FEBRUARY 2014

POST-IMPLEMENTATION REVIEW REPORT

FASB Statement No. 157, *Fair Value Measurements*

(Codified in Accounting Standards Codification Topic 820, Fair Value Measurements and Disclosures)

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The accompanying *Post-Implementation Review Report* on FASB Statement No. 157, *Fair Value Measurements (*Statement 157), summarizes the FAF's post-implementation review (PIR or Review) team's research results and conclusions (collectively, Findings), and recommendations from its Review of Statement 157. The PIR process is an important part of our FASB and GASB standard-setting oversight responsibilities. Our oversight objectives are to improve the standard-setting process, in part, through a robust, independent, and credible PIR process.

The PIR team's review accomplishes the objectives we set out for the PIR process: (1) to determine whether Statement 157 is accomplishing its stated purpose, (2) to evaluate Statement 157's implementation and continuing compliance costs and related benefits, and (3) to provide recommendations to improve the FASB's standard-setting process. To maintain the FASB's standard-setting independence, the PIR team does not make recommendations for the FASB to take standard-setting action.

We have reviewed the Statement 157 Review team's procedures and the accompanying Statement 157 Report. We believe that they performed a robust, independent, and credible Review of Statement 157. The team's summarized conclusions and recommendations, with which we concur, are included in the "Summary" section of the Report.

The Statement 157 Report addresses the technical, operational, and cost-effectiveness aspects of Statement 157. We agree with the PIR team's findings that the ongoing costs associated with applying Statement 157 are not solely related to application of the guidance. We believe that there are a number of environmental factors contributing to the increase in costs that may need to be considered in a broader context. The FASB has reviewed the Statement 157 Report and the PIR team's detailed Findings. After additional review and consideration, the FASB will provide a timely response to the matters discussed in the Report and Findings.

We would like to thank all of the individuals and organizations that provided input on Statement 157 and helped the PIR team further develop its Review process.

We welcome your input on our PIR process at presidentsdesk@f-a-f.org.

Sincerely,

John Davidson
Co-Chair
Standard-Setting Process Oversight Committee
FAF Board of Trustees

W. Daniel Ebersole
Co-Chair
Standard-Setting Process Oversight Committee
FAF Board of Trustees

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SUMMARY

In 2010, the Trustees implemented a post-implementation review (*PIR* or *Review*) process as part of their FASB and GASB oversight responsibilities. The Trustees' objectives for these Reviews are to determine whether a standard is accomplishing its stated purpose, evaluate its implementation and continuing compliance costs and related benefits, and provide recommendations to improve the standard-setting process.

Given stakeholder diversity, seldom will stakeholders have unanimous views on whether any standard or its provisions are effective. In our (the PIR team) research, we note that stakeholder views on some issues vary based on respondent type and size. We reached our conclusions using our judgment, considering all the input received, and striving to be objective and balanced.

The Statement 157 PIR team reached the following overall conclusions:

- Statement 157 adequately resolved the issues underlying its stated need.
- Information resulting from the application of Statement 157 generally provides investors with decision-useful information. The most useful disclosure for decision-making purposes appears to be the description of the inputs and valuation technique(s) used to measure fair value. Our research indicates that some investors have difficulty understanding fair value information provided in the financial statements and their level of satisfaction with that information varies. Additionally, there are varying views about the consistency of fair value information in the financial statements. There are indications from some participants in each of the stakeholder groups included in our research that the volume and extent of disclosures may be beyond what is necessary for investors and other users of financial statements. However, there are also indications from some investors that additional disclosures would be helpful, particularly around the distribution of unobservable inputs.
- Overall, Statement 157's requirements are understandable, can be applied as intended, and allow information to be reported reliably. However, certain requirements are difficult for specific types of entities to apply (particularly employee benefit plans, not-for-profit organizations, and private companies). Those difficulties relate to: valuations requiring significant use of judgment, the absence of observable markets for the assets being valued, inconsistent application of measurement and disclosure requirements across entities, and resource constraints. Those application difficulties appear to be magnified by the (small) size of the entity and their business model.
- Some stakeholders believe the changes made to financial reporting and operating practices to implement Statement 157 were significant. Some of those changes may be attributable to changes in the regulatory and economic environment rather than the requirements of Statement 157. For example, preparers and practitioners are faced with increased audit requirements. Additionally, some of the challenges associated with the implementation of Statement 157 may have been amplified by the global financial crisis of 2008.

