Federation of European Accountants
Fédération des Experts comptables Européens

Sir David Tweedie
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Ref.: ACC/HvD/LF/ID

Dear Sir David,

**Re: FEE Comments on IASB Exposure Draft Fair Value Measurement**

(1) FEE (the Federation of European Accountants) is pleased to provide you below with its comments on the IASB Exposure Draft Fair Value Measurement (the "ED").

(2) As a founding organisation of EFRAG we have also contributed to the EFRAG consultation process by submitting on 6 October 2009 the FEE comments on EFRAG's Draft Comment Letter of 30 July 2009. EFRAG has issued its final comment letter on 16 October 2009. We have considered the EFRAG Final Comment Letter in our response and made reference to the EFRAG comments where relevant.

(3) As a general observation, we wish to emphasise that the purpose of the ED is not to provide guidance on when to apply fair value but on how to perform valuation at fair value. However, while the purpose of the proposals is to establish how to define fair value, we note that IFRS require the application of fair value for different items in the various individual standards in specific circumstances. In our opinion, the proposed new definition of fair value narrowly defined as an exit value is not appropriate in all cases where measurement at fair value is currently required. The scope of use of fair value (i.e. of when) has an impact on its definition (i.e. of how) and vice-versa.

(4) As a matter of principle, we believe that there is more than one way of defining fair value depending on the circumstances surrounding the asset or liability that is to be measured. Accordingly, instead of trying to establish a single definition of fair value that is unlikely to be adapted to all the references to fair value in IFRS, an alternative approach may be to develop various notions of fair value with a description and guidance on how to measure each of these fair value notions. Each individual standard could then refer to the specific fair value notion that is considered the most appropriate to the specific circumstances.

(5) Fair value could encompass for example the following notions:

- Exit price notion;
- Entry price notion;
- Exchange notion;
- Transfer price notion;
- Settlement value notion (with a counterparty to instrument/obligation).

This list is not exhaustive. Further notions could be defined in other projects, for example in the insurance and liabilities projects.

(6) If the currently proposed narrow definition of fair value as exit price were to be retained, in several standards for the measurement of certain items and instruments, the term “fair value” should not be used and fair value should be replaced by a different term (entry price, transfer price, etc.). In our view, the proposed narrow definition would only work and be appropriate in some cases for example when financial assets are measured at fair value through profit or loss.

(7) Whether or not the IASB retains our suggestions to develop specific guidance on the application of the various notions of fair value, we would expect this guidance to form part of the future fair value standard so that all guidance on fair value is available in a single document.

(8) Our response to this ED should be considered in light of our comment letter dated 14 September 2009 on the IASB Exposure Draft Financial Instruments: Classification and Measurement, in which like EFRAG, FEE supports the continued application of a mixed measurement model for financial instruments and agrees with the IASB’s conclusion that measuring all financial assets and financial liabilities at fair value is not the most appropriate approach to improving financial reporting for financial instruments.

Our responses to the questions in the Invitation to comment of the ED are included as an Appendix to this letter.

For further information on this letter, please contact Ms. Saskia Slomp, Technical Director.

Yours sincerely,

Hans van Damme
President

## DEFINITION OF FAIR VALUE AND RELATED GUIDANCE

### 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 relevant only 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?**

(9) As previously indicated in our letter issued in July 2007 in response to the IASB Discussion Paper on Fair Value Measurements and as set out in our covering letter, we believe that fair value can have different notions depending on the circumstances and accordingly it should not only be defined as an exit price. Indeed, if the term "fair value" is narrowly defined as an exit price, it will only be applicable to the measurement of certain items in certain circumstances, for example for financial assets measured at fair value through profit or loss. For certain items, a measurement that reflects the exchange value or an entry price or settlement value may provide more relevant information based on the nature of the item measured and the manner in which the item will be realised (or extinguished) in accordance with an entity's business model.

(10) For instance, fair value defined as an exit price is not appropriate for initial measurement when a liability cannot be extinguished through a transfer transaction, such as is the case for many liabilities.

