market participant. If the restriction would transfer to a market participant, then the effects of the restriction should be taken into consideration in measuring the fair value of the asset. If the restriction would not transfer to a market participant, then the effects of the restriction should not be taken into consideration in measuring the fair value of the asset. One factor to consider is whether the restriction is specific to the asset or to the entity. If the restriction is specific to the asset, then it may transfer to a market participant. If the restriction is specific to the entity, then it may not transfer to a market participant.

As discussed in the preceding paragraph, a transferrable restriction on an asset is taken into consideration in measuring the fair value of the asset. In taking the restriction into consideration, it may be necessary to adjust other inputs (i.e., market prices) used in the fair value estimation process. While a restriction on the transfer of a liability is also conceptually taken into consideration in measuring the fair value of the liability, a separate or explicit adjustment to reflect such restriction should not be made in the fair value estimation process. As discussed in Question D7-5, a separate or explicit adjustment is not appropriate because the effects of the restriction are already reflected in other inputs used in the fair value estimation process. FASB ASC 820-10-35-16F explains the FASB's basis for treating restrictions on assets and liabilities differently in the fair value estimation process.

D9. Transaction Costs

D9-1. Are adjustments made for transaction costs when determining the fair value of an asset or liability?

No. Adjustments to fair value should not be made for transaction costs. Such costs should be accounted for in accordance with other applicable authoritative literature. However, it may be necessary to incorporate transportation costs of the asset if such costs are necessary to sell the asset and a market participant would incorporate those costs in the price of the asset.

D10. Measuring Alternative Investments

D10-1. What is an alternative investment?

An alternative investment is an investment in an entity in which the investor may have the ability under the investee's governing documents to redeem its investment with the investee or otherwise receive scheduled distributions from the investee. Examples of alternative investments include investments in hedge funds, private equity funds, and real estate funds. In many cases, the investee will provide its investors with what is referred to as a "net asset value per share," which is defined in the "Master Glossary" for the *Codification* as: "…the amount of net assets attributable to each share of capital stock (other than senior equity securities, that is, preferred stock) outstanding at the close of the period. It excludes the effects of assuming conversion of outstanding convertible securities, whether or not their conversion would have a diluting effect." This definition is provided in the context of a financial metric calculated and reported by investment companies. While this definition or terminology may not be entirely relevant to certain types of alternative investments, an equivalent to the net asset value per share provided by investment companies would likely be provided by those investees. For purposes of the discussion in this paper about measuring the fair value of alternative investments, net asset value per share includes the equivalent metric that may be provided for these other alternative investments (e.g., certain investments in real estate funds that calculate net assets attributable to member units or an ownership interest in partners' capital).

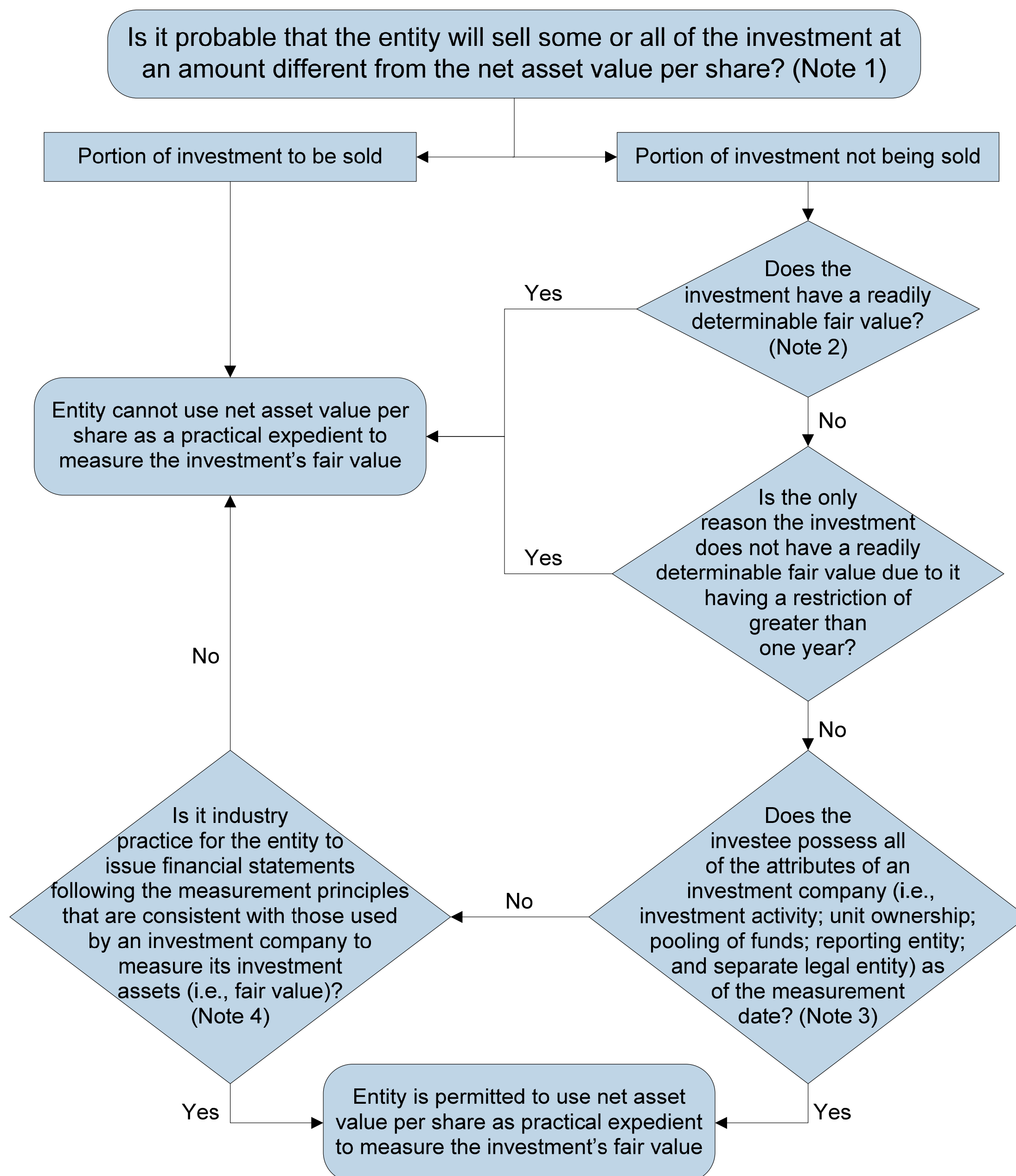
The general concept of unit of account is discussed in Questions C-1 and C-2 of this document. In applying this general concept to an alternative investment, the unit of account is the interest in the alternative investment itself (e.g., the entity's proportionate interest in the overall real estate fund), not the interests in individual investments held by (or within) the alternative investment (e.g., not the entity's proportionate interest in the individual real estate investments held by the real estate fund). Taking this approach is consistent with the notions that: (a) the entity owns an undivided interest in the alternative investment itself and not an interest in each of the investments held by the alternative investment and (b) the entity is only able to sell its interest in the alternative investment itself and not its interest in individual investments held by the alternative investment.

