



International Accounting Standards Board
30 Cannon Street
London EC4M 6 XH

28 September 2009

Dear Sirs,

Subject: Fair Value Measurement ED/2009/5

The IVSC is pleased to respond to your request for comments on the exposure draft, *Fair Value Measurement*.

The governance structure of the IVSC includes two independent technical Boards – the **International Valuation Standards Board** and the **International Valuation Professional Board**. Responses to consultations issued by related standard setters and others are submitted on behalf of the IVSC by the International Valuation Professional Board.

The IVSC response to the questions set out in the Exposure Draft are attached. We trust these comments are useful to you. If you wish to discuss any of them, please do not hesitate to contact the IVSC Executive Director – ivsc@ivsc.org

The IVSC would be pleased to be represented at the round-table meeting in London on 11 December.

Sincerely,

Brad Wagar
Chairman, International Valuation Professional Board

DEFINITION OF FAIR VALUE AND RELATED GUIDANCE
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QUESTION 1

The exposure draft proposes defining 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’ (an exit price) (see paragraph 1 of the draft IFRS and paragraphs BC15-BC18 of the Basis for Conclusions). This definition is only relevant when fair value is used in IFRSs.

Is this definition appropriate? Why or Why not? If not, what would be a better definition and why?

IVSC is of the view the proposed definition of fair value offers less clarity than the current definition.

While we appreciate the proposed definition appears in FAS 157, the objective of consistency with US GAAP should not override the objective to determine the definition that best describes the requirement and is least likely to be misinterpreted. One needs to read the additional explanatory information in para 13 in order to establish that a market participant needs to be knowledgeable and acting at arm’s length, whereas this is explicit in the current definition. It appears there is no intention to fundamentally change the fair value concept as it is currently understood, so the reason for the proposed change is not clear.

From the perspective of many valuation professionals, the choice of the term “fair value” to describe what is clearly intended to be an estimate of the price that could be obtained in the market, i.e. “market value”, is unfortunate. Outside the world of IFRS and US GAAP, fair value has a meaning that is distinct from market value. However, this anomaly is so well established in the accounting literature that we do not dwell on it in this response.

SCOPE

QUESTION 2

In three contexts, IFRSs use the term ‘fair value’ in a way that does not reflect the Board’s intended measurement objective in those contexts:

- (a) In two of those contexts, the exposure draft proposes to replace the term ‘fair value’ (the measurement of share-based payment transactions in IFRS 2 *Share-based Payment* and reacquired rights in IFRS 3 *Business Combinations*) (see paragraph BC29 of the Basis for Conclusions).**
- (b) The third context is the requirement in paragraph 49 of IAS 39 *Financial Instruments: Recognition and Measurement* that the fair value of a financial liability with a demand feature is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid (see paragraph 2 of the draft IFRS and**

paragraph BC29 of the Basis for Conclusions). The exposure draft proposes not to replace that use of the term ‘fair value’, but instead proposes to exclude that requirement from the scope of the IFRS.

Is the proposed approach to these three issues appropriate? Why or why not? Should the Board consider similar approaches in any other contexts? If so, in which context and why?

IVSC agrees with the Board’s assessment that the definition of fair value in the ED is not appropriate in the examples cited.

While the objective of the IASB in trying to establish a single source of guidance on fair value measurement appears sensible, the exceptions noted above illustrate the problems in trying to bring together measurement objectives that appear superficially similar for disparate asset types. There are other instances within the ED itself where the “market based” concept of fair value appears to be adapted or even abandoned.

- Para 31 provides that a restriction on an entity’s ability to sell does not affect the fair value of a liability. This means the assumptions set out in para 5 and paras 7 - 14 which set out the general basis for determining fair value do not apply.
- The Basis for Conclusions paper identifies at paras 61 - 63 a problem that frequently arises under IAS 16 with specialised assets. It explains the Board favours a replacement cost approach for specialised assets. However, this is not clear from the ED itself.
- There are other examples where the fair value to be determined is not a sum that could be realised (i.e. received) by the entity in a transfer in the market.

There are good reasons for these exceptions but the fact they are needed does call into question whether a “single source” for the application of fair value will actually reduce complexity and the general ease of use of IFRS.