(11) Further, we believe that the assumption in the proposed new definition of fair value that an entry price is the same as an exit price would only be appropriate where an active market exists. This is not the case for many items for which a fair value measurement is required under IFRS (for example, assets and liabilities acquired in a business combination) or for most assets and liabilities subsequently measured at cost. We therefore believe that the question of whether an entry price or an exit price provides more relevant information needs to be addressed. At this time, we concur with the EFRAG assessment in paragraph 10 of its final letter that the ED does not provide any compelling argument demonstrating the superiority of the exit price over the entry price.

Appendix - Responses to the questions in the Invitation to comment of the IASB Exposure Draft Fair Value Measurement

(12) As a matter of principle, we believe that there is more than one way of defining fair value depending on the circumstances surrounding the asset or liability that is to be measured. Accordingly, instead of trying to establish a single definition of fair value that is unlikely to be adapted to all the references to fair value in IFRS, an alternative approach may be to develop various notions of fair value with a description and guidance on how to measure each of these fair value notions. Each individual standard could then refer to the specific fair value notion that is considered the most appropriate to the specific circumstances.

(13) Fair value could encompass for example the following notions:

- Exit price notion (including or excluding own credit risk changes for financial liabilities, see our comments in paragraph 18 of this letter);
- Entry price notion;
- Exchange notion;
- Transfer price notion;
- Settlement value notion (with a counterparty to instrument/obligation).

This list is not exhaustive. Further notions could be defined in other projects, for example in the insurance and liabilities projects.

(14) Specific guidance on the application of the various notions of fair value will be needed to address the specific cases. We would expect this guidance to form part of the future fair value standard so that all guidance on fair value is available in a single document.

(15) In addition, as explained above in paragraph 3 of this letter, we agree with EFRAG that the proposed new definition of fair value will not be appropriate in all cases where the term "fair value" is currently required.

(16) It would appear to us that the appropriateness of the definition is best assessed based on the on-going measurement of the items (i.e. whether an item is measured at fair value on an on-going basis). We believe that this is a relevant distinction in as much as it reflects the manner in which the asset (or liability) will be realised (or extinguished) under the entity's business model.

(17) Where an asset (financial and non-financial) is subsequently measured at fair value (because this measurement best reflects the manner in which it will be realised), we believe that it is appropriate to recognise this asset, initially and subsequently, at fair value as an exit price as defined in the ED. Where an asset is not subsequently measured at fair value, we consider that an alternate definition of fair value may be more relevant at initial recognition (whether it be the transaction price or an entry price).

(18) Similarly, where a liability is subsequently measured at fair value, we also consider that measurement based on an exit price is appropriate as this reflects the fact that the liability is expected to be extinguished in a transfer transaction rather than through performance. However, as stated in the FEE response to the Discussion Paper on Credit Risk in Liability Measurement, the measurement basis for financial liabilities that currently fall in the fair value through profit or loss category but that are not expected to be settled by transfer would reflect exit price excluding changes in own credit risk subsequent to initial measurement. Consequently, they should be excluded from the fair value notion in IAS 39. Where a liability is not subsequently measured at fair value, like for assets, we consider that an alternate definition of fair value may be more relevant (whether it be the transaction price, settlement price or an entry price). We would expect that most non financial liabilities would fall in this latter category since we expect that most non financial liabilities are extinguished through settlement.

## 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?**

(19) If the suggested approach of a broader definition of fair value that we developed in response to Question 1 were to be followed, the exemptions suggested would not be needed since the appropriate fair value notion can be referred to in the specific individual standard.

(20) However, if the restrictive definition proposed in the ED were to be kept, we support the exemptions of the application of the new proposed definition of fair value in two of the contexts presented: in IFRS 2 *Share-based Payment* and reacquired rights in IFRS 3 *Business Combinations*.

(21) We also agree with the suggestions made by EFRAG in paragraphs 16 (a) and (b) of its final comment letter relating to demand deposits:

- In our view a financial liability with a demand feature measured pursuant to IAS 39.49 cannot be described as measured at fair value. Consequently, the term "fair value" should be replaced as the description of the current value for the cases described in IAS 39.49.

