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RE: CESR's response to EFRAG's draft comment letter on the IASB's Exposure Draft *Fair Value Measurement*

The Committee of European Securities Regulators (CESR) has, through its standing committee on financial reporting (CESR-Fin), considered EFRAG's draft comment letter on the IASB's Exposure Draft (ED) *Fair Value Measurement*.

We thank you for this opportunity to comment on your draft letter.

A number of IFRSs currently require some assets, liabilities and equity instruments to be measured at fair value. However, guidance on how to measure fair value has been generated on a piecemeal basis and is as a result dispersed through various different standards. In addition such guidance as has been generated is also internally inconsistent on occasions. CESR therefore welcomes the idea of establishing a single source of guidance to reduce complexity and to improve consistency and which both clarifies the definition of fair value and enhances related disclosures for financial and non-financial items.

The Exposure Draft does not address 'when' assets and liabilities shall be measured at fair value. But, in CESR's view, when a particular standard requires an asset or liability to be measured at fair value, a common definition and guidance should be in place. Therefore, CESR agrees with both the EFRAG – and the IASB – to support the idea of having a common fair value measurement framework described in the ED. In its comment letter, EFRAG raises the question of the relevance of the fair value measurement for non-financial items. CESR has not reviewed each particular standard that requires or allows fair value to assess whether fair value is the most appropriate current measurement basis for that type of asset or liability can be more appropriate. In light of the concerns raised by EFRAG, CESR believes the IASB should evaluate if fair value, as currently defined in the ED, should still be required or allowed under IFRSs for some non-financial items.

CESR supports the further convergence between IFRS and US GAAP that would result from the proposed amendments but would nevertheless encourage the IASB to work jointly with the FASB to reduce or eliminate any remaining differences as quickly as possible. This is consistent with the July 28 report from the Financial Crisis Advisory Group that encouraged the achievement of a single set of high quality, globally converged financial reporting standards.

The above mentioned comments show that CESR is in broadly agreement with EFRAG on the main approach related to this project. However, as will appear from the following comments, CESR also has concerns on some key aspects of EFRAG's draft comment letter:



CESR concurs with the IASB that when fair value is required or permitted by a particular standard for either financial or non financial assets, the calculation of fair value should be consistent with a single definition and guidance based on market-driven assumptions. However, CESR would request the IASB to assess whether using entity-specific assumptions for some non-financial items in certain circumstances may result in more decision-useful information. If that were the case, fair value should not be applied to those non financial items.

CESR thinks that the “highest and best use” notion is consistent with market participants’ assumption and therefore appropriate when fair value is required or permitted. However, for the same reasons as explained above, it is, in principle, conceivable that an entity’s intended use could provide in specific circumstances more useful information than the highest and best use notion. If the IASB believes this is the case a measurement attribute – other than fair value – would be more adequate.

Concerning the application of fair value measurement to liabilities, CESR generally agrees with EFRAG, however, CESR is of the opinion that non-performance risk covers factors other than own credit risk, like the ED proposes, and that these other factors should be incorporated into the fair value measurement of a liability.

CESR’s detailed comments to the questions raised in the ED are set out in the appendix to this letter.

I would be happy to discuss all or any of these issues further with you.

Yours sincerely,

Fernando Restoy
Chairman of CESR-Fin



Appendix: Answers to the questions included in the ED

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?

As EFRAG points out, the ED explains the ‘how to’ part of the fair value debate but, does not touch upon the ‘when to’ part of the debate i.e. when fair value measurement should be applied. CESR concurs with EFRAG’s declarations in the past that the ‘how’ and ‘when’ aspects of fair value measurement can only be comprehensively addressed when the IASB also resolves the ‘why’ part of the debate¹, i.e. why and in which circumstances current value measurements are appropriate and why fair value should be considered as one such measurement. It should be noted that some parties have suggested using alternative current value measurements to fair value, as is mentioned by the IASB in the Basis for Conclusion to the ED *Financial Instruments: Classification and Measurement*.

The ED sets itself the objective only of clarifying how fair value should be measured (“the mechanics”) without providing an adequate context in which to assess the appropriateness of any of the alternatives. We agree with EFRAG that a more comprehensive framework is needed in the long term, since it would not be particularly useful to resolve the ‘how to’ part of the debate only to be forced to conclude once the outstanding issues have also been resolved, that the current measurement objective would have been better achieved with another valuation methodology.