Another potential disadvantage of grouping all requirements for the application of fair value across the whole range of IFRS is the proposed removal of guidance that exists at present that is specific to a standard and asset class. For example, we are aware that many of the major users of IAS 40 are concerned the well established and well understood guidance on the fair value of investment property is to be removed in favour of the generic guidance in the ED. Because the proposed new standard is not asset specific, there is concern this could lead to certain preparers exploring the scope for changing the established protocols for assessing fair value.

Before proceeding with a single generic standard that requires a significant volume of supporting material to support implementation, we believe consideration should not only be given to simplifying the “Fair Value” standard to focus simply on the definition and

contextual framework, but to improve the existing wording of how fair value is to be applied to different assets or for different objectives in the relevant standards themselves. This would have the advantage of allowing the specific issues to be addressed in the given standard that users and preparers are familiar with and lessen the danger of inappropriate application of methods that appear in a generic standard but that are not applicable in all cases.

THE TRANSACTION

QUESTION 3

The exposure draft proposes that a fair value measurement assumes that the transaction to sell the asset or transfer the liability takes place in the most advantageous market to which the entity has access (see paragraphs 8-12 of the draft IFRS and paragraphs BC37-BC41 of the Basis for Conclusions).

Is this approach appropriate? Why or why not?

IVSC is in general agreement.

We do not consider that much turns on the assumed distinction between a principal and most advantageous market. More important than the adjective used is the explanation that the market to be used is the one in which the entity would normally enter into a transaction for the asset or liability, e.g. an entity that holds stock for sale in a wholesale market does not have to assume that it can be sold in a retail market if it cannot access that market directly. This concept of market accessibility is well understood by professional valuers.

QUESTION 4

The exposure draft proposes that an entity should determine fair value using the assumptions that market participants would use in pricing the asset or liability (see paragraphs 13 and 14 of the draft IFRS and paragraphs BC42-BC45 of the Basis for Conclusions).

Is the description of market participants adequately described in the context of the definition? Why or why not?

IVSC is of the view the description of a market participant provides an adequate summary of the principal properties and should avoid inappropriate interpretations. However, we draw attention to the properties assumed of the “willing buyer” and the “willing seller” in the International Valuation Standards definition of Market Value, which provides a more detailed exposition of the properties of the participants in a hypothetical market transaction. The aforementioned additional detail in IVS includes, but is not limited to, a willing buyer being motivated but neither over-eager or determined to buy at any price. Similarly, in the case of

a willing seller, one who is not forced or prepared to sell at any price or one who will hold out for a price not considered reasonable in the current market.

In para 14 c we believe it is important that the reference is to market participants with whom the entity COULD enter into a transaction in that market. As worded it would invite entities to disregard the potential bid that could be obtained from a party or parties to whom it is not prepared to sell, e.g. competitors. This could be used to negate the intention that it is a market price that is required regardless of the particular entity's preferences.

APPLICATION TO ASSETS: HIGHEST AND BEST USE AND VALUATION PREMISE
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QUESTION 5

The exposure draft proposes that:

- (a) The fair value of an asset should consider a market participant's ability to generate economic benefit by using the asset or by selling it to another market participant who will use the asset in its highest and best use (see paragraphs 17-19 of the draft IFRS and paragraph BC60 of the Basis for Conclusions).**
- (b) The highest and best use of an asset establishes the valuation premise, which may be either 'in use' or 'in exchange' (see paragraphs 22 and 23 of the draft IFRS and paragraphs BC56 and BC57 of the Basis for Conclusions).**
- (c) The notions of highest and best use and valuation premise are not used for financial assets and are not relevant for liabilities (see paragraph 24 of the draft IFRS and paragraphs BC51 and BC52 of the Basis for Conclusions).**

Are these proposals appropriate? Why or why not?

IVSC considers the proposals inappropriate, for the following reasons.