D10-2. What are the challenges that arise in measuring the fair value of an alternative investment?

Many alternative investments do not have "readily determinable fair values" (as defined in the "Master Glossary" for the *Codification*). As a result, many investors equate the fair value of the alternative investment to be the same as the net asset value per share for the investment. In some cases, the net asset value per share for the alternative investment may, in fact, represent its fair value (as defined by the fair value measurement and disclosure guidance in the *Codification*). This may be the case if: (a) the net asset value per share is available as of the measurement date; (b) the investment is unrestricted and redeemable at the measurement date; and (c) transactions are occurring with other investors at the net asset value per share on or near the measurement date. However, any number of factors may cause the net asset value per share for an alternative investment to differ from its fair value. For example, if the redemption of the alternative investment is restricted at the measurement date, its net asset value per share and fair value would likely differ. As such, an adjustment to the alternative investment's net asset value per share may be necessary to arrive at its fair value. Many complexities arise in determining the amount of the adjustment resulting from this restriction or other factors. As a result, the FASB has provided a practical expedient that allows for the use of an alternative investment's net asset value per share in its fair value estimation process under certain circumstances (refer to Question D10-3).

D10-3. Under what circumstances may an entity use an alternative investment's net asset value per share as a practical expedient in measuring the fair value of the investment?

The FASB addressed use of an alternative investment's net asset value per share as a practical expedient in measuring the fair value of an alternative investment under certain circumstances in ASU 2009-12. The following decision tree captures the conclusions reached in that ASU with respect to whether an entity is ***permitted*** to use an alternative investment's net asset value per share as a practical expedient in the fair value estimation process for the investment.



Note 1: FASB ASC 820-10-35-62 provides the criteria for determining whether a sale is "probable."
Note 2: The "Master Glossary" in the *Codification* defines "readily determinable fair value."
Note 3: FASB ASC 946-10-15-2 further explains the attributes of an investment company.
Note 4: The measurement principles applicable to an investment company can be found in FASB ASC 946.

To the extent an entity is not permitted to use net asset value per share as a practical expedient, the fair value of the alternative investment should be determined using the otherwise applicable fair value measurement and disclosure guidance in the *Codification*. In applying this guidance, the net asset value per share could be one of many inputs considered for use in the fair value estimation process.

The assessment and decision as to whether an entity can use net asset value per share as a practical expedient to measure an alternative investment's fair value is performed on an investment-by-investment basis. To the extent appropriately elected, an entity should use the net asset value per share to measure the fair value of its entire position in the investment, unless it is probable that a portion of the investment will be sold by the entity at an amount other than the investment's net asset value per share. FASB ASC 820-10-35-62 provides the criteria for determining whether a sale is "probable."

If an entity is permitted to use net asset value per share as a practical expedient to measuring an alternative investment's fair value and elects to do so, the entity must consider whether it is necessary to make an adjustment to the net asset value per share. Two situations in which it would be necessary to make such an adjustment include the following: (a) the net asset value per share is not calculated as of the measurement date or (b) the net asset value per share is not calculated using the measurement principles applicable to measuring the investment assets of an investment company (i.e., fair value). The measurement principles applicable to an investment company can be found in FASB ASC 946, "Financial Services—Investment Companies." In ascertaining whether the measurement principles found in FASB ASC 946 have been used in calculating the alternative investment's net asset value per share, an entity will need to gain an understanding of how the alternative investment's fund manager values its investments and calculates its net asset value per share.

Refer to Question F-5 for discussion of the incremental disclosure requirements applicable to alternative investments for which an entity ***could*** elect to use net asset value per share as a practical expedient to measure the investments' fair values.

ASU 2009-12 is effective for the first reporting period ending after December 15, 2009 (including interim periods). An entity can early adopt the guidance in the ASU only if it has not yet issued the financial statements in which it wishes to adopt the guidance. In addition, the entity can early adopt the measurement provisions of the ASU (as described in this question and Question D10-4) without early adopting the disclosure provisions of the ASU (as discussed in Question F-5). The effects of any change resulting from adoption of the guidance in this ASU are reflected as a change in accounting estimate. To the extent the guidance in the ASU results in a change in the valuation technique or inputs for an alternative investment, the entity should disclose that fact and quantify the effects of the change.

The American Institute of Certified Public Accountants (AICPA) has issued practice aids that provide implementation guidance on use of the net asset value per share for purposes of measuring the fair value of an alternative investment. These practice aids should be used when applying the guidance in ASU 2009-12. The practice aids are included in TIS Section 2220, "Long-Term Investments," of the AICPA's *Technical Practice Aids*. While these practice aids are not part of GAAP, they do provide helpful implementation guidance.

D10-4. If an entity uses an alternative investment's net asset value per share as a practical expedient to measure the investment's fair value, into what level of the fair value hierarchy does that measurement fall?

Question E2-1 discusses the levels within the fair value hierarchy. The level at which the net asset value per share falls when it is used as a practical expedient for the fair value of an alternative investment depends on whether the entity has the ability to redeem its investment with the investee at its net asset value per share and, if so, when that redemption can take place:

- *No ability to redeem*. If the entity does not have the ability to redeem, then the net asset value per share is considered a Level 3 fair value measurement.