- We agree with the comments made by EFRAG in paragraph 16 (b) of its final comment letter that the measurement of financial liabilities with a demand feature is appropriately excluded from the scope of the standard on fair value measurement only as a temporary measure until the issue gets fixed in IAS 39.

(22) If the IASB continues with its approach of narrowly defining fair value as proposed in the ED, we believe that there may be other instances where exemptions from the definition of fair value as an exit price may be warranted, for example in the context of the allocation of the purchase price to individual assets and liabilities in a business combination under IFRS 3 or for the subsequent measurement of property, plant and equipment measured under the revaluation model in IAS 16. It would be worthwhile if the IASB considered whether the definition of fair value as an exit price is appropriate in the measurement of embedded derivatives in non-financial contracts which are settled with the counterparty to such hybrid instruments rather than transferred.

(23) Indeed, it appears conceptually appropriate that the initial measurement of assets and liabilities acquired in a business combination should reflect the transaction price had the items been acquired or issued separately (i.e. an entry price). While for many of these items using an exit price may provide a reasonable proxy of what the transaction price (or entry price) would be, this may not be the case for all items. For example, for certain liabilities assumed in a business combination that are not subsequently measured at fair value (such as provisions) a settlement value would be a more relevant value since this better reflects the manner in which the liability will be extinguished. Similarly, we note that certain assets that are so specific that they cannot be acquired on the market (e.g. a very specific brand or R&D), valuation at a replacement cost may be the most relevant measurement.

(24) Additionally, in order to assist constituents in evaluating whether all situations that warrant an exemption have been identified, we encourage the IASB to publicise the result of the IASB standard-by-standard review of the use of the term "fair value" in IFRS and of its case study involving the valuation of the identifiable assets acquired in liabilities assumed in a business combination.

## 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?**

(25) Like EFRAG, we are not convinced about the superiority of the most advantageous market concept over the concept of principal market. However, in practice, we expect that the most advantageous market and principal market may often be the same, being the market in which the entity normally transacts since it can be assumed that an entity normally enters into the most advantageous market to which it has access. Accordingly, we suggest that the requirement that the entity must undertake a search of all possible markets to identify the most advantageous market be removed and replaced by a presumption that the entity would normally transact in the most advantageous market.

### 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?**

(26) We support this proposal and agree with EFRAG that the market participants are adequately described.

## APPLICATION TO ASSETS: HIGHEST AND BEST USE AND VALUATION PREMISE

### 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?**

(27) In our view, the proposals in (a) and (b) are appropriate to the extent that the result reflects an alternative use that is realistic to the entity considering its activities and its business model. Otherwise, the measurement of assets at a higher value does not result in decision-useful information to the reader of the financial statements. In fact, we believe the business model should be the main driver as to the relevance of following a highest and best use approach. For example, an entity may be willing to pay more for adjacent land than the value in highest and best use.

(28) Further, it would be helpful if the IASB provided a comprehensive example to illustrate how the proposals would work in more complex scenarios, for instance when dealing with combined depreciable assets as opposed to one single asset or when the asset that is not used to its highest and best use is a depreciable asset and not land as in the example provided.

(29) In addition, it would be useful if the IASB clarified the nature of the costs related to the change in use of an asset that would be considered in assessing highest and best use (e.g. would it consider employee termination benefits?).

(30) We believe additional guidance would be useful in regards to the extent of judgement that would need to be applied in some cases. In addition, the appropriateness of the proposals might also be assessed by taken into account the practicability of the proposals, including costs and benefits considerations.

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(31) We also agree that the concept of highest and best use is not relevant for liabilities.

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 (ie their incremental value). The entity should recognise 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?**

(32) As noted above, we are not convinced that the proposed guidance is sufficient and appropriate. Our main concern is the difficulties that might be encountered when applying the proposals, requiring substantial judgement.