Although the description of the concept of "highest and best use" ("HABU") is not incorrect, paras 17 & 18 of the ED are effectively rendered redundant by paras 7 - 14 inclusive. It is clear from these earlier paras that fair value in this standard is to be the price that would be paid in a market transaction between knowledgeable and willing parties after adequate marketing, and is not a forced or distressed sale. Under such a scenario, the bidders in the market will ensure the price is optimised, i.e. it will reflect the use that is physically possible, legally permissible and financially feasible and which provides the highest value on the date of the assumed transaction. This is not a concept separate from that of fair value as defined in the ED, and therefore it is unhelpful to present it as a distinct or supplementary part of the required valuation objective.

In para 20 there is confusion between HABU and the value of an alternative use. These are not synonymous. An asset may have potential for a more valuable alternative use; this potential would be reflected in the price that would be bid by market participants, and

therefore would be reflected in its HABU. However, that alternative use may not yet be physically possible, legally permissible or financially feasible. The value for the **alternative use** would assume any such obstacles had been overcome. In the example given of a factory, the fair value on the measurement date could reflect the market's anticipation that the land could be redeveloped with residential buildings if the factory were vacated and demolished, if zoning and other legal permissions were obtained and if the end value exceeded the cost of redevelopment. However, the HABU would reflect the fact that not all of these conditions existed at the valuation date, and that market participants would therefore discount the value for the alternative use to allow for the costs, risk and delay in achieving the alternative use.

QUESTION 6

When an entity uses an asset together with other assets in a way that differs from the highest and best use of the asset, the exposure draft proposes that the entity should separate the fair value of the asset group into two components: (a) the value of the assets assuming their current use and (b) the amount by which that value differs from the fair value of the assets (i.e. their incremental value). The entity should recognize the incremental value together with the asset to which it relates (see paragraphs 20 and 21 of the draft IFRS and paragraphs BC54 and BC55 of the Basis for Conclusions).

Is the proposed guidance sufficient and appropriate? If not, why?

IVSC finds the valuation and accounting objectives to be unclear and the guidance confusing. It appears the intention is to address the problem in IAS 16 whereby it is currently possible that depreciation can be calculated using a value that has nothing to do with the use to which an asset is put by the entity, nor its useful life to that entity. Since depreciation is an accounting requirement we do not comment on this solution, other than to point out para 21 seems to introduce a general reporting requirement into other IFRSs which has nothing to do with the measurement of fair value per se.

We also observe that the incremental amount could be considerably more volatile than the value in the current use. Moreover, from a valuation perspective, such an approach is illogical as it mixes two valuations on different assumptions. While it is correct that management and investors should be alerted to situations where an asset may be being used sub optimally, it is not clear why this should be the basis of the carrying amount unless there is an active intention to liquidate the asset.

We also point out that in valuation terms, Example 2 (IE 5 - 8) is incorrect. It requires the entity to "measure" i.e. recognise the land value at CU 240,000, whereas it is clear from the facts described that its fair value is in fact CU 300,000. If the FV reflects an alternative use and this exceeds the value of the land and buildings for the current use then the factory has no value - it is an encumbrance on the land. It should not be allocated a value of CU 60,000.

Neither does the ED adequately address the situation whereby values may be over-stated by assuming an alternative use for one asset (e.g. land) and the current use for other inter-dependent assets (e.g. buildings, site improvements and plant & equipment). For example:

An entity acquires a manufacturing operation comprising land, buildings, site improvements and plant & equipment in a business combination. The land has a highest & best use as a residential sub-division. However to achieve the highest and best use of the land, the entity will need to demolish the buildings and site improvements and relocate the plant & equipment at significant cost and with significant impact on the value of the inter-dependent buildings, site improvements and plant & equipment.

Value of interdependent assets assuming current use:

Land	CU50,000
Buildings & site improvements	CU50,000
Plant & equipment	CU100,000
Total value	CU200,000

Value of interdependent assets assuming alternative use of land as a residential sub-division:

Land	CU100,000
Buildings & site improvements	CU0
Plant & equipment	CU50,000
Total value	CU150,000

If the values adopted for fair value reporting included a mix of values assuming an alternative use for the land (CU100,000) and current use of the buildings, site improvements and plant & equipment (CU50,000 and CU100,000) the aggregate fair value would be over-stated because the highest and best use of the inter-dependent assets when considered in combination, is the current use.