Until these questions have been answered, any standard encompassing the proposals in this ED could only be considered preliminary and would probably need to be overhauled afterwards, when the new conceptual framework has been finalised.

This said, CESR supports the objective of establishing a single source of guidance in the short term for all fair value measurements when they are required or permitted by particular standards, covering both financial (excluding own credit risk) and non-financial items. Notwithstanding that, CESR thinks the IASB should also move forward with its comprehensive and long term work on the framework, as any amendments resulting from the ‘when’ and ‘why’ debate could result in consequential changes also to the proposals put forward in this ED.

CESR has in addition the following comments:

- CESR supports EFRAG’s view that the IASB should further clarify in the Basis for Conclusions why it has decided in favour of an exit-price concept of fair value.

According to BC 28 of the ED, it seems there is no distinction between an entry and an exit price for the same asset at the same date in the same market other than as a result of the cost of transacting. On this basis, the IASB concludes the debate on an exit notion versus an entry notion is a non-issue. However, that conclusion is not so easily drawn from BC97 where the IASB appears to acknowledge that other differences can exist

¹ For example in EFRAG’s comment letter to the IASB’s Discussion Paper ‘Reducing Complexity in Reporting Financial Instruments’



An example that occurs to CESR is related to transportation costs. The transportation costs incurred to move an asset from its current location with a supplier (the reporting entity) to a purchaser's location in an hypothetical transaction to sell or dispose of that asset (exit price) can be considered to be different from the costs of transporting the same asset from the location where the supplier first bought the asset to his own premises (entry price). The most advantageous market in which the original acquisition of an asset or liability takes place might also be different from the most advantageous market in which the same entity eventually sells or transfers that asset or liability.

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?

CESR agrees with EFRAG in supporting the removal of the term "fair value" in each of the three contexts detailed in a) and b) above and agrees that in all three cases the items concerned (including on demand liabilities) should be re-labelled.

The ED sets out to provide a single definition of and source of guidance for estimating fair value. The methodology required by paragraph 49 of IAS 39 as regards financial liabilities with demand features cannot be consistent with an assumption of a market participant's view and a different term for the measurement required in that paragraph should therefore be found to avoid any confusion. This is the case also for IFRS 2 and IFRS 3.

CESR also supports EFRAG's request that, in the longer term, the measurement of such instruments should be reconsidered in order to find a solution that is consistent with the new definition of fair value proposed, as such instruments represent an exception to the overriding principle that all financial instruments are measured at fair value on initial recognition. CESR would however be concerned if any reconsideration of the treatment of such instruments implied the recording of a gain on initial recognition of a demand deposit.

As a last point, the IASB states it considered whether to exempt leases from fair value measurement. As EFRAG's comment letter remains silent on this issue, CESR assumes EFRAG implicitly agrees with the IASB. Leases are however scoped out of US GAAP by SFAS 157. We would urge the IASB to work jointly with the FASB to remove this difference in scope in the near term, for example as part of their joint project on leases.



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?

We concur with EFRAG in agreeing with the IASB's proposal. However, CESR believes there could be a conflict between the two presumptions in paragraphs 10 and 11. If an entity normally operates in one market, that market is presumed to be the entity's most advantageous market. At the same time, it is assumed that an entity's principal market is its most advantageous market. A conflict may arise if the market in which the entity operates is not the principal market. One of the two presumptions should win out over the other. If this is not the case, then the IASB must be concluding that the two presumptions cancel each other out and the entity will need to collect further evidence regarding which is its most advantageous market. This situation, however, would create additional costs for issuers.

As this is one of the remaining differences with SFAS 157, we would again recommend the IASB to work jointly with the FASB to remove it.

EFRAG also thinks that the notion of the most advantageous market "to which the entity has access" introduces entity-specific factors and that this is inconsistent with the notion of a market participant's perspective, which seems to be fundamental to the fair value principle.

CESR understands EFRAG's reasoning but does not see this inconsistency. Fair value is defined in the ED as an exit price meaning the price the entity (as a potential 'seller') would receive in a hypothetical transfer of an asset or liability to a third party. For this hypothetical transfer to be feasible, the reporting entity needs to have access to the market. It would be illogical to allow an entity to reference a market which it cannot access and where it consequently would not be able to sell the asset or transfer the liability.