- Statement 157 did not result in any significant unanticipated consequences.
- Some stakeholders believe the ongoing costs to comply with Statement 157 are significant. The most significant cost drivers are the incremental increase in audit fees and audit requirements and the incremental increase in the use of third-party pricing services and valuation specialists. We believe that these ongoing costs are not exclusively a result of the Statement 157 requirements. Rather, we believe that some of the costs relate to regulatory environment factors arising after the issuance of Statement 157, such as the requirements associated with the Sarbanes-Oxley Act of 2002, SEC reviews, and PCAOB inspections. Additionally, we believe that as the size of the preparer or practitioner declines (based on revenue), their concerns about the costs related to Statement 157 increase. Similarly, certain types of entities, including private equity as well as employee benefit plans, not-for-profit organizations, and private companies are concerned about the costs as they relate to their specific type of entity.
- Overall, Statement 157 achieved its expected benefits as it adequately resolved all of the issues underlying its stated need and it generally provides users with decision-useful information. However, some investors think that the fair value information, including fair value measurements and the related disclosures, resulting from application of Statement 157 is not relevant or meaningful for employee benefit plans, not-for-profit organizations, or private companies.

The Statement 157 PIR team recommends that the FASB:

- Continue its recent efforts to summarize and document clearly its cost-benefit considerations in the project files.
- Continue its efforts to broaden its outreach activities, identify the most effective means of employing the variety of available outreach methods, and clearly document in the project files the level of stakeholder outreach performed.

GLOSSARY OF ACRONYMS AND TERMS

FAF: Financial Accounting Foundation

FASB: Financial Accounting Standards Board (or Board)

NAC: Not-for-profit Advisory Council

Oversight Committee: FAF Trustees' Standard-Setting Process Oversight Committee

PCAOB: Public Company Accounting Oversight Board

PCC: Private Company Council

PIR: Post-implementation review

Review: Post-implementation review

Statement 157: FASB Statement No. 157, *Fair Value Measurements* (codified in Accounting Standards Codification Topic 820, Fair Value Measurements and Disclosures)

Survey Firm: Rockbridge Associates, Inc.

Team: Post-implementation review team (or Our, We)

Trustees: FAF Board of Trustees

US GAAP: U.S. generally accepted accounting principles

User: an investor, creditor, or other user of financial statements (or Investor)

POST-IMPLEMENTATION REVIEW REPORT

PIR OBJECTIVES AND PROCEDURES

The three primary PIR objectives are to (1) determine whether a standard is accomplishing its stated purpose, (2) evaluate its implementation and continuing compliance costs and related benefits, and (3) provide feedback to improve the standard-setting process (as opposed to recommending standard-setting actions). We divide the first objective further to determine whether:

- The standard resolved the issues underlying its need.
- Decision-useful information is being reported to, and being used by, financial statement users.
- The standard is operational.
- Any significant unexpected changes to financial reporting or operating practices have occurred.
- Any significant unanticipated consequences resulted from applying the standard.

Our criteria and procedures for reviewing selected accounting standards are described and posted on the FAF website (Evergreen Process Description). Generally, we will review significant standards that the FASB currently is not reassessing. Our procedures included reviewing the FASB's project archive files (particularly the on-topic documents issued by the FASB); obtaining feedback from subject-matter experts who are part of a resource group; conducting stakeholder surveys; reviewing academic, industry, and user publications; and reviewing financial statements (including footnote disclosures) and other information for selected public and private companies.

We design our surveys to obtain a variety of perspectives from each of the FASB's principal stakeholder groups. Our surveys are conducted by an independent research firm (the Survey Firm).

Our research results include 294 responses to our Statement 157 survey: 19% from users of financial statements, 27% from preparers, 45% from accounting practitioners, and 9% from academics. The user survey respondents varied by type (for example, credit and equity analysts, and loan officers). Almost half of the user participants analyze primarily public companies. Preparer respondents were generally diverse by industry and size. Approximately 50% of preparer participants were from public companies. Practitioner participants were fairly represented in terms of firm revenues. Almost all practitioner respondents are licensed CPAs and 69% have over 20 years' experience in practice. Additionally, 12% of practitioner respondents were valuation specialists.

We focused our outreach, research, and surveys on achieving the PIR objectives. We correlated our various research inputs to establish whether there were consistent views. In some cases, there was a great deal of consensus in views. In other cases, the views were diverse. Responses to our surveys did not reach the level necessary to draw statistically valid inferences, but they were informative when considered with our other research. Therefore, our research observations are indications of stakeholder views and do not constitute statistically valid inferences. We came to our conclusions using our judgment, considering all the input received, and striving to be objective and balanced.