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 (eg 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?**

(33) We believe that it would be necessary that the IASB describes the rationale supporting use of the transfer notion for all liabilities. In our opinion, the usual and economically rational mode of exit for almost all financial liabilities not subsequently measured at fair value as well as all non-financial liabilities is not transfer, but settlement or performance. Therefore, in our view, in the case of a liability, measurement on the basis of settlement or performance, as opposed to transfer, will often provide a more useful current value for a liability. The ED should recognise the measurement of the liabilities on this basis.

(34) We agree with EFRAG that the proposal to use the observed price of an active market for transactions between parties who hold a financial instrument as an asset to determine the issuer's liability is not always appropriate. This is particularly true when the entity does not expect to extinguish the liability through the acquisition of the corresponding financial asset but rather to extinguish it through settlement. Furthermore, as noted in our comment letter on the Discussion Paper Credit Risk in Liability Measurement, the impact of credit risk (and therefore fair value) differs when considered in the measurement of an asset as compared to the corresponding liability because the perspective of the holder of the instrument is fundamentally different from the perspective of the entity obligated to settle it.

(35) Even if, as a general principle, we agree with using valuation techniques, we disagree with EFRAG and with the IASB proposals that present value should be used to estimate "the market price participants would demand to assume a liability for which there is no corresponding asset" because we do not see the rationale for estimating a transfer price in most cases.

## 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, ie the risk that an entity will not fulfill 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?**

(36) We agree that the fair value of a liability reflects non-performance risk. However, we would like to note our comments on the IASB Discussion Paper Credit Risk in Liability Measurement (as included in the FEE Comment Letter to the IASB issued on 24 September 2009), in which FEE supports EFRAG's suggestions that credit risk should only be taken into account in the initial measurement of a liability if an entity's own credit risk is priced into the transaction that gave rise to the initial recognition of a liability. Changes in own credit risk should not be taken into account in subsequent measurement of liabilities with the exception of financial liabilities (and possibly also insurance liabilities) which, in accordance with the business model, are expected to be disposed of at fair value.

(37) In practice, we believe that the fair value of a liability might be affected by a restriction on an entity's ability to transfer the liability since such restriction is usually an inherent part of the liability terms with valuation consequences compared to a similar liability without such restrictions. Accordingly, we believe that it would be useful if the IASB clarified what is meant by the reference to "a restriction on an entity's ability to transfer a liability ... does not affect the fair value of the liability" in paragraph 31 of the ED and explained the principles governing whether or not a separate adjustment should be made for contractual restrictions in determining the fair value of a liability.

## 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 recognise 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 recognise 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?**

(38) We agree with EFRAG and support the proposal that an entity would recognise any gain or loss resulting from initial recognition of an asset or liability at fair value when fair value differs from the transaction price, unless the relevant IFRS for the asset or liability requires otherwise (i.e. determining whether the recognition of day one gains or losses is appropriate on a standard-by-standard basis).

(39) We believe that there is currently considerable divergence in the way Day 1 gains or losses are recognised in practice (immediately, linear recognition etc.) and as such it would be useful if the IASB clarified the principle underlying the Day 2 measurement and for related guidance. We note in particular that the reference to “including time” in IAS 39.AG 76(b) is a source of ambiguity.

## 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?**

(40) Like EFRAG, we broadly support the guidance provided in the ED.

(41) It would be helpful if the IASB clarified that the IASB’s Expert Advisory Panel Report *Using judgement to measure the fair value of financial instruments when markets are no longer active* published in October 2008 continues to be valid in the context of the new proposals.

## 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 measurements 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?**

(42) Conceptually, we believe that disclosure requirements for fair value would best be dealt with in individual standards as opposed to including them in the future standard of Fair Value Measurement.

## 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?**

(43) We are broadly supportive of EFRAG's response to Question 12 and we believe that most of the differences represent generally improvements.

## OTHER COMMENTS

### Question 13

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

### Portfolio basis

(44) It would be helpful if the IASB clarified that the portfolio basis of measurement is allowed in the proposals where applicable. In our view, it may be appropriate in certain cases.