Notice for Recipients
of This Proposed FASB Staff Position

This proposed FASB Staff Position (FSP) provides guidance on the fair value measurement of liabilities under FASB Statement No. 157, *Fair Value Measurements*.

The Board invites individuals and organizations to send written comments on all matters in this proposed FSP. Comments are requested from those who agree with the provisions of this proposed FSP as well as from those who do not. Comments are most helpful if they identify the issues to which they relate and clearly explain the issue or question. Those who disagree with provisions of this proposed FSP are asked to describe their suggested alternatives, supported by specific reasoning.

Responses must be received in writing by June 1, 2009. Interested parties should submit their comments by email to director@fasb.org, File Reference: Proposed FSP FAS 157-f. Those without email may send their comments to "Technical Director, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116, File Reference: Proposed FSP FAS 157-f." Responses should not be sent by fax.

All comments received by the FASB are considered public information. Those comments will be posted to the FASB website and included as part of the project record with other project materials.

PROPOSED FASB STAFF POSITION

No. FAS 157-f

Title: Measuring Liabilities under FASB Statement No. 157

Date Released: May 1, 2009

Comment Deadline: June 1, 2009

Objective

1. This FASB Staff Position (FSP) provides guidance on the fair value measurement of liabilities under FASB Statement No. 157, *Fair Value Measurements*.

Background

2. Statement 157 defines the fair value of a liability as the price that would be paid to transfer the liability in an orderly transaction between market participants at the measurement date. Under that definition, the liability to the counterparty is presumed to continue and is not settled. Statement 157 also states that the fair value of a liability shall reflect the nonperformance risk (including, but not limited to, the reporting entity's own credit risk) relating to that liability and that such nonperformance risk is the same before and after its transfer. A reporting entity is required to consider the effect of its own credit risk on the fair value of a liability in all periods in which the liability is measured at fair value.

3. Some entities are concerned that there may be a lack of observable market information to determine the fair value of a liability. In many cases, an entity would extinguish a liability by settling the obligation directly with the counterparty rather than by paying another entity to assume the existing obligation. In the limited circumstances when an existing liability may be transferred to a new obligor, the transferee may not have the same nonperformance risk as the transferor.

4. Furthermore, some entities question how to measure the fair value of a liability in a hypothetical transaction when a contractual restriction prevents such a transfer. They assert that, unlike an asset for which observable data may simply be limited, there is no observable data available to measure a liability because that liability is contractually restricted from being transferred.

5. Furthermore, some liabilities (for example, bonds) are traded in the marketplace as assets. Questions have arisen about whether prices of debt instruments traded as assets represent the fair value of that instrument for the issuer (obligor).

6. Because of these issues, some entities believe that the consistency in the application of Statement 157 could be improved if the Board were to provide guidance on the fair value measurement of liabilities.

All paragraphs in this FSP have equal authority.
Paragraphs in bold set out the main principles.

FASB Staff Position

Scope

7. **The guidance in this FSP applies to the fair value measurement of liabilities within the scope of Statement 157.**

Measurement

8. A fair value measurement assumes that a liability is exchanged in an orderly transaction between market participants. However, liabilities are rarely transferred in the marketplace because of contractual restrictions preventing the transfer of liabilities. Some liabilities (for example, debt obligations), however, are traded in the marketplace as assets.

9. If a quoted price in an active market for the identical liability is available, it represents a Level 1 measurement. In circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity shall measure fair

value using one of the following approaches that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs.

a. The quoted price of the identical liability when traded as an asset in an active market
b. The quoted price of the identical liability or the identical liability when traded as an asset in markets that are not active
c. The quoted price for similar liabilities or similar liabilities when traded as assets in markets that are active
d. Another valuation technique that is consistent with the principles of Statement 157. Two examples would be an income approach, such as a present value technique, or a market approach, such as a technique that is based on the amount the reporting entity would receive if the reporting entity was to transfer or enter into the identical liability at the measurement date.

10. When measuring the fair value of a liability using the price of the liability when traded as an asset, the price shall be adjusted for factors specific to the asset that are not applicable to the fair value measurement of the liability. Some circumstances in which an entity should consider whether adjustments are required to the price of the asset include:

a. The quoted price for the asset relates to a similar (but not identical) liability traded as an asset.
b. The quoted price for the asset is not determinative of the fair value for the asset (which may be the case when there has been a significant decrease in the volume and level of activity for the asset in relation to the normal market activity for the asset). See FSP 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,* for further guidance.
c. The quoted price of the asset includes the effect of a restriction preventing the transfer of the asset.
d. The unit of account for the asset is not the same as for the liability (for example, the quoted price for the asset includes the effect of a third-party credit enhancement). See EITF Issue No. 08-5, "Issuer's Accounting for Liabilities Measured at Fair Value with a Third-Party Credit Enhancement," for further guidance.