Seldom will stakeholders have unanimous views on whether any standard or its provisions are effective. Given stakeholder diversity, we expect stakeholders will have varying views about any standard's provisions and hold such views with varying conviction. In our Statement 157 research, we noted that stakeholder views varied primarily based on the size of the company (preparer) or firm (practitioner) and whether the company is publicly or privately held.

After completing our research, we compiled our procedures, research results, and conclusions into our Findings. We reviewed our Findings with the FAF president and CEO and the Oversight Committee members. We also reviewed our Findings with the FASB chairman and obtained his views on our preliminary conclusions and recommendations. We resolved and clarified factual differences before drafting our PIR report, which summarizes the contents of our Findings. We reviewed a draft of that Report with the Oversight Committee and the Trustees. After Trustee acceptance of the Report, we posted the PIR Report to the FAF website.

BACKGROUND ON STATEMENT 157

Statement 157 was undertaken for the purposes of establishing within U.S. GAAP a single definition of the term *fair value,* a framework for making fair value measurements, and enhancing disclosures about items measured at fair value in the financial statements. Statement 157 did not, nor was it intended to, change existing U.S. GAAP requirements that specify which items entities should measure and report at fair value.

Prior to Statement 157, some stakeholders had expressed concerns about the ability to apply the fair value measurement objective in U.S. GAAP. In large part, those concerns focused on the reliability of the measurements in the absence of quoted market prices, including concerns about the ability to verify the measurements. The FASB thought that, in part, those concerns were a result of the limited guidance for applying the fair value measurement objective in U.S. GAAP. The guidance that existed prior to Statement 157 had evolved over time and was dispersed among the accounting pronouncements that require fair value measurements. Differences in that earlier guidance created inconsistencies that added to the complexity in U.S. GAAP. There was also limited conceptual guidance for addressing measurement issues in the FASB's conceptual framework.

The FASB issued Statement 157 in September 2006. Statement 157 provides a single definition of *fair value*, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. Statement 157 applies under other accounting pronouncements that require or permit fair value measurements as the FASB had previously concluded in those pronouncements that fair value is the relevant measurement attribute.

The definition of *fair value* in Statement 157 retains the exchange price notion, contained either explicitly or implicitly, in earlier definitions of fair value. However, Statement 157 clarifies that the exchange price is the price in an orderly transaction between market participants to sell the asset or transfer the liability in the principal (or most advantageous) market for the asset or liability.

Fair value measurement is based on a hypothetical transaction at the measurement date, considered from the perspective of a market participant that holds the asset or owes the liability. Therefore, the objective of a fair value measurement is to determine the price that would be received for the asset or paid to transfer the liability at the measurement date, that is, an exit price. The FASB concluded that an exit price objective is appropriate because it embodies current expectations about the future inflows associated with the asset and the future outflows associated with the liability from the perspective of market participants. The emphasis on inflows and outflows is consistent with the definitions of assets and liabilities in FASB Concepts Statement No. 6, *Elements of Financial Statements*.

SCOPE OF STATEMENT 157 REVIEW

This Review is limited to Statement 157 and *how* fair value is measured. This Review does not include other standards that require the use of fair value either for measurement or disclosure purposes. Despite that scope exclusion, many of the stakeholders who participated in our review expressed the view that the definition of *fair value* (specifically, the exit price notion) is not appropriate in all instances that the term is used within U.S. GAAP. Although addressing those comments is beyond the scope of our review, we did share those comments with the FASB.

PIR OBJECTIVE 1: DID STATEMENT 157 ACCOMPLISH ITS STATED PURPOSE?

Did Statement 157 Resolve the Issues Underlying the Need for the Standard?

The FASB's objectives (the underlying need) in issuing Statement 157 were to:

- Provide a single definition of fair value
- Establish a framework for measuring fair value
- Expand disclosures about fair value measurement
- Simplify and codify the fair value measurement guidance.

A majority of preparers, practitioners, and academics who participated in our Review indicated that Statement 157 either completely or mostly meets the first three objectives. In addition, about half of the Review participants agree completely or mostly that Statement 157 simplifies and codifies the fair value measurement guidance. Thus, we conclude that Statement 157 adequately addressed the objectives identified above.

Does Statement 157 Provide Decision-Useful Information?