In addition, CESR thinks the first sentence of paragraph 9 of the ED may encourage an interpretation that the most advantageous market can be different for different business units or subsidiaries within a reporting entity. CESR cannot believe that this is the IASB's intention and would welcome clarification on the matter in the Basis for Conclusions.

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?

CESR agrees with EFRAG's view that market participants are correctly described. CESR believes that the use of a market participant's view will generally lead to more robust, objective and comparable figures and will minimise the risk of subjectivity and of earnings' management.

One of the features of a market participant as given in paragraph 13 of the ED is that he or she is presumed to be as knowledgeable about the asset or liability as the reporting entity. This



assumption has to be considered an entity-specific factor and its effects on how an entity values an asset or liability may be unclear (contrast for example valuing the same asset in the situation, where (i) the reporting entity proves to have the highest knowledge of the asset (e.g.: it is the originator of and main dealer in a financial asset, such as a CDO); with the situation where (ii) the reporting entity proves to have a low knowledge of the asset (e.g. because it is the first time the entity has entered into a transaction on the specific asset or liability).

In CESR's view, the reference to "knowledgeable parties" should simply refer to an objectively established reasonable degree of knowledge sufficient to understand the transaction and the asset's main features and should make no specific reference to the reporting entity. We think that one of the current references in IFRS could be used for this purpose (e.g. current paragraph 42 of IAS 40). This requirement would be sufficient for the measure to qualify as fair value and the last part of the sentence that includes the presumption should be removed. Nevertheless, if the IASB considers this not to be enough, it should develop further guidance to address situations where asymmetry of information exists, such as those mentioned in BC 44.

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?

CESR agrees with the IASB's proposal that the 'in use' valuation premise does not apply as well to financial assets or liabilities as the pragmatic presumption that, unless there is evidence to suggest otherwise, an entity's current use of an asset is that asset's highest and best use.

However, although CESR understands EFRAG's concerns about applying fair value as defined in the ED to non-financial items, CESR is generally more supportive of the ED's proposals and believes that the guidance provided in the ED does allow consistent application, even if significant judgement may be needed in some circumstances.

For the reasons explained earlier in this letter, we support generally the use of a notion of a market participant's view rather than an entity-specific notion. EFRAG thinks an entity's intended use provides more useful information than the highest and best use. CESR is not convinced as we believe that the notion of a market participant's view may improve comparability and can be used to assess opportunity costs, using the market as a benchmark. Such reporting would also help shareholders assess management's stewardship of the company on comparable bases. However, for the same reasons as explained above, it is, in principle, conceivable that an entity's intended use could provide in specific circumstances more useful information than the highest and best use notion. If the IASB believes this is the case a measurement attribute – other than fair value – would be more adequate. In addition, CESR thinks the disclosure of both components of fair value measurement when the



intended use differs from its highest and best use, as proposed by paragraph 60 of the ED, would provide useful information to users.

CESR is not convinced that imposing the conditions that the use proposed should physically, legally and financially be possibly, as prescribed in paragraph 17 of the ED, adds much further clarity to the standard as these conditions are clearly implicit in the highest and best use. The IASB should consider removing these conditions or providing more decision useful guidance.

The highest and best use principle seems to be enough to achieve consistent application if management applies its judgement in accordance with IAS 8. If the IASB wishes to keep the two valuation premises, more and clearer guidance could be needed as is suggested by EFRAG.

Among the same lines, CESR thinks additional guidance will be needed to draw a distinction between “value in use” as set out in IAS 36 and the ‘in-use’ valuation premise. In addition, we believe there is a need to clarify how to allocate the total ‘in use value’ of a group of assets to each of the individual assets within that group. We are not convinced by the IASB’s arguments. If there are no quoted prices for each individual asset within the group and a present value technique is used to determine the cash flows generated by the group of assets, the total fair value obtained should be allocated to individual assets. If allocation is only possible on an arbitrary basis, then perhaps, the assets concerned should be measured at cost, since fair value could not be considered reliable enough².

EFRAG raises the point that there is a potential inconsistency between requiring on the one hand that the reference market should be entity-specific (and accessible by the entity) while on the other requiring the use of a notion of a market participant’s view when assessing an asset’s highest and best use. Even if more guidance and clarification could be useful, CESR does not see a fundamental inconsistency here. It would be odd to have to take into account exit prices in a market which the entity cannot access (fair value being the exit price of an asset in an hypothetical sale entered into by the reporting entity with another third party viewed from a market participant’s perspective).. However, it does seem reasonable to us to use market participants’ views in relation to a market the entity does have access to.