- *Ability to redeem on measurement date.* If the entity has the ability to redeem on the measurement date, then the net asset value per share is considered a Level 2 fair value measurement.
- *Ability to redeem on a future date.* If the entity does not have the ability to redeem on the measurement date, but does have the ability to redeem on a future date, other factors related to the length of time until redemption are considered in determining whether the net asset value per share is considered a Level 2 or Level 3 fair value measurement.
  - *Does the entity know when it can redeem the investment?* If not, then the net asset value per share is considered a Level 3 fair value measurement.
  - *Is the investment redeemable in the near term?* If not, then the net asset value per share is considered a Level 3 fair value measurement.

In addition, as discussed in Question D10-3, it may be necessary to adjust the net asset value per share. For example, an adjustment may be necessary to the net asset value per share because it was not calculated as of the measurement date or because it was not calculated using the measurement principles applicable to measuring the investment assets of an investment company. In these situations, the adjusted net asset value per share would likely be considered a Level 3 fair value measurement.

E. Valuation Techniques and Inputs

E1. Basics

E1-1. What valuation techniques should be used to measure fair value?

FASB ASC 820 lists the following three types of valuation techniques as viable options for measuring fair value: (1) market approach; (2) income approach; and (3) cost approach. The approach that should be used in a particular situation depends on the facts and circumstances. FASB ASC 820-10-35-24 through 35 (from paragraphs 18 through 20 of Statement 157) discusses each of these approaches in more detail.

E1-2. Should only one valuation technique be used to measure fair value in a specific set of facts and circumstances?

Not necessarily. Depending on the facts and circumstances, it may be possible and prudent to measure fair value using more than one valuation technique. In other words, the facts and circumstances may support use of multiple valuation techniques. In these situations, a fair value (or range of fair values) is measured using multiple appropriate valuation techniques. The resulting fair value measurements are then analyzed to determine which one is most representative of fair value. Many factors would be considered in this analysis, including the relative reliability of the inputs used in each valuation technique. In addition, if the fair value measurements resulting from the different valuation techniques used fall across a wide range, the entity should consider whether such a result is reasonable. Assessing whether the range is reasonable may help to lessen the range and to identify the point within the range that best represents the fair value of the item being measured. In some situations, it may be appropriate to weight the different points in the range in arriving at the final fair value estimate.

One of the situations in which it may be appropriate to use multiple valuation techniques is when the market for the asset or liability has experienced a significant decline in volume and level of activity (see Question E2-2).

E1-3. Can an entity change the valuation technique it uses to measure the fair value of an asset or liability?

An entity can only change the valuation technique used to measure the fair value of an asset or liability if the technique the entity is changing to provides a fair value that is as good as or better than the fair value provided by the technique used previously. Changing from one valuation technique to another valuation technique is treated as a change in estimate for accounting purposes.

One of the situations in which it may be appropriate to change valuation techniques is when the market for the asset or liability has experienced a significant decline in volume and level of activity (see Question E2-2). In this situation, there may not be enough market activity to support the continued use of a market approach valuation technique, in which case a change in valuation technique may be warranted.

E1-4. What types of inputs are used in a valuation technique?

Inputs are required when using any of the three valuation techniques discussed in the fair value measurement and disclosure guidance in the *Codification*. A distinction is made in that guidance between observable inputs and unobservable inputs. Observable inputs come from independent sources. Unobservable inputs are based on the entity's own assumptions about assumptions that would be made by market participants. It is important to note that both observable inputs and unobservable inputs are still meant to capture assumptions representative of assumptions that market participants would make.

E1-5. For markets in which there are bid and ask prices, which price should be used as an input for purposes of estimating fair value?

The prices within the bid-ask spread should be analyzed to determine which price is most representative of the fair value of the asset or liability being measured. The price that is determined to be most representative of fair value should be used in the fair value measurement. Pricing conventions, such as mid-market pricing, can be used to determine the most representative price within the bid-ask spread. It is important that the conventions used are used consistently.

E1-6. Should quotes from brokers or pricing services be accepted "carte blanche" as an appropriate input to a fair value measurement?

No. When receiving a quote from a broker or pricing service, the entity should consider the source of the quote and whether the quote was developed in accordance with the fair value measurement and disclosure guidance in the *Codification*. In doing so, the entity needs to understand whether there is an active market for what is being measured. If there is an active market, the entity should gain assurance from the broker or pricing service that the quote is based on information from that active market. If there is not an active market or there has been a significant decrease in the volume or level of activity in the market, the entity needs to understand what information the broker or pricing service used to develop the quote. If a model was used by the broker or pricing service, the entity needs to understand the model and the inputs used in the model. Questions that should be considered in this regard are whether the model is using current information about orderly transactions and whether the model reflects market participant assumptions. Only after these and other questions are answered with respect to the nature of the model and inputs used by the broker or pricing service will the entity be able to assess which level the quote falls within the fair value hierarchy and whether the quote should be used in the fair value estimation process. When making this assessment, more credence should be given to quotes that incorporate relevant market transactions and that are based on binding offers.

E1-7. If an entity determines that it would be appropriate to use the discount rate adjustment technique discussed in FASB ASC 820-10-55-9 through 12 (from Appendix B of Statement 157) for purposes of estimating the fair value of a security for which the market is not active, how should the discount rate (or market rate of return) used in that technique be determined?

A discount rate adjustment technique requires an entity to determine the cash flows associated with the asset or liability whose fair value is being measured. Depending on the facts and circumstances, the single set of cash flows used in the discount rate adjustment technique may come from a range of estimated amounts and may represent contractual or promised cash flows or the most likely cash flows. The cash flows themselves are conditional in that they will not happen until another event occurs. The discount rate applied to this single set of conditional cash flows is based on observable market rates of return for comparable assets or liabilities. The discount rate adjustment technique is often used to estimate the fair value of a bond. The contractual or promised cash flows are conditioned

upon there being no default by the borrower. A range of possible cash flows related to the bond is determined and, from this range, a single set of cash flows is identified. The discount rate applied to this single set of cash flows is based on the observed market rate of return for comparable bonds.

