Accounting Standards Update 2011-04:
Fair Value Measurement and Disclosure

Last May, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) issued an Accounting Standards Update (ASU 2011-04) that attempts to converge Generally Accepted Accounting Principles (GAAP) with International Financial Reporting Standards (IFRS) for fair value measurement and disclosure.

Wording differences between GAAP and IFRS for fair value measurement caused confusion among reporting entities. The ASU is meant to eliminate these discrepancies and provide new and updated information related to the topic of fair value measurement and disclosure. New standards took effect for interim and annual periods beginning after December 15, 2011 for both public and non-public entities.

It should be noted that the ASU 2011-04 is meant to provide guidance as to how, and not when, one should measure fair value. For information concerning what assets and liabilities require fair value measurement and when to measure them for fair value, see the reporting unit topic in the ASC 350.

A few of the important changes and clarifications from the Update are:

- The concept of "highest and best use," which has always applied to all assets and liabilities, now only applies to nonfinancial assets and liabilities when measuring fair value. The ASU found that this concept was not relevant to financial assets and liabilities, and therefore unnecessary.

- Before the ASU was issued, there was no guidance for measuring the fair value of instruments classified in shareholder's equity. The Update provides that these instruments should be measured "from the perspective of a market participant that holds that instrument as an asset," using the same guidance that it would use for its liabilities.

- In certain cases, the Update provides an exception to fair market measurement principles when the financial asset or liability in question has "offsetting positions in market risks or counterparty credit risk." When this and certain other criteria are met, these assets/liabilities are measured on the fair value of their net risk position.

- Premiums and discounts that meet certain requirements are no longer permitted in a fair value measurement. Premiums or discounts related to size as a characteristic of a reporting entity's holding, for instance, fall within this category.

- The ASU expands disclosure guidance for Level 3 inputs, requiring disclosure of quantitative information for unobservable inputs and assumptions, a description of the valuation process, and a narrative description of the sensitivity of the fair value to "changes in unobservable inputs and any interrelationships between those unobservable inputs."

- Further guidance on disclosure requirements is also included in the ASU.

For more information on the new standards for fair value measurement and disclosure, please feel free to contact any of the principals of Bond & Pecaro.