We researched whether decision-useful information about fair value measurements is being reported to, and being used by, investors, creditors, and other users of financial statements. We also asked preparers, practitioners, and academics about their views on whether specific fair value disclosures provide users with decision-useful information.

In summary, our research indicates that investors regularly incorporate fair value measurement information into their investment decision-making process and consider the information to be reliable and important to their analyses. The most useful disclosure for decision-making purposes appears to be the description of the inputs and valuation technique(s) used to measure fair value. Our research also indicates that investors have varied opinions on the understandability of fair value information in the financial statements and about the consistency and comparability of the fair value information.

We learned that preparers and practitioners are concerned with the decision-usefulness of the Statement 157 disclosures. They cited concerns about disclosure overload, particularly as it relates to Level 3 disclosures, including the Level 3 rollforward.

We also learned that some financial statement users think that most of the fair value information resulting from application of Statement 157 is not relevant or meaningful for employee benefit plans, not-for-profit organizations, and private companies. The feedback we received indicates that the users of those entities' financial statements may have different information needs than other financial statement users.

Therefore, we conclude that Statement 157 generally meets the needs of investors. However, there are indications from respondents in each of the stakeholder groups included in our research that the volume and extent of disclosures may be beyond what is necessary for investors and other users of financial statements. On the other side of the spectrum, there are also indications from some investors that additional disclosures would be helpful, particularly around the distribution of unobservable inputs.

Is Statement 157 Operational?

The third area we researched is whether the standard is operational. Operationality addresses whether preparers and practitioners understand and are able to apply the standard as intended and whether preparers are able to report the information reliably.[1]

Our findings lead us to conclude that Statement 157 is operational overall. However, some of its requirements are difficult to apply by specific types of entities (particularly employee benefit plans, not-for-profit organizations, and private companies). Those difficulties relate to: valuations requiring significant use of judgment, the absence of observable markets for the assets being valued, inconsistent application of measurement and disclosure requirements across entities, and resource

[1] The term reliably is used with its general meaning, rather than in a specific accounting or technical sense. Reliable means "likely to be accurate – able to be trusted or to provide a correct result." Encarta Dictionary: English (North America) [accessed online].

constraints. Those application difficulties appear to be magnified by the (small) size of the entity and their business model. Additionally, private equity firms expressed operational concerns; however, we believe those are really cost-benefit concerns.

For most areas for which we sought feedback, our research indicates that preparer respondents from small companies[2] and practitioner respondents from small-to-medium-sized firms[3] have more difficulty applying/interpreting Statement 157 than respondents from larger companies/firms.

Based on our research, there seem to be a few fair value measurement concepts that stakeholders believe might be worth further consideration by the FASB. Both preparers and practitioners struggle with application of Statement 157 in the following areas:

- Guidance on applying fair value framework to non-financial assets and liabilities
- Guidance on valuation techniques used to measure fair value
- Guidance on determining market participants
- Requirements to disclose information about both nonrecurring fair value measurements and level 3 recurring fair value measurements.

Did Statement 157 Result in Significant Changes in Financial Reporting or Operating Practices?

Our research indicates that some stakeholders believe that changes to financial reporting or operating practices that resulted from the application of Statement 157 were significant. Some of these changes may be attributable to the PCAOB's increased focus on auditing fair value measurements as evidenced by public PCAOB inspection reports for large public accounting firms. This has resulted in greater focus by preparers and auditors on testing and documenting significant assumptions and inputs used in fair value measurements, which in turn may affect the complexity of valuation techniques used to measure fair value, the time required to complete required valuations and the use of external valuation expertise to measure the fair value of assets and liabilities.

Did Statement 157 Result in Significant Unanticipated Consequences?

Our research indicates that there have not been any significant unanticipated consequences resulting from the application of Statement 157.

[2] Preparers from companies with less than $100 million in annual revenues.

[3] Practitioners from firms with less than $500 million in annual revenues.

Overall Conclusion on Objective 1

Our findings lead us to conclude that Statement 157 adequately resolved all of the issues underlying its stated need.

We conclude that the information resulting from the application of Statement 157 generally provides investors with decision-useful information. However, our research indicates that some investors have difficulty understanding fair value information provided in the financial statements and their satisfaction with that information varies. Additionally, there are varying views about the consistency of fair value information in the financial statements. There are indications from respondents in each of the stakeholder groups included in our research that the volume and extent of disclosures may be beyond what is necessary for investors and other users of financial statements. Alternatively, some users of financial statements indicate that additional disclosures would be helpful, particularly around the distribution of unobservable inputs.