When the market for the asset or liability whose fair value is being measured is not active, questions arise as to determining the discount rate that should be used in the discount rate adjustment technique. The fair value measurement and disclosure guidance in the *Codification* does not prescribe a specific method or formula that should be used to determine the market rate of return incorporated in the discount rate adjustment technique under these circumstances. However, FASB ASC 820-10-55-59A through 59I (from FSP FAS 157-4) provides an example of one approach that could be used to estimate the market rate of return in a specific set of facts and circumstances. Refer to that example for the types of information considered in estimating the market rate of return and the mechanics of how the information was used in the estimation process. One important point illustrated by this example is that an inactive market does not make the discount rate adjustment technique unusable.

E2. Three-Level Fair Value Hierarchy

E2-1. Is there any further distinction with respect to the inputs that should be used in valuation techniques?

Yes. The fair value measurement and disclosure guidance in the *Codification* provides a three-level fair value hierarchy. The levels are simply referred to as Level 1, Level 2, and Level 3. As discussed in Question E2-8, the levels in the fair value hierarchy apply both when referring to inputs used in valuation techniques and the fair value measurements themselves. When discussing fair value inputs, Levels 1 and 2 include only observable inputs (see Question E1-4) and Level 3 captures only unobservable inputs. Level 1 is the highest or best level in the hierarchy. This is because, as noted in FASB ASC 820-10-35-40 (from paragraph 24 of Statement 157), Level 1 captures inputs based on "quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date." Given the high relevance of a Level 1 input to what is being measured, if such an input exists, it must be used over a Level 2 or Level 3 input. Level 2 captures all other observable inputs, including other relevant quoted prices not captured in the definition of a Level 1 input:

	Active Market	Inactive Market
Quoted price for identical asset or liability	Level 1	Level 2
Quoted price for similar asset or liability	Level 2	Level 2

FASB ASC 820-10-35-48 (from paragraph 28 of Statement 157) discusses other types of Level 2 inputs.

FASB ASC 820-10-35-16C (from ASU 2009-05) and 820-10-35-36 (from FSP FAS 157-4) make a further distinction with respect to observable inputs to indicate that the use of "relevant" observable inputs should be maximized in the fair value estimation process and that unobservable inputs should be used only to the extent "relevant" observable inputs are unavailable. An observable input is "relevant" if it falls within Level 1 or Level 2 of the fair value hierarchy and, in the case of a Level 2 input, a significant adjustment to the input was not warranted (see Question E2-3). Indicating that a Level 2 input is only a relevant observable input if a significant adjustment to the input was not warranted, effectively indicates that a Level 2 input that requires a significant adjustment is a Level 3 input (i.e., a Level 2 input is no longer a Level 2 input once a significant adjustment is made to it).

The following table provides examples of inputs within the different levels of the fair value hierarchy and the types of financial instruments whose fair value might incorporate such inputs:

Level Number	Inputs	Examples	Types of Financial Instruments
1	Quoted market prices in active markets for identical assets	Prices from exchange traded markets (e.g., New York Stock Exchange [NYSE], Nasdaq, Chicago Mercantile Exchange [CME], and Chicago Board Options Exchange [CBOE])	Exchange traded and actively traded instruments
2	Inputs other than Level 1 inputs that are either directly or indirectly observable:		Restricted investments, secondary market loans, interest rate swaps, and collateralized debt securities
	• Quoted prices for similar instruments	Public common stock that is restricted under Rule 144	
	• Quoted prices for identical assets in inactive markets	Brokered markets for unrestricted securities	
	• Quoted prices for similar assets in inactive markets	A tranche of a securitized mortgage pool with similar rated loans and subject to a similar ranking for receipt of the cash flows	
	• Inputs other than quoted prices that are observable	Interest rates; yield curves at quoted intervals; volatilities; prepayment speeds; loss severities; credit risks; and default rates	
	• Inputs not directly observable, but obtained from observable market data	Transaction multiples and price/earnings multiples	
3	Unobservable inputs developed using management's estimates and assumptions (which reflect a market participant's perspective)	Expected cash flow; expected volatility; forward prices for assets beyond the term for which observable quotes exist	Private equity, complex derivatives, long-dated securities and derivatives

E2-2. What is the significance of concluding that a transaction price is from an inactive market? What makes a market "inactive"?

If a transaction price is from an active market for an identical asset or liability, it represents a Level 1 input. FASB ASC 820-10-20 (from paragraph 24 of Statement 157) defines an active market as one "in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis." Level 1 inputs are not adjusted.

If a transaction price is from an inactive market, that means it would represent, at best, a Level 2 input. As a Level 2 input, it may be appropriate to make adjustments to the input when using it in the fair value estimation process. The circumstances under which it is appropriate to make adjustments to a Level 2 input in the fair value estimation process are discussed in Question E2-3.

As discussed in the "Introduction" to this document, FSP FAS 157-4 was issued in April 2009. This FSP discussed some of the factors that should be considered in determining whether a market is inactive or whether "there has been a significant decrease in the volume and level of activity for the asset or liability when compared to normal market activity for the asset or liability (or similar assets or liabilities)." This guidance is included primarily in FASB ASC 820-10-35-51A through 51D. The following table captures questions that should be considered in determining whether a market is inactive or whether there has been a comparative decrease in the volume and level of activity in the market:

Question…	Answer indicative of an inactive market or that there has been a comparative decrease in the volume and level of activity in the market…
How many recent transactions are there in the market?	Few such transactions
Are the price quotations based on current or noncurrent information?	Noncurrent information
Over time or among market makers, how significant have the variations in the price quotations been?	Substantial variations
How has the level of correlation between an index and recent indications of fair value changed?	Gone from highly correlated to uncorrelated
How significant is the bid-ask spread?	Wide bid-ask spread
How has the bid-ask spread changed?	Significant increase in the bid-ask spread
How much information about the market is publicly available?	Little public information
How has the market for new issuances of the asset or liability (or similar asset or liability) changed?	Significant decline in new issuances or overall lack of a market
How have implied liquidity risk premiums, yields, or performance indicators changed in comparison to estimates of expected cash flows that take into consideration all available market data on relevant nonperformance risks (e.g., credit risk)?	Significant increase in implied liquidity risk premiums, yields or performance indicators

After considering these and other relevant factors, an entity evaluates the weight of the evidence to determine whether the market has become inactive or that there has been a comparative decrease in the volume and level of activity in the market. If the weight of the evidence indicates that the market is inactive or that there has been a comparative decrease in the volume and level of activity in the market, then transactions or quoted prices from that market may not represent fair value. Additional analysis of the market data must be performed and judgment exercised to determine whether an adjustment (perhaps a significant adjustment) to the market data is needed in order to make it more representative of fair value. The circumstances under which it is appropriate to make an adjustment to a Level 2 quoted price are discussed in Question E2-3. It is important to keep in mind that just because a quoted price comes from an inactive market does not automatically render that quoted price as irrelevant or useless in the fair value estimation process. In its fair value measurement and disclosure guidance, the FASB clearly contemplated quoted prices from inactive markets playing a role in the fair value estimation process.

