Unobservable inputs should be developed based on the best information available in the circumstances, which might include the reporting entity's own data. In developing unobservable inputs, the reporting entity need not undertake all possible efforts to obtain information about inputs, whether these inputs are observable in active markets or not, as long as the reporting entity follows a reasonable and defensible methodology. The reporting entity shall not ignore information about inputs just because the information is unobservable. However, the reporting entity shall not use inputs that are not available to market participants.  

Therefore, the reporting entity's own data used to develop unobservable inputs should be market participant assumptions that is reasonably available without undue cost and effort.  

What is the definition of Level 1 inputs?  

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities. Level 1 inputs are usually the most reliable and precise measure of fair value. The reporting entity must have access to reliable Level 1 inputs to determine if Level 2 inputs are observable inputs for substantially the full term of the asset or liability. For situations in which there is little, if any, market activity for the asset or liability at the reporting date, Level 1 inputs are not available.  

What are the three pricing input levels?  

Level 1 and Level 2 inputs are inputs that are observable to market participants and are used to determine fair value. Level 3 is a Level 1 (or Level 2) input that is adjusted for factors specific to the asset or liability. Level 3 inputs are unobservable inputs to be used in situations where markets don’t exist or are illiquid such as the present credit crisis. At this point fair market valuation becomes highly subjective.  

What is the AICPA’s role in this?  

The AICPA supports the independent role of the FASB in carrying out its mission and in developing the GAAP framework. The FASB is the independent private-sector standard setter whose mission is to establish financial accounting and reporting standards that are accepted internationally for companies and other entities that are subject to all forms of capital markets, either domestically or in international capital markets. The FASB is governed by a seven-member Board that is responsible for overseeing the development and issuance of financial accounting and reporting standards. The AICPA is the organization that represents the public interest in the U.S. accounting profession. Our history of serving the public interest has inspired the AICPA to support the independent role of the FASB. The AICPA ensures that our members remain at the forefront of the FASB’s standard-setting activities, making sure they are aware of changes to guidance and how these affect their companies.  

What is Fair Value Accounting?  

Fair value accounting, also called “mark-to-market,” is a way to measure the value of an asset or liability when a market exists for it. Assets and liabilities are measured at fair value on a recurring basis. Beginning in 2009, the standard will apply to other non-financial assets. SFAS 157 applies to non-financial assets and liabilities that are recognized, or disclosed, at fair value on a recurring basis. It also applies to non-financial assets and liabilities that are recognized, or disclosed, at fair value on a non-recurring basis. The standard applies to defined benefit pension and other postretirement plans. It also applies to financial instruments and certain derivative instruments. The Fair Value Accounting Standard makes it clear that fair value accounting applies to financial instruments and currently applies to defined benefit plan assets and other non-financial assets.  

What does SFAS 157 require?  

SFAS 157 requires companies to report the fair value of certain financial and non-financial instruments and other assets and liabilities at each reporting date. SFAS 157 also applies to non-financial assets and liabilities that are recognized, or disclosed, at fair value on a non-recurring basis. SFAS 157 requires companies to make a clear distinction between recurring and non-recurring transactions. SFAS 157 requires companies to use a market approach, a cost approach, or a income approach to measure fair value. SFAS 157 also requires companies to disclose information about the methodology used to measure fair value.