Para 22 (a) seems to provide some assistance on this point but is then contradicted by para 23, which asserts that under either the “in use” or the “in exchange” premise, the asset is assumed to be sold individually.

Indeed, the whole discussion on the use of the HABU of an asset (or as we have explained, its fair value) to determine the valuation premise in para 22 creates a circular argument. A value can be placed on an asset (or liability) once the valuation premise is determined; i.e., is the asset to be valued on a stand alone basis or as part of a portfolio or larger working group? We believe what is intended is that the “in use” premise should be used if the aggregate value of individual assets sold as part of a working group is greater than the aggregate value of those same assets sold separately; and the “in exchange “ premise if vice versa. However, this is not clear at all in the ED, and the reference to HABU and same having to be determined at an individual asset level, which is apparently confirmed by BC60, is one of the main causes of this confusion.

APPLICATION TO LIABILITIES: GENERAL PRINCIPLES**QUESTION 7**

The exposure draft proposes that:

- (a) A fair value measurement assumes that the liability is transferred to a market participant at the measurement date (see paragraph 25 of the draft IFRS and paragraphs BC67 and BC68 of the Basis for Conclusions).
- (b) If there is an active market for transactions between parties who hold a financial instrument as an asset, the observed price in that market represents the fair value of the issuer's liability. An entity adjusts the observed price for the asset for features that are present in the asset but not present in the liability or vice versa (see paragraph 27 of the draft IFRS and paragraph BC72 of the Basis for Conclusions).
- (c) If there is no corresponding asset for a liability (e.g. for a decommissioning liability assumed in a business combination), an entity estimates the price that market participants would demand to assume the liability using present value techniques or other valuation techniques. One of the main inputs to those techniques is an estimate of the cash flows that the entity would incur in fulfilling the obligation, adjusted for any differences between those cash flows and the cash flows that other market participants would incur (see paragraph 28 of the draft IFRS).

Are these proposals appropriate? Why or why not? Are you aware of any circumstances in which the fair value of a liability held by one party is not represented by the fair value of the financial instrument held as an asset by another party?

IVSC considers these proposals are workable for liabilities for which there is an observable market for the instrument creating the liability. However, IVSC does not believe para 26 provides a workable solution to the problem of valuing liabilities under derivative or other OTC financial instruments.

For example, Entity A needs to value its liability as a debtor to Entity B. The definition of fair value in para 1 requires a hypothetical transfer of the liability to A*. In practice, such transaction is difficult to achieve, except:

- For derivatives through assignment, but it is rare as three counter parties need to be in agreement to allow the transfer
- For demand deposits, but this is also rare and are excluded from the scope of the ED anyway
- In the case entity A is taken over by entity A* who becomes the new debtor, but there is no real transaction on the specific liability

Neither would such a transfer be easy to achieve with a loan or a bond issued by A. A bond would need to disappear and be recreated under a new issuer because investors would not

accept a transfer except in case of business combination or absorption. The transfer required by the fair value definition is therefore highly theoretical.

The natural alternative to an exit of a liability is a settlement, i.e. reimbursement between A and B. That can take the form of an unwind of a derivative (relatively frequent), a reimbursement of a loan or a buy back of bonds from investors (which can be done in the market). In paragraph 25, the exposure draft states that the liability transfer should not be a settlement. We suggest this ignores the way the market actually operates.

In paragraph 26, the ED proposes to use the transfer of the symmetric asset as a way to remedy to lack of transferability of the liability. That would be a transfer between B and B*, the new creditor, A, remaining the debtor. The question is: in what respect does this give an exit price for A, given that A would remain the debtor and would not benefit in any way in the transaction between B and B*?

There is one case when this works: this is when A* is in fact the same entity as B: the debtor buys back its own debt on the market. This looks like a settlement, but on bonds, B can buy back from A (which is in fact many different market participants) at market price because the different A would compete to sell to the different A*, one of them being B.