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?

EFRAG thinks the guidance in the ED on the issue raised in this question does not relate to a realistic or usual situation and believes the guidance therefore to be more distracting than enlightening.

Contrary to EFRAG, CESR considers the examples given may occur quite frequently in practice, as entities do not always utilise assets for their highest and best use. Financial reporting helps shareholders to make decisions on such management stewardship issues. CESR thus supports the guidance as proposed in the ED.

CESR also acknowledges that distinguishing between the ‘fair value’ measurement of an asset in its current use [component (a)] and the value in use of the same asset is not always very easy.

² The use of a cost measurement value would create problems in a business combination, as the whole difference should be allocated to the goodwill



CESR is also supportive of the associated disclosure requirements proposed in paragraph 60 of the ED, as we believe they will prove very helpful to users of financial statements seeking to assess an entity's resources and how efficiently they are deployed. CESR would ask the IASB to consider whether it would provide useful information to extend these disclosure requirements to cover also the situations described in paragraph 19 of the ED, where the intended use of a stand-alone asset might differ from its highest and best use. In these circumstances, even if the asset is not used together with other assets but on its own, separate disclosure of the value [component b] of the asset in its current use (which could be nil) and its incremental value could also be useful to users of accounts.

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?

Transfer value versus settlement value versus fulfilment value

CESR concurs with EFRAG in accepting the general premise in the ED that fair value is an exchange notion.

CESR also agrees with EFRAG that the notion of exchange is not so obviously an appropriate measurement criteria for liabilities when compared to the notion of settlement. The ED itself seems to contain conflicting views on this issue. Paragraph 25 of the ED states that "a fair value measurement assumes the liability is transferred to a market participant, [that] the liability continues...and is not settled with the counterparty or otherwise extinguished".

However, the measurement of a liability can differ depending on whether there is a corresponding asset. In this case, the ED considers the fair value of the corresponding asset to equate to the fair value of the liability, adjusting for the different features of each. This approach implies in substance a notion of settlement which matches the liability and the corresponding asset against each other, which is conceptually different to that of a price required to transfer the liability to a market participant. Furthermore, the IASB does not justify why a change in the level of liquidity in the market for the asset would have an impact on the fair value of the liability.



The proposal to include the reporting entity's own credit risk also seems to reflect an entry price or settlement notion rather than the notion of a transfer to a third market participant. Credit risk is clearly incorporated into the fair value of the corresponding asset, as it is a characteristic of the asset, and it is also incorporated initially in the measurement of a liability for cash, but this transaction price is not an exit price but an entry price. Along the same lines, in the circumstances where an entity is willing in principle to transfer a liability to a third market participant, then hypothetically credit standing is not a characteristic of the liability to be transferred but of the transferee who will finally assume the liability. Therefore, own credit risk arises from the transaction itself and will depend on the credit standing of the final transferee. If there are restrictions on transferring a liability between market participants with a different credit standing, it seems that this restriction would fall under the scope of paragraph 31 of the ED, which states that such restrictions will not affect the fair value of the liability.

Therefore, notwithstanding CESR's willingness to accept an exchange notion for liabilities, CESR is reluctant to conclude that a settlement notion for financial and non-financial liabilities, subject to the exclusion of changes in own credit risk when settlement is not intended or feasible, would provide more relevant information or minimise measurement asymmetries (with the corresponding assets) that might otherwise arise.

Using the fair value of the corresponding asset as the fair value of the liability

CESR generally agrees with EFRAG on this issue. We support EFRAG's view that market participants holding the instrument as an asset are likely to be in a different position to market participants that might assume the instrument as a liability. Firstly because of the role of an entity's own credit risk (which we will explore further in our response to the following question) and secondly, as pointed out in BC 75, because the fair value of a liability, unlike an asset, is not a function of marketability, but of performance. This seems to imply that, unlike the case with an asset, liquidity risk, is not a factor affecting the fair value of a liability. As a result, an increase in the liquidity risk of the market in which the corresponding asset is traded should decrease the corresponding asset's fair value while leaving the liability's fair value unaffected.