Statement 157 represented a change in determining fair value measurement, which was significant in many instances. We conclude that Statement 157 is operational overall. However, there are some operational concerns related to specific types of entities including employee benefit plans, not-for-profit organizations, and private companies. Additionally, we believe that as the size of the preparer or practitioner declines (based on revenue), the difficulty experienced in applying/interpreting Statement 157 increases.

We conclude that Statement 157 resulted in changes to financial reporting or operating practices that were significant. Even though some changes were expected, the extent of such changes may have been greater than originally anticipated, in part because of regulatory environmental factors (for example, increased audit requirements) not solely related to the standard.

Lastly, we conclude that Statement 157 did not result in any significant unanticipated consequences.

PIR OBJECTIVE 2: STATEMENT 157'S COSTS AND BENEFITS

Are Statement 157's Implementation and Continuing Application Costs Consistent with the Costs the Board Considered and Stakeholders Expected?

Overall, our research indicates that some stakeholders believe that the implementation costs incurred as a result of Statement 157 were significant. These implementation costs primarily relate to additional time, effort, and costs associated with the disclosure requirements. Similarly, our research indicates that the ongoing costs incurred by some stakeholders to comply with Statement 157 are significant. The most significant drivers of the ongoing costs are the incremental increase in audit fees and audit requirements and the incremental increase in the use of third-party pricing services and valuation specialists. We believe that these ongoing costs are not exclusively a result of Statement 157's requirements. Rather, we believe that some of the costs relate to factors arising after the issuance of Statement 157, such as the requirements associated with Sarbanes-Oxley, SEC reviews, and PCAOB inspections. Additionally, some of the costs may have been amplified by the global financial crisis of 2008.

Additionally, we believe that as the size of the preparer or practitioner entity declines (based on revenue), the concerns about the costs related to Statement 157 increase. Similarly, certain types of entities, including those within the private equity industry, such as venture capital firms, expressed concerns about their ongoing costs associated with fair value measurements. As noted above, we believe that these costs are not solely a result of Statement 157's requirements. Rather, we believe that some of the costs relate to factors arising after the issuance of Statement 157. Other types of entities—including employee benefit plans, not-for-profit organizations, and private companies—noted similar cost concerns.

Are the Benefits of Statement 157 Consistent with the Benefits the Board Intended and Stakeholders Expected?

We conclude that overall Statement 157 achieved its expected benefits as it adequately resolved all of the issues underlying its stated need and it generally provides users with decision-useful information. However, as noted previously, some investors think that most of the fair value information resulting from application of Statement 157 is not relevant or meaningful for employee benefit plans, not-for-profit organizations, or private companies.

PIR OBJECTIVE 3: STANDARD-SETTING PROCESS IMPROVEMENTS

Our third PIR objective is to provide feedback to improve the standard-setting process. To meet that objective we ask stakeholders participating in our Review to comment on the process FASB used to develop Statement 157. We also assess whether the results of our Review suggest that process improvements are needed. Some of these findings and our related recommendations follow.

During our review of the project files, we found that there was no summary documentation of the Board's cost-benefit considerations related to Statement 157. An overall summary memo is consistent with FASB procedures and would provide a clear picture of the cost-benefit analysis that was performed by the FASB for Statement 157.

> **Recommendations:** Consistent with prior PIR recommendations, we recommend that the FASB continue its efforts to summarize and clearly document its cost-benefit considerations in the project files.

During our Review, stakeholders raised entity-specific issues with Statement 157. The amount and type of stakeholder outreach was unclear from our review of the project files. As such, we cannot determine whether the FASB considered these concerns during deliberations.

> **Recommendations:** We recommend that the FASB continue its efforts to broaden its outreach activities, identify the most effective means of employing the variety of available outreach methods, and clearly document in the project files the level of stakeholder outreach

performed. We encourage the FASB to continue its efforts with the PCC and the NAC to understand how projects on the FASB's technical agenda might affect private companies and not-for-profit organizations.

PIR PROCESS

We received valuable stakeholder input on our PIR process from the Statement 157 survey and our resource group members. We will consider that stakeholder input during our internal review of the Statement 157 PIR process. We will modify and improve our PIR process after that internal review and as we complete our reviews of other standards.

Statement 157 Post-Implementation Review Team:

Melissa Maroney, Project Manager

Kim Petrone, Director

February 2014