If a debtor cannot transact in a particular market in which its debt is traded or quoted, that market should not be viewed as the 'most advantageous market' when determining value. Therefore, quotes obtained from that market should be considered, but should not be determinative of fair value. In practice, repurchase of debt or settlement (including unwinding the position) is the most practical exit strategy that can bring a benefit or cost to the debtor. But there is a need to distinguish between repurchase at market level and settlement with no exposure to the market, where the negotiating power of the debtor is more limited.

APPLICATION TO LIABILITIES: NON-PERFORMANCE RISK AND RESTRICTIONS

QUESTION 8

The exposure draft proposes that:

- (a) The fair value of a liability reflects non-performance risk, i.e. the risk that an entity will not fulfil the obligation (see paragraphs 29 and 30 of the draft IFRS and paragraphs BC73 and BC74 of the Basis for Conclusions).**
- (b) The fair value of a liability is not affected by a restriction on an entity's ability to transfer the liability (see paragraph 31 of the draft IFRS and paragraph BC75 of the Basis for Conclusions).**

Are these proposals appropriate? Why or why not?

IVSC considers these proposals inappropriate as currently presented.

From a valuation perspective we agree the credit risk of a debtor will affect the value of a liability as between third parties. However, we have difficulty with extending this concept to the valuation of an entity's own liabilities, especially when these are held in instruments that cannot be traded. Taking into account the entity's own financial position in this situation is a significant departure from the concept of a transaction between unconnected market participants possessed of the attributes outlined in para 14. It can be argued that this is no more correct than increasing the value of an asset that is of particular value to an entity.

When valuing assets or liabilities that are rarely traded a valuer will need to construct a model based on how the hypothetical market participants would interact to determine the price in a hypothetical transaction. A price is a figure that is realisable by one or other of the parties. Looked at another way, if no benefit or cost will be realised from a transaction then it is unlikely to occur, and therefore a valuation model that assumes it will is flawed. An unrealisable price is not a sound valuation concept. If a debtor could repurchase its own bond at market price, then this market price is relevant to the valuation hypothesis. But if the only means of exit is a settlement, why would the creditor accept a reduction in the settlement value to reflect the credit risk of the debtor? What would oblige him to do so? It is likely that the creditor would only discount cashflows due under the instrument at a risk free rate to calculate a settlement value.

We consider that own credit should affect the fair value of liabilities only to the extent that this value can be realised, i.e. that a benefit or a cost can be materialised, as this would most closely reflect how the hypothetical market participants in the theoretical market would behave.

In the case of derivatives it would be next to impossible for an entity to realise the benefits or costs of its own credit risk in derivatives. The cost to "unwind" a position is invariably calculated at a risk free rate, unless the entity is on the verge of bankruptcy when the creditor might accept a reduced price rather than run the risk of receiving nothing.

IVSC recommends that the impact of own credit in fair value should be included only to the extent it is realisable, either by the possibility of repurchase or an agreement to settle on this condition.

FAIR VALUE AT INITIAL RECOGNITION

QUESTION 9

The exposure draft lists four cases in which the fair value of an asset or liability at initial recognition might differ from the transaction price. An entity would recognize any resulting gain or loss unless the relevant IFRS for the asset or liability requires otherwise. For example, as already required by IAS 39, on initial recognition of a financial instrument, an entity would recognize the difference between the transaction price and the fair value as a gain or loss only if that fair value is evidenced by observable market prices or, when using a valuation technique, solely by observable market data (see paragraphs 36 and 37 of the draft IFRS,

paragraphs D27 and D32 of Appendix D and paragraphs BC76-BC79 of the Basis for Conclusions).

Is this proposal appropriate? In which situation(s) would it not be appropriate and why?

IVSC has no issues with the proposals.

From a valuation perspective we can confirm professional valuers would normally recognise prices paid in the four circumstances identified in para 36 as being unreliable evidence of general market prices and therefore of market value.

VALUATION TECHNIQUES

QUESTION 10

The exposure draft proposes guidance on valuation techniques, including specific guidance on markets that are no longer active (see paragraphs 38-55 of the draft IFRS, paragraphs B5-B18 of Appendix B, paragraphs BC80- BC97 of the Basis for Conclusions and paragraphs IE10-IE21 and IE28-IE38 of the draft illustrative examples).