As already mentioned, another risk may arise depending on whether own credit risk, unlike the case with assets, is incorporated into the fair value measure of liabilities. As fair value is not an entity specific measurement, this concept does not seem to be consistent with the fair value definition. Therefore, based on the proposed definition of fair value, own credit risk should be ignored when estimating the fair value of liabilities. This would cause another difference between the fair value of a liability and its corresponding asset.

CESR believes there could be other circumstances in which the fair value of a liability and its corresponding asset might be different. One example might be where an entity issues asset-based securities (debt securities classified as liabilities for the entity) the returns from which are based on the future inflows from certain music copyrights. These securities (financial assets) are offered to the public. In this case is the fair value of the liability (for the issuing entity) and of the financial asset held by the investors the same?

Assuming the pay-offs (represented by the future cash flows generated by the copyrights) are the same for the asset and the liability, the expected cash flows would also be the same. Therefore, if we use a method of discounting expected cash flows, the discount rate should adjust for the risk that the real cash flows received differ from the expected cash flows.

Assuming a decreasing marginal utility of cash and a hypothesis of risk aversion for investors and debtors, then the risk premium required by investors should be added to the risk-free interest rate in the case of the asset and detracted from the risk-free interest rate in the case of the liability.



This means investors will be shown to require higher returns as the risk increases that real cash flows will differ from expected whilst debtors, on the other hand will require a higher amount (a lower interest rate) to assume a liability in which the cash flows are uncertain and can differ from the expected.

CESR acknowledges that if the reporting entity has the practical ability to settle the instrument with the counterparty at any time, the fair value of the corresponding asset could be a relevant indicator of the fair value of the liability, as the value of the one represents a cap on the value of the other. However, if the fair value of the asset is higher than that of the liability, neither the holder of the asset nor the debtor will have any incentive to settle the instrument with each other. CESR tends to think at this stage that a present value technique taking into account all the factors that a market participant would consider relevant should be used to estimate the fair value of all liabilities, even in cases where there is a corresponding asset.

We would recommend EFRAG ask the IASB to explore these issues further before issuing the final standard.

Using techniques to estimate the price that a market participant would demand

Like EFRAG, we support the proposal to use present value and similar techniques in these situations.

However, CESR believes that Annex C should provide additional guidance, including some examples of how to measure the fair value of liabilities and how to incorporate risk premia into the estimation. Such guidance should be consistent with that provided in paragraph B4 (d) of the ED, which can be considered a useful starting point.

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?

We generally agree with EFRAG's draft response on this issue. We would like to refer to CESR's comment letter on the Discussion Paper *Credit Risk in Liability Measurement* and to our response to the previous question on how own credit risk should be treated.

CESR nevertheless thinks that non-performance risk should cover factors other than own credit risk, as the ED proposes, and that these should be incorporated into the fair value measurement of a liability.

For example, the risk that an entity cannot fulfil a liability in accordance with the contractual terms agreed with the counterparty, should be reflected in the fair value of that liability to the extent a market participant would consider that risk relevant. As the consequences of not performing an obligation to deliver goods or services will depend on the terms and conditions agreed with the counterparty, a reporting entity should look carefully at those terms and conditions and the potential sanctions and other consequences that can be imposed if the obligation is not properly fulfilled when



valuing the obligation itself. In order to promote consistent application, the IASB should develop guidance on this issue.

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?

Like EFRAG, CESR supports the proposed amendments, including that of allowing the determination and recognition of day one gains or losses on a standard-by-standard basis.

However, CESR is uncertain why paragraph 36 of the ED includes a list of four cases in which the fair value of an asset or liability at initial recognition might differ from the transaction price.

It is not completely clear to us whether the four cases are supposed to be illustrative examples of when it can be assumed that a transaction price is not the best indicator of fair value or whether the IASB intends these to be the only circumstances where such an assumption can be made (paragraph 36 says “the transaction price is the best evidence of fair value **unless...**”).

We think it would be better if the four examples are moved to Appendix B where the IASB can further clarify their consistency with the other guidance provided. For instance, according to that appendix, there can be other situations in which the fair value of an asset or liability at initial recognition might differ from its transaction price. Such a situation arises for example when a market is not active and an adjustment to the transaction price is needed, either because the transaction is not orderly (e.g. the transaction price is an outlier when compared with other recent transactions) or, even if the transaction is orderly, because the management has concluded an adjustment is necessary because of the requirements of paragraph B13.