11. When estimating the fair value of a liability, an entity shall not include a separate input or adjustment to other inputs relating to the existence of a contractual restriction that prevents the transfer of the liability (see paragraph A1(e) of the appendix). The

effect of a contractual restriction that prevents the transfer of a liability is either implicitly or explicitly included in the other inputs to the fair value measurement. For example, at the transaction date, both the creditor and the obligor are willing to accept the transaction price for the liability with full knowledge that the obligation includes a contractual restriction that prevents its transfer. As a result of the restriction already being included in the transaction price, a separate input or adjustment to an existing input into the fair value measurement of a liability is not necessary at the transaction date to reflect the effect of the contractual restriction on transfer. Additionally, a separate input or adjustment to other inputs into the fair value measurement of a liability is not necessary at subsequent measurement dates to reflect the effect of the contractual restriction on transfer.

12. When measuring the fair value of a liability using a valuation technique, an entity shall ensure that the fair value measurement is consistent with the principles of Statement 157. For example, the valuation technique shall reflect the assumptions that market participants would use (or the reporting entity's own assumption about the assumptions that market participants would use) in pricing the liability and shall comply with the principal market and unit-of-account requirements of Statement 157.

Disclosure

13. A Level 1 fair value measurement for a liability is a quoted price in an active market for the identical liability at the measurement date. In addition, the quoted price for the identical liability when traded as an asset in an active market is a Level 1 fair value measurement for that liability when no adjustments to the quoted price of the asset are required. However, an entity needs to determine whether the quoted price for the identical liability when traded as an asset in an active market should be adjusted for factors specific to the liability and the asset (paragraph 10). Any adjustment to the quoted price of the asset shall render the fair value measurement a lower level measurement.

Effective Date and Transition

14. This FSP shall be effective for the first reporting period (including interim periods) beginning after issuance. Earlier application is permitted. In the period of adoption, entities shall disclose any change in valuation technique resulting from the application of this FSP, and quantify its effect, if practicable. Revisions resulting from a change in the valuation technique or its application shall be included in changes in fair value in the period of adoption.

The provisions of this FSP need not be applied to immaterial items.

Appendix

AMENDMENTS TO STATEMENTS 157 AND 107

A1. Statement 157 is amended as follows: [Added text is underlined and deleted text is ~~struck out~~.]

a. Paragraphs 15A–15E are added as follows:

15A. A fair value measurement assumes that a liability is exchanged in an orderly transaction between market participants. However, liabilities are rarely transferred in the marketplace because of contractual restrictions preventing the transfer of liabilities. Some liabilities (for example, debt obligations), however, are traded in the marketplace as assets.

15B. If a quoted price in an active market for the identical liability is available, it represents a Level 1 measurement. In circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity shall measure fair value using one of the following approaches that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs.

a. The quoted price of the identical liability when traded as an asset in an active market
b. The quoted price of the identical liability or the identical liability when traded as an asset in markets that are not active
c. The quoted price for similar liabilities or similar liabilities when traded as assets in markets that are active
d. Another valuation technique that is consistent with the principles of Statement 157. Two examples would be an income approach, such as a present value technique, or a market approach, such as a technique that is based on the amount the reporting entity would receive if the reporting entity was to transfer or enter into the identical liability at the measurement date.

15C. When measuring the fair value of a liability using the price of the liability when traded as an asset, the price shall be adjusted for factors specific to the asset that are not applicable to the fair value measurement of the liability. Some circumstances in which an entity should consider whether adjustments are required to the price of the asset include:

a. The quoted price for the asset relates to a similar (but not identical) liability traded as an asset.

b. The quoted price for the asset is not determinative of the fair value for the asset (which may be the case when there has been a significant decrease in the volume and level of activity for the asset in relation to the normal market activity for the asset). See FSP 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*, for further guidance.
c. The price of the asset includes the effect of a restriction preventing the transfer of the asset.
d. The unit of account for the asset is not the same as for the liability (for example, the quoted price for the asset includes the effect of a third-party credit enhancement). See EITF Issue No. 08-5, "Issuer's Accounting for Liabilities Measured at Fair Value with a Third-Party Credit Enhancement," for further guidance.