Is this proposed guidance appropriate and sufficient? Why or Why not?

IVSC believes the guidance in the ED is inappropriate for the reasons stated below. Although the summaries of different valuation techniques in para 38 are not incorrect and International Valuation Standards (“IVS”) identify and discuss the same three principal valuation approaches, different terminology is used in IVS. While it is a fact that different terms for identical concepts and principles are currently used by valuers in different parts of the world, one of the roles of IVS is to try and establish globally accepted and understood terms. Having IASB include its own explanations and commentaries on valuation terms would not be helpful to IVSC in achieving this objective.

What preparers and valuers advising them need from accounting standards is improved clarity as to the valuation objective and the appropriate assumptions that should be made in order to achieve the required accounting measurement. In other words, the focus should be on establishing the appropriate context for the valuation, not how the valuation should be undertaken. To go down the route of including directions on the methods that may be used to calculate the valuation is one that we cannot support for a number of reasons:

- Valuation involves the exercise of professional judgement. Arriving at the most appropriate estimate of the price that would probably be achieved in a hypothetical transaction can be a complex exercise employing a range of stochastic and heuristic approaches. However, the fundamental requirement must be to mirror what the market participants are doing and the basis for

doing it. Consequently, the appropriateness of any particular approach will vary from asset to asset and for the same asset will vary with market changes. Including material in a standard that directs or even implies a preference as to how a valuation may be undertaken may produce undesirable results if that technique is not aligned with the method currently used in that market to calculate prices. It can also absolve the valuer from the need to use proper judgement to ensure that the correct result is reported, rather than one that can be justified simply because it has been derived using a prescribed or preferred technique that appears in an authoritative standard.

- There is a significant body of knowledge on valuation techniques and theory that is constantly evolving. If standards identify acceptable valuation approaches at anything more than a generic level, there is a risk of undermining the standards if different techniques are developed and become accepted as more relevant in the real world.
- Providing a superficial summary of valuation methods and techniques in the body of a standard may encourage those with insufficient understanding to treat the standards as a “recipe book” which can be used to produce the desired results.

It is for these reasons that the IVSB has recently confirmed that its impending project to rewrite the IVS will exclude the small amount of material that currently appears discussing valuation techniques and methods. This will be developed and separately published as educational material by the IVSC Professional Board. Even in the current IVS, the material on Discounted Cash Flow and the Cost Approach is presented as guidance rather than as a standard. Appendix C, which we note is stated to be an integral part of the ED, is something that the IVSB would consider inappropriate to include in IVS, let alone IFRS.

We note that in a number of places FAS 157 refers to “Practice Guides” issued by the AICPA. While this may be appropriate in the context of US GAAP, it clearly is not under IFRS. However these references reinforce our view that there will be a need for guidance on applying the basic accounting objective of measuring assets and liabilities to fair value across a wide range industry and asset types. Rather than include limited, and therefore potentially misleading, valuation references and guidance alongside the accounting objectives for fair value measurement in the accounting standard, we believe preparers, auditors and users would find it helpful if more specific and detailed supporting material was developed.

IVSC also notes that financial statements frequently require a range of expert inputs on different topics, but beyond defining the required accounting objective, IFRS does not generally attempt to prescribe how these expert inputs are to be calculated.

Accordingly, we recommend that references to valuation techniques be minimised in the accounting standard and that IASB work with IVSC to develop valuation guidance that is issued as educational material outside the standards.

DISCLOSURES

QUESTION 11

The exposure draft proposes disclosure requirements to enable users of financial statements to assess the methods and inputs used to develop fair value measurement and, for fair value measurements using significant unobservable inputs (Level 3), the effect of the measurements on profit or loss or other comprehensive income for the period (see paragraphs 56-61 of the draft IFRS and paragraphs BC98-BC106 of the Basis for Conclusions).

Are these proposals appropriate? Why or Why not?

IVSC is an advocate of adequate valuation disclosure.

From the perspective of good valuation practice, we support adequate disclosures in financial statements so that users are aware of who prepared fair value estimates, i.e. were they prepared by an independent valuer or by the entity itself, together with the key information on the approach or approaches adopted. Accordingly, we have always felt the omission of similar valuation disclosure requirements to those appearing in IAS 16 and IAS 40 from other IFRS standards that require or permit fair value measurements to be an unfortunate oversight.