We think there may well be other cases too and would therefore suggest that it is made clearer that the examples given are just a selection of possible situations.

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?

EFRAG broadly supports the guidance provided in the ED but raises a couple of detailed concerns. Although CESR understands EFRAG’s concerns, we generally believe the guidance to be helpful and sufficient. We also believe the guidance in the ED will increase convergence with the requirements of US GAAP.



CESR agrees with EFRAG that the existing guidance in the IASB's Expert Advisory Panel Report is sufficient, appropriate and helpful, and would encourage the IASB to consider whether further aspects of this guidance can be incorporated into the final standard.

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?

CESR concurs with EFRAG that the disclosure requirements in the ED are helpful and sufficient overall.

However, CESR disagrees with EFRAG's view on the disclosure requirement relating to assets which are not employed in their highest and best use. CESR supports the disclosure requirement as proposed in paragraph 60 of the ED. CESR also thinks that this disclosure requirement should be extended to the situations described in paragraph 19, where the intended use of a stand-alone asset might differ from that asset's highest and best use. In these circumstances, even if the asset is not used together with other assets but on its own, separate disclosure of the value of the asset in its current use (which might be nil) and its incremental value would also be useful for users of accounts.

CESR also believes the disclosures applicable at level 3 may be extended to level 2 measurement values as well, in particular in those cases where all significant observable inputs are derived from non-active markets and the degree of discretion (e.g. deciding which observable inputs and techniques are the most appropriate and whether significant adjustments are needed) are not particularly different from those existing under a level 3 measurement.

In addition, the effects of fair value measurements on profit or loss or other comprehensive income for the period may be disclosed for all types of assets and liabilities, not just for level 3 assets and liabilities. The disclosure requirement in paragraph 58.(f) related to the amount of total gains or losses for the period that are attributable to gains or losses referring to those assets and liabilities held at the reporting date would also be helpful for all types of assets and liabilities.

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?

CESR agrees with EFRAG's view that the IFRS literature provides better guidance for the divergences that remain between US GAAP and what is proposed in this ED. However we do believe



that additional guidance is necessary for circumstances when an entity uses an asset together with other assets in a way that differs from the highest and best use.

In addition, CESR would encourage the IASB to work jointly with the FASB to reduce the remaining differences with US GAAP.

Other comments

Question 13

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

CESR broadly supports EFRAG's additional comments and in particular its comment (c) which has been previously raised in our comment letter.

We also have some additional, less significant comments we would like to provide:

- Paragraph 16 of the ED states that a price shall be adjusted for the costs that would be incurred to transport an asset **to** or **from** a market. Transport costs are defined in Appendix A along the same lines. However BC 49 refers to costs to transport an asset to a market only. As fair value is an exit price the reference to transportation costs "from" a market does not seem appropriate. More guidance is needed to clarify the different types of transportation costs involved and the extent to which such costs can adjust a price. Guidance for instance is needed on whether transportation costs also include the costs of transporting an asset from its current location (e.g. within the reporting entity's facilities) to a market place, or even to an acquirer's premises, which might be far removed from the actual market's location. The latter would in CESR's view be an entity-specific factor and therefore should not be included.
- We believe that there should be a reference in paragraph 28 to how to estimate the discount rate when determining the fair value of liabilities and how risk premia should be incorporated in that estimate. The reasoning contained in the last sentence of B4 (d) of the ED could be taken into account.
- CESR supports the IASB's view that transaction costs are a characteristic of the transaction rather than of the asset or liability itself. However transaction costs can be relevant even for some financial instruments (eg. redemption fees for some investment funds). At present, current standards require or allow some assets or liabilities to be measured at fair value (eg: financial instruments, investment properties) or other assets at fair value less costs to sell (eg. biological assets, non-current assets held for sale, to estimate the recoverable amount of non financial assets in accordance with IAS 36, etc). The IASB should consider if the current differences in treatment are sufficiently justified.
- Some disclosure requirements refer to the concept of "a class". However, we note that a class is not defined in Appendix A.
- Paragraph B8 says that the existence a wide range of fair value estimates may be an indication that further analysis is needed. However the Framework (in paragraph 83) requires that a measurement basis must be reliable to qualify for recognition. Therefore a wide range of possible values can also be an indication that a fair value cannot be reliably established and is thus not appropriate as a measurement basis. We think consideration of this issue should be explicitly included in the standard.