15D. Therefore, when estimating the fair value of a liability, an entity shall not include a separate input or adjustment to other inputs relating to the existence of a contractual restriction that prevents the transfer of the liability (see Examples 13 and 14 in Appendix A). The effect of a contractual restriction that prevents the transfer of a liability is either implicitly or explicitly included in the other inputs to the fair value measurement. For example, at the transaction date, both the creditor and the obligor are willing to accept the transaction price for the liability with full knowledge that the obligation includes a contractual restriction that prevents its transfer. As a result of the restriction already being included in the transaction price, a separate input or adjustment to an existing input into the fair value measurement of a liability is not necessary at the transaction date to reflect the effect of the contractual restriction on transfer. Additionally, a separate input or adjustment to other inputs into the fair value measurement of a liability is not necessary at subsequent measurement dates to reflect the effect of the contractual restriction on transfer.

15E. When measuring the fair value of a liability using a valuation technique, an entity shall ensure that the fair value measurement is consistent with the principles of this Statement. For example, the valuation technique shall reflect the assumptions that market participants would use (or the reporting entity's own assumption about the assumptions that market participants would use) in pricing the liability and shall comply with the principal market and unit-of-account requirements of this Statement.

b. Paragraph 24A is added as follows:

A Level 1 fair value measurement for a liability is a quoted price in an active market for the identical liability at the measurement date. In addition, the quoted price for the identical liability when traded as an asset in an active market is a Level 1 fair value measurement for that liability when no adjustments to the quoted price of the asset are required. However, an entity needs to determine whether the quoted price for the identical liability when traded as an asset in an active market should be adjusted for factors specific to the liability and the asset (paragraph 15C). Any adjustment to the quoted price of the asset shall render the fair value measurement a lower level measurement.

c. Paragraph 24:

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. An active market for the asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available, except as discussed in paragraphs 15C, 25, and 26.

d. Paragraph 29:

Adjustments to Level 2 inputs will vary depending on factors specific to the asset or liability. Those factors include the condition and/or location of the asset or liability, the extent to which the inputs relate to items that are comparable to the asset or liability including those factors discussed in 15C, and the volume and level of activity in the markets within which the inputs are observed. An adjustment that is significant to the fair value measurement in its entirety might render the measurement a Level 3 measurement, depending on the level in the fair value hierarchy within which the inputs used to determine the adjustment fall.

e. Paragraphs A32H–A32R and the headings preceding them are added as follows:

Example 12—Asset Retirement Obligation

A32H. On January 1, 20X1, Entity A completes construction of and places into service an offshore oil platform. The entity is legally required to dismantle and remove the platform at the end of its useful life, which is estimated to be 10 years. Based on the requirements of FASB Statement No. 143, *Accounting for Asset Retirement Obligations*, the entity is required to recognize, at fair value, an asset retirement obligation.

A32I. For the reasons enumerated in paragraph 8 of Statement 143, Entity A uses the expected present value technique to measure the fair value of the asset retirement obligation.

A32J. If Entity A was contractually allowed to transfer its asset retirement obligation to a market participant, Entity A believes a market participant would use the following inputs (consistent with paragraph B2 of this Statement) in determining the price it would expect to receive:

a. Probability-weighted estimate of labor costs
b. Allocation of overhead costs
c. Profit on labor and overhead costs
d. Effect of inflation on estimated costs and profits
e. Risk premium for bearing the uncertainty inherent in cash flows, other than inflation
f. Time value of money, represented by the risk-free rate
g. Nonperformance risk relating to the liability, including Entity A's own credit risk.

A32K. The significant assumptions used in Entity A's estimate of fair value are as follows:

a. Labor costs are based on current marketplace wages required to hire contractors to dismantle and remove offshore oil platforms. Entity A assigns probability assessments to a range of cash flow estimates as follows:

Cash Flow Estimate	**Probability Assessment**	**Expected Cash Flows**
$100,000	25%	$ 25,000
125,000	50%	$ 62,500
175,000	25%	$ 43,750
		$131,250

The probability assessments are based on Entity A's experience with fulfilling obligations of this type and its knowledge of the market.

b. Entity A estimates allocated overhead and equipment operating costs using the rate it applies to labor costs (80 percent of expected labor costs). This is consistent with the cost structure of market participants.

c. A contractor typically adds a markup on labor and allocated internal costs to provide a profit margin on the job. The profit margin used (20 percent) represents Entity A's understanding of the operating profit that contractors in the industry generally earn to dismantle and remove offshore oil platforms. Entity A believes this rate is consistent with the rate a market participant would demand as a return for bearing the obligation.

d. Entity A assumes a rate of inflation of 4 percent over the 10-year period on the basis of available market data.

e. A contractor would typically demand and receive a premium (market-risk premium) for bearing the uncertainty inherent in locking in today's price for a project that will not occur for 10 years. Entity A estimates the amount of that premium to be 5 percent of the expected cash flows, adjusted for inflation.

f. The risk-free rate of interest for a 10-year maturity on January 1, 20X1, is 5 percent. Entity A adjusts that rate by 3.5 percent to reflect its risk of nonperformance. Therefore, the discount rate used to compute the present value of the cash flows is 8.5 percent.