E2-3. When is it appropriate to make an adjustment to a Level 2 quoted price? What effect does an adjustment have on the level of the input within the fair value hierarchy?

Because quoted prices falling within Level 2 of the fair value hierarchy may come from an inactive market and (or) relate to a similar (instead of identical) asset or liability, it may be appropriate to adjust the quoted price when using it in the fair value estimation process. Questions that should be considered in determining whether an adjustment to a Level 2 quoted price is appropriate include the following:

- *Does the condition of the asset or liability for which there is a quoted price differ from the condition of the asset or liability whose fair value is being measured?* If there are significant differences in condition, then an adjustment to the quoted price might be appropriate.
- *Does the location of the asset or liability for which there is a quoted price differ from the location of the asset or liability whose fair value is being measured?* If there are significant differences in location, then an adjustment to the quoted price might be appropriate.
- *How comparable (or incomparable) is the asset or liability for which there is a quoted price to the asset or liability whose fair value is being measured?* The greater the degree of comparability, the less likely that an adjustment to the quoted price would be appropriate.
- *What volume and level of activity exists in the market from which the quoted price originates?* The higher the volume and level of activity, the less likely that an adjustment to the quoted price would be appropriate.
- *Are there multiple quoted prices that vary over a relatively confined period of time?* If so, the more significant the variations, the more likely that an adjustment to the quoted price would be appropriate.
- *Are there multiple quoted prices that vary among market participants?* If so, the more significant the variations, the more likely that an adjustment to the quoted price would be appropriate.
- *How current are the quoted prices?* The less current the quoted price, the more likely that an adjustment to the quoted price would be appropriate.
- *Would a market participant adjust the quoted price for nonperformance or liquidity risks?* If so, then an adjustment should be made to the quoted price to reflect the market participant's assumptions about nonperformance and liquidity risk at the measurement date under current market conditions. The difficulty that may arise in determining the risk adjustment does not excuse the entity from making the adjustment.

The complement of answers to these questions should be analyzed to determine whether, based on the weight of the evidence, it would be appropriate to adjust a Level 2 quoted price and, if so, the amount of the adjustment. The nature and significance of any adjustment could ultimately result in the quoted price being considered a Level 3 input. The mere fact that an adjustment is made to a Level 2 quoted price does not automatically mean that the Level 2 quoted price should not be used or that it would be appropriate to use a Level 3 input in place of the "adjusted" Level 2 quoted price. In other words, making an adjustment to a Level 2 quoted price does not make it a "bad" estimate or automatically justify use of a Level 3 input.

Refer to Question D7-6 for additional discussion regarding when adjustments may be warranted in estimating the fair value of a liability. Refer to Questions D10-3 and D10-4 for additional discussion regarding when adjustments may be warranted in estimating the fair value of an alternative investment.

E2-4. If a Level 1 or Level 2 input represents the "last transaction price" in an active or inactive market, must that input be used in a fair value measurement?

In general, if the "last transaction price" is a Level 1 input, then it should be used in the fair value measurement. If the "last transaction price" is a Level 2 input, then it should be taken into consideration in the fair value estimation process. In addition, depending on the facts and circumstances, it may be appropriate to adjust the "last transaction price" if it is a Level 2 input (see Question E2-3).

E2-5. Does the white paper issued by the International Accounting Standards Board (IASB) Expert Advisory Panel entitled, "Measuring and disclosing the fair value of financial instruments in markets that are no longer active," provide guidance that is relevant under U.S. GAAP?

Yes. While not the same, the definitions of fair value used in IFRS and U.S. GAAP are quite similar. For example, both require determining fair value using a market participant's perspective; both make similar distinctions between

prices in active markets and prices in inactive markets; and both indicate that prices from forced or distressed sales do not represent fair value. Given these similarities, the guidance in the white paper may be helpful in understanding certain aspects of the fair value measurement and disclosure guidance in the *Codification*. Refer to the following URL for a copy of the white paper: http://www.iasb.org/NR/rdonlyres/0E37D59C-1C74-4D61-A984-8FAC61915010/0/IASB_Expert_Advisory_Panel_October_2008.pdf

E2-6. Is a Level 3 input an entity-specific measurement?

Level 3 inputs are based on an entity's assumptions. However, those assumptions must still be focused on the assumptions that market participants would make with respect to estimating the fair value of the asset or liability. The information used to form these assumptions may come from external sources or it may come internally from the entity's own data.

E2-7. What type of information is used to develop a Level 3 input?

FASB ASC 820-10-35-55 (from paragraph 30 of Statement 157) indicates that when developing a Level 3 input "the best information available in the circumstances" should be used so long as that information "is reasonably available without undue cost and effort." The entity is not expected to exhaustively search for all relevant information. But, there is an expectation that a base level of effort will be put forth to gather relevant information. Once identified, relevant information cannot be ignored.

E2-8. Do the levels in the fair value hierarchy apply when discussing inputs to valuation techniques or the fair value measurements themselves?

Both. The levels in the fair value hierarchy apply both when referring to inputs used in valuation techniques and the fair value measurements themselves. For purposes of the inputs used in valuation techniques, it is necessary to determine which level of the fair value hierarchy an input falls as higher level inputs should be used to the extent available. For purposes of the fair value measurements themselves, the level in the fair value hierarchy in which a measurement falls depends on the inputs used in conducting the fair value measurement (see Question E2-9). Additional factors are considered in determining the level in the fair value hierarchy in which the estimate of an alternative investment's fair value falls (see Question D10-4). It is necessary to determine which level of the fair value hierarchy a fair value measurement falls as the disclosure requirements for a particular measurement are dependent on the level in the fair value hierarchy in which it falls (see Question F-1).