While we can see that for financial instruments the distinction between those that can be measured at Level I of the hierarchy and those for which valuation techniques are required is important, we have concerns that it cannot be so clearly applied to other asset classes, the vast majority of which will require a valuation technique to estimate the price payable in a transaction. For many such assets the distinction between Level 2 and Level 3 in the hierarchy is one that is far from clear as there is a seamless continuum between valuations that are derived from abundant evidence of concurrent transactions involving very similar assets, through those derived from limited evidence drawn from quite dissimilar assets, to those for which no evidence of other remotely similar transactions exist. For assets such as real estate, plant, equipment and intangibles, we do not consider the requirement to disclose the level in the hierarchy and movements between levels set out in para 57 helpful to users, especially when compared with the existing disclosure requirements in IAS 16 and IAS 40. They would add needlessly to the cost and complexity of financial statements.

CONVERGENCE WITH US GAAP**QUESTION 12**

The exposure draft differs from Statement of Financial Accounting Standards No. 157 *Fair Value Measurements* (SFAS 157) in some respects (see paragraph BC110 of the Basis for Conclusions). The Board believes that these differences result in improvements over SFAS 157.

Do you agree that the approach that the exposure draft proposes for those issues is more appropriate than the approach in SFAS 157? Why or why not? Are there other differences that have not been identified and could result in significant differences in practice?

IVSC generally considers the ED improves certain aspects of FAS 157.

Although the US standard advanced the debate on fair value by providing clarification that fair value is intended to be a market based value and that this value is affected by the valuation “premise”, we do not consider FAS 157 a suitable model for introduction into IFRS. The principal reason for this is that fair value is used in more accounting applications under IFRS than under US GAAP and applied to a wider range of asset types.

We also consider the exclusion of ALL financial instruments from valuation on an “in use” premise in para 24 is less satisfactory than the position under FAS 157, where the requirement to consider instruments individually only applies to those that can be valued under Level 1.

We have highlighted some of the problems created by attempting to develop a comprehensive overarching “fair value” accounting standard rather than clarifying the application principles on a standard by standard basis. Also, given IFRS are generally principles or objective based standards, the degree of prescription in the ED which in many cases exceeds that in FAS 157, will almost certainly create difficulties in practical application across the wide range of markets and accounting functions where its use will be required.

Consequently, although we do not believe that a valuation under FAS 157 and one under the ED would result in a different outcome, the greater concern is that the ED may result in different outcomes being produced than under existing IFRS, even though we are sure that this is not what is generally intended.

OTHER COMMENTS

Question 13

Do you have any other comments on the proposals in the exposure draft?

IVSC asks the Board to consider the following additional comments observations in its deliberations:

13a Exit Price

While we are pleased to see the Board’s conclusion at BC 28 that a current entry and exit price will normally be equal, we note that at various points throughout the ED and in the Basis for Conclusions reference is still made to fair value being an “exit price”. We consider that this is unhelpful.

We understand that the Board believes it necessary to include these references to an exit price to emphasise that entity specific considerations are not generally relevant to the assessment of fair value. However, this should be self evident from the fact that a transaction between market participants is the stipulated requirement in the definition, one of whom is entering and one of whom is exiting. Our objection is not merely that the references to an exit price are redundant. More specifically:

- It is clear from questions raised in relation to the application of FAS 157, that a considerable number of constituents and commentators assume the reference to an “exit price” implies a break up or liquidation scenario.
- The focus on “exit price” actually reinforces the impression that fair value is something that is determined by the seller’s intentions, as it is the seller who is exiting. However, the price obtainable by a seller in the market is determined by the amount that a willing buyer is prepared to pay, not just by what the seller is prepared to accept. In the falling markets that have been prevalent for the past two years, many commentators claim they are not willing to sell at the reduced price and therefore market values (AKA “fair values”) are not relevant to them. However, as is clear from IVS, a willing seller is simply one willing to transact at the price currently available. Since we believe that the objective of the Board is that fair value should be a price that would be obtainable in the market, it is more appropriate to focus on the price that a buyer would pay rather than focus on the seller’s motivation.