A32L. Entity A believes that its assumptions would be used by market participants. In addition, Entity A does not adjust its fair value measurement for the existence of a contractual restriction preventing it from transferring the liability. As illustrated in the following table, Entity A estimates the fair value of its liability for the asset retirement obligation to be $194,879.

	Expected Cash Flows 1/1/X1
Expected labor costs	131,250
Allocated overhead and equipment costs (.80 × $131,250)	105,000
Contractor's profit markup [.20 × ($131,250 + $105,000)]	47,250
Expected cash flows before inflation adjustment	283,500
Inflation factor (4% for 10 years)	1.4802
Expected cash flows adjusted for inflation	419,637
Market-risk premium (.05 × $419,637)	20,982
Expected cash flows adjusted for market risk	440,619
Expected present value using discount rate of 8.5% for 10 years	194,879

Example 13—Debt Obligation: Quoted Price

A32M. On January 1, 20X1, Entity B issues at par a $2 million BBB-rated exchange-traded 5-year fixed-rate debt security with an annual 10 percent interest coupon. Entity B has elected to account for this security under the fair value option.

A32N. On December 31, 20X1, the security is trading as an asset in an active market at $929 per $1,000 after payment of accrued interest. Entity B uses the quoted price for the asset in an active market as its initial input into the fair value measurement of its liability ($929 × 2,000 = $1,858,000). In determining whether the quoted price for the asset in an active market represents the fair value of the liability, Entity B evaluates whether the quoted price for the asset includes the effect of factors not applicable to the fair value measurement of a liability, for example, whether the quoted price for the asset includes the effect of third-party credit enhancements. Entity B determines that no adjustments are required to the quoted price of the asset. Accordingly, Entity B concludes that the fair value of its debt security at December 31, 20X1, is $1,858,000. Entity B categorizes and discloses the fair value measurement of its debt security as a Level 1 measurement.

Example 14—Debt Obligation: Present Value Technique

A32O. On January 1, 20X1, Entity C issues at par in a private placement a $2 million BBB-rated 5-year fixed-rate debt security with an annual 10 percent interest coupon. Entity C has elected to account for this security under the fair value option.

A32P. At December 31, 20X1, Entity C still carries a BBB credit rating. Market conditions, including available interest rates, credit spreads for a BBB-quality credit rating and illiquidity, remain unchanged from the issuance date of the debt security. However, Entity C's credit spread has deteriorated by 50 basis points. After considering all market conditions, Entity C concludes that if it was to issue the security at the measurement date, the security would bear a rate of interest of 10.5 percent or Entity C would receive less than par in proceeds from the issuance of the security.

A32Q. For the purpose of this example, the fair value of Entity C's liability is calculated using a present value technique. Entity C believes a market participant would use the following inputs (consistent with paragraph B2 of this Statement) in determining the price it would expect to receive to assume Entity C's obligation:

a. Terms of the debt security, including:
   (1) Coupon interest rate of 10 percent
   (2) Principal amount of $2 million
   (3) Term of 4 years.
b. Change in risk of nonperformance from the date of issuance of 50 basis points.

A32R. On the basis of its present value technique, Entity C concludes that the fair value of its liability at December 31, 20X1, is $1,968,641. Because Entity C's obligation is a financial liability, Entity C does not include any additional input into its present value technique for risk or profit that a market participant might require for compensation for assuming the liability, because Entity C believes the interest rate already captures these considerations. Furthermore, Entity C does not adjust its present value technique for the existence of a contractual restriction preventing it from transferring the liability.

A2. FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*, is amended as follows:

a. Paragraph 31, as amended:

Bank A might disclose the following:

Note V: Disclosures about Fair Value of Financial Instruments

[For the ease of use, only the portion of this note affected by this FSP has been reproduced.]

Long-term debt

~~Rates currently available to the Bank for debt with similar terms and remaining maturities are used to estimate fair value of existing debt.~~Fair value of long-term debt is based on quoted market prices or dealer quotes for the identical liability when traded as an asset in an active market. If a quoted market price is not available, an expected present value technique as described in Statement 157 is used to estimate fair value.