E2-9. How does an entity determine which level within the fair value hierarchy a fair value measurement falls when that fair value measurement includes inputs from more than one level in the hierarchy?

As noted earlier, the level in the fair value hierarchy in which a measurement falls depends on the inputs used in conducting the fair value measurement. When all of the inputs used in a fair value measurement fall within the same level of the fair value hierarchy, then determining the level in which the fair value measurement itself falls is easy. In other words, if all of the inputs to a fair value measurement fall within Level 1 of the fair value hierarchy, then the measurement itself would fall within Level 1. When inputs from more than one level in the hierarchy are involved in measuring fair value, then determining the level in which the fair value measurement itself falls requires an additional step – assessing the significance of each one of the inputs to the fair value measurement. The lowest level input deemed to have a significant effect on the fair value measurement sets the level of the fair value measurement itself within the fair value hierarchy. For example:

- A fair value measurement involves inputs from all three levels of the fair value hierarchy. However, only the Level 1 and Level 2 inputs have a significant effect on the fair value measurement. The fair value measurement falls within Level 2 of the fair value hierarchy.
- A fair value measurement involves inputs from all three levels of the fair value hierarchy. There is a Level 3 input that has a significant effect on the fair value measurement. The fair value measurement falls within Level 3 of the fair value hierarchy.

F. Disclosures

F-1. What types of fair value disclosures are required by the fair value measurement and disclosure guidance in the *Codification*?

The nature of the disclosures required by the fair value measurement and disclosure guidance in the *Codification* depends on whether the fair value measurement is recurring or nonrecurring and which level within the fair value hierarchy the fair value measurement falls. The following are the disclosure objectives included in FASB ASC 820-10-50-1 for recurring fair value measurements:

> The reporting entity shall disclose information that enables users of its financial statements to assess both of the following:
>
> a. For assets and liabilities that are measured at fair value on a recurring basis in periods subsequent to initial recognition (for example, trading securities), the inputs used to develop those measurements
>
> b. For recurring fair value measurements using significant unobservable inputs (Level 3), the effect of the measurements on earnings (or changes in net assets) for the period.

The following is the disclosure objective included in FASB ASC 820-10-50-5 for nonrecurring fair value measurements: "…the reporting entity shall disclose information that enables users of its financial statements to assess the inputs used to develop those measurements."

To meet these objectives, information must be disclosed in interim and annual periods to answer the questions in the following table for recurring and (or) nonrecurring fair value measurements made during the reporting period. The information must be provided for each major category of assets and liabilities.

	Recurring	Nonrecurring
What fair value measurements have been made at the reporting date?	X	X
Why were the fair value measurements made?		X
Do the fair value measurements made fall within Level 1, 2, or 3 of the fair value hierarchy?	X	X
What were the beginning and ending amounts of Level 3 fair value measurements and what types of activities caused the change in the beginning and ending amounts? (Note 1)	X	
What income statement line item includes realized and unrealized gains and losses on Level 3 fair value measurements that were reflected in earnings?	X	
What is the amount of the unrealized gains or losses recorded on Level 3 fair value measurements that are still reflected on the entity's balance sheet at the balance-sheet date and what income statement line item includes those gains or losses?	X	
What inputs were used in Level 3 fair value measurements and how were those inputs developed?		X
Which inputs and valuation techniques were used in the fair value measurements?	X	X
What types of changes, if any, were made to the valuation techniques and related inputs used in the fair value measurements? (Note 2)	X	X

Note 1: This information must be presented as a rollforward from the beginning balance to the ending balance. In addition, FASB ASC 820-10-50-2(c) (from paragraph 32(c) of Statement 157) lists specific types of activities that must be shown separately within this rollforward, such as information about realized and unrealized gains and losses and transfers from Level 1 or 2 into Level 3 and transfers from Level 3 into Level 1 or 2. Refer to FASB ASC 820-10-50-2(c) for additional information.

Note 2: For nonrecurring fair value measurements, when determining whether a change occurred reference would be made to fair value measurements made in previous periods for assets and (or) liabilities that are similar to the assets and (or) liabilities being measured in the current period.

For purposes of preparing the necessary disclosures, "major category of assets and liabilities" is defined in FASB ASC 820-10-50-2 (from paragraph 32 of Statement 157). There are two pending changes (brought about by FSP FAS 157-4 and ASU 2009-12) to this paragraph of the *Codification*.

The primary difference between the disclosures required for recurring and nonrecurring fair value measurements are those focused on the Level 3 fair value measurements. In both cases, additional disclosures are required for Level 3 fair value measurements. However, for recurring Level 3 fair value measurements, the disclosure requirements are particularly involved given the reconciliation requirement. Question F-6 discusses how the disclosure requirements applicable to fair value measurements are expected to change as a result of a pending FASB project.

F-2. How should the quantitative information that must be disclosed to comply with the requirements of the fair value measurement and disclosure guidance in the *Codification* be presented?

The fair value measurement and disclosure guidance in the *Codification* requires tabular presentation of the quantitative information that must be disclosed to comply with its requirements.

F-3. Does an entity have to provide the disclosures required by the fair value measurement and disclosure guidance in the *Codification* for the disclosure-only fair value measurements required by FASB ASC 825-10-50 (from FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*)?

No. The disclosure requirements in the fair value measurement and disclosure guidance in the *Codification* apply to fair value measurements that affect the accounting for an asset or liability. As such, if a fair value measurement is made for disclosure purposes only (i.e., to comply with FASB ASC 825-10-50), the disclosures required by the fair value measurement and disclosure guidance in the *Codification* do not have to be provided for that fair value measurement. That said, an entity is not prohibited from providing those disclosures for disclosure-only fair value measurements.

F-4. Does an employer have to comply with the disclosure requirements of the fair value measurement and disclosure guidance in the *Codification* as it pertains to the employer's defined benefit pension plan assets or other postretirement benefit plan assets and the related fair value measurements?