13b Restrictions on Sale.

Para 46 on Level 1 inputs seems to contradict para 5 and allows an entity to avoid measuring the asset on the measurement date if there are restrictions in place on the measurement date.

If this is simply to cover the situation where, say, the required measurement date is on a day when markets are closed, then this is obviously a necessary clarification. However, as worded, it could be interpreted as allowing an entity to avoid measuring at the closest date possible because, for instance, there was an inactive market. We are sure that this is not intended.

Another reading of para 46 might suggest the entity has access to the market on the measurement date, but the fair value of the asset is estimated ignoring the restriction. Whether or not ignoring the restriction is appropriate will only be determined if doing so mirrors market participant actions. Para 47 supports this assertion, effectively confirming para 5 and contradicting para 46.

13c Forced Sales

This term is not defined but is used frequently throughout the exposure draft. The closest the ED comes to a definition is on page 41 in Appendix B, paragraph B11.

Under IVS, a forced sale arises if a seller is under compulsion to sell within a time frame that precludes proper marketing. We do not therefore agree that either b) or c) or d) are normally indicative of a forced sale.

- b) “Marketing to”, or more precisely, “negotiating with” a single market participant cannot be itself an indicator of a forced sale; many assets are transacted “off market” but at market prices.
- c) The fact that the seller may be subject to insolvency MAY be an indicator, but the difference in the price that might be paid before and after insolvency for the same assets is more likely to depend upon other factors following the insolvency, for example, the loss of sellers’ warranties, unavailability of records, the effect of cessation of trade etc. In many jurisdictions, an insolvency office holder is required to obtain the best price so the insolvency of the seller per se is not necessarily grounds to reject a price agreed as good evidence of the market price. We suggest that words are added to clarify this point.
- d) The fact that a price is simply out of line is not in itself an indication of a forced sale.

13d Portfolio effect for Financial Assets

Para 24 states that the “in-use” valuation premise is not relevant for financial assets, and that the benefits of holding in a portfolio is reflected in the value under an “in exchange” premise. This is contrary to current practice where the risk management of financial assets is made on a portfolio basis. Derivatives valuation is carried out on the basis of portfolios. The starting point is the “mid-market value” which is the sum of the assets and liabilities

represented in the individual instruments. Three adjustments are then made which are normally negative. These are:

- Bid-offer adjustments on net exposure to liquid parameters,
- Reserves for uncertainty on models and illiquid parameters. . IAS 39 is silent as to whether such reserves can be taken or not, but it is standard market practice
- Adjustments for counter party risk calculated on the net exposure with a counter party.

Moreover, analysis often reflects so called “concentration risk” as having a large position makes it more difficult to sell with the risk of affecting market prices. Regulators require the value of concentrated positions to be adjusted for capital calculation purposes and it would seem rather peculiar if financial statements were not in line with the prudential capital measures required of financial institutions.

We would ask IASB to reconsider its position on the appropriate unit of account and block discount, because practical valuations made by professionals in this sector invariably include a portfolio effect. Some suggest that para 55 provides a solution to this problem as the counter party valuation adjustment could be interpreted as the equivalent of a bid-ask spread. However, it would be preferable for this point to be made expressly rather than requiring entities and their advisors to draw analogies. This issue is specific to derivatives, but derivatives are probably the category of instruments where the use of valuation techniques is most wide spread.

13e Vocabulary

The use of the terms “in use” and “in exchange” to describe the two valuation premises is unhelpful. Firstly, a valuation on either premise assumes a hypothetical exchange so the distinction is not clear to a non specialist reader. “In use” is too similar to the very different “value in use” term used to describe an entity specific value in IAS 36. Even in discussions between experienced accounting and valuation professionals, this latter term does cause confusion.

We therefore ask that thought be given to introducing alternative terms for the two concepts. The “in use” premise might be redefined “value as part of the operational unit” and “in exchange” might be “value if sold separately”. Although such alternatives would be more wordy, they would at least be more descriptive of the required assumption.

END