No. FASB ASC 820-10-50-10 (FASB Staff Position (FSP) No. FAS 132R-1, *Employers' Disclosures about Postretirement Benefit Plan Assets*), explains that the disclosure requirements of the fair value measurement and disclosure guidance in the *Codification* are not applicable to the fair value measurements involved in the accounting for an employer's postretirement benefit plan assets. However, additional fair-value related disclosure requirements for an employer's defined benefit pension plan assets or other postretirement benefit plan assets were added to FASB ASC 715-20-50-1 and ASC 715-20-50-5. Many of these required disclosures are similar to those required by the fair value measurement and disclosure guidance in the *Codification*. Refer to the *Codification* for the detailed disclosure requirements applicable to fair value measurements of plan assets. These additional disclosure requirements are effective for fiscal years ending after December 15, 2009.

F-5. Are additional disclosures required for alternative investments for which an entity ***could*** elect to use net asset value per share as a practical expedient to measure the investments' fair values (see Questions D10-3 and D10-4)?

Yes. Additional disclosures are required for alternative investments regardless of whether the entity avails itself of the practical expedient. Separate objectives were established for the disclosures related to these types of investments. To satisfy these objectives, a whole host of information about these types of investments must be disclosed in each interim and annual period. The information that must be disclosed focuses on:

- The fair value of these investments by major category;
- The investment strategies followed by the investees in each major category;
- The redemption provisions and timing applicable to each major category of these investments;

- The timing of distributions to be received related to each major category of these investments as a result of the liquidation of the underlying assets of the investees;
- The entity's unfunded commitments related to each major category of these investments;
- Restrictions on the entity's ability to sell these investments by major category; and
- The planned sale of any of these investments.

Refer to FASB ASC 820-10-50-6A for the disclosure objectives and requirements applicable to alternative investments for which an entity could elect to use net asset value per share as a practical expedient to measure the investments' fair values. Refer to FASB ASC 820-10-55-64A for an illustration of the disclosure requirements applicable to alternative investments.

These disclosures are required by ASU 2009-12 (see Questions D10-3 and D10-4), which is effective for the first reporting period ending after December 15, 2009 (including interim periods). An entity can early adopt the guidance in the ASU only if it has not yet issued the financial statements in which it wishes to adopt the guidance. In addition, the entity can early adopt the measurement provisions of the ASU (as described in Questions D10-3 and D10-4) without early adopting the disclosure provisions discussed in this question. To the extent the guidance in the ASU results in a change in the valuation technique or inputs for an alternative investment, the entity should disclose that fact and quantify the effects of the change.

F-6. Does the FASB have any plans to require additional disclosures related to fair value measurements?

Yes. The FASB issued a proposed ASU on August 28, 2009 that would amend the fair value measurement and disclosure guidance in the *Codification* to improve disclosures about fair value measurements. The comment period for the proposed ASU ended on October 12, 2009. The FASB has considered the comments received on the proposed ASU and has decided to move forward with a final standard that requires more disclosures about fair value measurements. These additional disclosures are focused on the needs of investors and the type of information that would assist in their understanding of the fair value measurements included in the financial statements and the effects those measurements have on the financial statements. The final standard will require disclosures related to the following matters:

- The transfer of fair value estimates in and out of Levels 1 and 2;
- Gross purchases, sales, issuances, and settlements within the rollforward of activity for Level 3 fair value estimates;
- The level at which fair value measurement disclosures must be provided (i.e., for each class of assets and liabilities); and
- The inputs and valuation techniques used for Levels 2 and 3 fair value estimates and any changes in those inputs and (or) techniques.

All but the detailed information related to the rollforward of activity for Level 3 fair value estimates will need to be provided in financial statements for interim and annual reporting periods beginning after December 15, 2009. The detailed information related to the rollforward of activity for Level 3 fair value estimates will not need to be provided until interim and annual reporting periods beginning after December 15, 2010. An entity may early adopt the final standard. This is a high priority project of the FASB and is expected to be completed during the first quarter of 2010. Refer to the FASB's website for the status of this proposed ASU: http://www.fasb.org/fas157_improving_disclosures_about_fvm.shtml.

The proposed ASU would have required an entity to provide disclosures about the sensitivity of Level 3 inputs to "reasonably possible alternatives." Based on the comments the FASB received on the proposed ASU, this disclosure requirement will not be included in the final standard. However, the FASB will reconsider adding this disclosure requirement as part of its "Fair Value Measurement and Disclosure" project (see Question H-1).

G. Effective Date and Transition

G-1. When is (or was) the fair value measurement and disclosure guidance in the *Codification* effective?

The general effective date provisions for the fair value measurement and disclosure guidance in the *Codification* vary depending on whether the fair value measurement is recurring or nonrecurring and on whether the fair value measurement involves a financial or nonfinancial asset:

	Recurring	Nonrecurring
Financial asset or liability	Fiscal years beginning after November 15, 2007	Fiscal years beginning after November 15, 2007
Nonfinancial asset or liability	Fiscal years beginning after November 15, 2007	Fiscal years beginning after November 15, 2008

In addition, the fair value measurement and disclosure guidance in the *Codification* is effective in the interim period of the year in which the standard first became effective. For a calendar year-end company, this guidance was effective for the year ending December 31, 2008 for recurring fair value measurements of both financial and nonfinancial assets and liabilities and is effective for the year ending December 31, 2009 for nonrecurring fair value measurements of nonfinancial assets and liabilities.

As discussed in several other questions within this document, certain elements of the fair value measurement and disclosure guidance in the *Codification* have been amended and these amendments have different effective dates. Captured in the table that follows are the effective dates for three of the more significant changes made to the fair value measurement and disclosure guidance in the *Codification*:

Standard-Setting Activity	Topic of Standard-Setting Activity	Effective for calendar year-end public company in…	Effective for calendar year-end private company in… (Note 1)	Question
FSP FAS 157-4	Determining whether a market is active or inactive and whether a transaction is orderly or disorderly	Quarter ending June 30, 2009	Year ending December 31, 2009	D4-3, E2-1 and E2-2
ASU 2009-05	Measuring fair value of liabilities	Period ending December 31, 2009	Year ending December 31, 2009	D7-4 through D7-7
ASU 2009-12	Measuring fair value of alternative investments	Period ending December 31, 2009	Year ending December 31, 2009	D10-1 through D10-4; F-5

Note 1: For purposes of this table, assume that the private company prepares only annual financial statements and issues these financial statements to its lenders in the months following its calendar year-end.

The transition and effective date guidance for all pending content in the fair value measurement and disclosure guidance in the *Codification* can be found in FASB ASC 820-10-65-1 through 6.

G-2. What were the general transition provisions for the fair value measurement and disclosure guidance in the *Codification*?

The fair value measurement and disclosure guidance in the *Codification* is (or was) generally applied prospectively, with limited exceptions. The limited exceptions all dealt with relatively narrow fact patterns involving certain types of financial instruments. Paragraph 37 of Statement 157 described these financial instruments and fact patterns and paragraph 38 of Statement 157 described the transition approach (i.e., cumulative-effect adjustment) applied in these situations. Paragraphs 37 and 38 of Statement 157 were not carried forward into the *Codification* given that the provisions of the fair value measurement and disclosure guidance in the *Codification* were applicable to financial

instruments in fiscal years beginning after November 15, 2007 (see Question G-1). In other words, the effective date for financial instruments has already passed.

As discussed in Question G-1, certain elements of the fair value measurement and disclosure guidance in the *Codification* have been amended and these amendments have their own transition provisions. The transition and effective date guidance for all pending content in the fair value measurement and disclosure guidance in the *Codification* can be found in FASB ASC 820-10-65-1 through 6.

H. Other Standard-Setting and Implementation Activities

H-1. Are there any current standard-setting activities on the subject of fair value measurements?

Yes. Question F-6 discusses a final standard that will affect disclosures related to fair value measurements. This final standard is expected to be issued in the first quarter of 2010. Also on the subject of disclosures, the FASB added the "Disclosure Framework" project to its agenda on July 8, 2009. As stated on the FASB's website (see http://www.fasb.org/cs/ContentServer?c=FASBContent_C&pagename=FASB%2FFASBContent_C%2FProjectUpdatePage&cid=1176156344894), "[t]he objectives of this project are to (1) establish an overarching framework intended to make financial statement disclosures more effective, coordinated, and less redundant, and (2) seek ways to better integrate information provided in financial statements, MD&A, and other parts of a company's public reporting package." The FASB is not expected to begin deliberations on this project until the first quarter of 2010. Given that one of the impetuses for this project was the "disclosure overload" some constituents believe exists, particularly with respect to fair value measurement disclosures, it is possible that this project could ultimately (yet indirectly) affect the nature and extent of such disclosures.

On October 28, 2009, the FASB agreed to add a project to its agenda in which it would work with the IASB to create converged fair value guidance. The IASB issued an exposure draft, *Fair Value Measurement*, in July 2009. While there are similarities between the guidance in the IASB's exposure draft and the fair value measurement and disclosure guidance in the *Codification*, there are also differences. The objective of the joint project between the FASB and IASB is to eliminate substantially all of these differences such that: (a) the FASB's and IASB's definitions of fair value are the same and (b) the FASB's and IASB's guidance on how to measure fair value is substantially the same. As the IASB considers comments received on its exposure draft, the FASB will also consider those comments and the conclusions reached by the IASB. In considering those comments and conclusions, the FASB will determine whether it is appropriate and necessary to amend the fair value measurement and disclosure guidance in the *Codification* so that the end result of the joint project is converged fair value guidance. The FASB expects to issue an exposure draft on this project in the first quarter of 2010. The FASB and IASB expect to have converged fair value measurement requirements by September 2010. Refer to the FASB's website for the status of this project: http://www.fasb.org/cs/ContentServer?c=FASBContent_C&pagename=FASB%2FFASBContent_C%2FProjectUpdatePage&cid=1176156576143.

One of the other joint projects between the FASB and IASB addresses the accounting for financial instruments. The purpose of this project is to comprehensively reconsider the accounting for financial instruments. In doing so, there should be: (a) improvements in the quality of information provided in the financial statements about financial instruments; (b) increased convergence between the FASB's and IASB's guidance on accounting for financial instruments; and (c) simplification of the accounting model applied to financial instruments. While this project is not expected to change the fair value measurement and disclosure guidance in the *Codification*, this project could result in more financial instruments being initially and subsequently measured at fair value using the fair value measurement and disclosure guidance in the *Codification*. This is a high priority project for the FASB. As a result, the FASB expects to issue an exposure draft for this project in the first quarter of 2010. Refer to the FASB's website for the status of this project:
http://www.fasb.org/cs/ContentServer?c=FASBContent_C&pagename=FASB%2FFASBContent_C%2FProjectUpdatePage&cid=1175801889654.

H- 2. What type of implementation guidance on fair value is available from the AICPA?

The AICPA is currently in the process of updating two practice aids that will discuss the fair value measurement guidance in the *Codification* as it relates to accounting for acquired in-process research and development (IPR&D) activities and the valuation of privately-held company equity securities (which is also known as the "cheap stock" practice aid). When updated versions of these practice aids are available they will be posted to the AICPA Store website (www.cpa2biz.com). In addition, the AICPA issued practice aids that provide implementation guidance on use of the net asset value per share for purposes of measuring the fair value of an alternative investment. These practice aids should be used when applying the guidance in ASU 2009-12 (see Questions D10-1 through D10-4) and are included in TIS Section 2220, "Long-Term Investments," of the AICPA's *Technical Practice Aids*. While the practice aids mentioned in this paragraph do not represent GAAP, they do (or will) provide helpful implementation guidance.

H-3. What is the Valuation Resource Group?

The FASB formed the Valuation Resource Group (VRG) to help identify issues that arise in practice with respect to the application of the fair value measurement and disclosure guidance in the *Codification*. The VRG held its first meeting in October 2007 and has met several times since then. The VRG consists of 15 to 20 members representing various constituencies, including public accounting firms, valuation specialists, preparers, and users of financial statements. Generally, the meetings of the VRG are not open to the public as they do not engage in formal standard-setting activities. However, a portion of the most recent meetings of the VRG has been open to the public because the FASB is present during that portion of the meeting. The VRG continues to provide input to the FASB staff and the FASB on the application issues related to the fair value measurement and disclosure guidance in the *Codification* that arise in practice. In some cases, they may indicate that an issue warrants additional guidance or clarification. Any standard-setting activity with respect to an issue raised or discussed by the VRG would need to be undertaken by the FASB.