EFRAG
European Financial Reporting Advisory Group

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

25 September 2017

Dear Mr Hoogervorst,

Re: Request for information and comment letters—Post-implementation Review—IFRS 13 *Fair Value Measurement*

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the Request for Information and comment letters—Post-implementation Review—IFRS 13 Fair Value Measurement, issued by the IASB on 25 May 2017 (the 'PIR').

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of definitive IFRS Standards in the European Union and European Economic Area.

This letter reflects the evidence gathered from European constituents during EFRAG's outreach activities, conducted in partnership with European National Standard Setters and the EFRAG User Panel and through questionnaires completed by users and preparers. We note that we found it difficult to obtain input from a wide range of constituents in this exercise and the attached summary should be read in this context.

The summary of our findings is set out in the Appendix.

The key areas of IFRS 13 on which constituents commented included inconsistencies in the level of detail provided and the difficulty of calculating valuation adjustments. IFRS 13 disclosure requirements should be reviewed in detail at standard level as part of the *Better Communication* project. Respondents noted that the detailed fair value disclosures provided by some non-financial entities can obscure other material information.

Most users strongly agreed with the use of the current application of the unit of account and therefore with PxQ as measurement for listed investments. They did not support the inclusion of discounts or premiums when measuring the fair value of such investments. Some preparers disagreed with this view and expressed support for considering control premiums in the measurement of listed investments. Those preparers suggested that the unit of account for fair value measurement should not differ between quoted and unquoted investments.

If you would like to discuss our comments further, please do not hesitate to contact Fredré Ferreira, Raffaele Petruzzella or Albert Steyn.

Yours sincerely,

Andrew Watchman
EFRAG TEG Chairman and CEO

Appendix – Summary of comments received from European constituents

Objective of the appendix

1 This Appendix summarises the feedback received by EFRAG from European constituents through questionnaires, outreach events and discussions.

Background to the Post-implementation Review

2 In May 2017, the International Accounting Standards Board (IASB) published the Request for Information on its Post-implementation Review (PIR) of IFRS 13 *Fair Value Measurement* and requested comments by 22 September 2017. IFRS 13 does not determine when fair value measurement is to be used; it applies when another IFRS Standard requires or permits the use of fair value measurement.

3 The objective of a PIR is to understand whether the standards being reviewed are working as intended and to evaluate their implementation and effects in relation to costs and benefits. It also provides an opportunity for preparers, users and other stakeholders to put forward suggestions on how the IFRS Standard under review can be improved.

Scope of the Post-implementation Review

4 The PIR primarily focused on the following four topics identified by many stakeholders during the preliminary outreach by IASB staff:

(a) *effectiveness of disclosures on fair value measurements*, in order to gain a deeper understanding of user and preparer perspectives on effectiveness of fair value measurement disclosures and how their different views reconcile;

(b) *unit of account and fair value measurement of investments that are quoted in an active market*, in order to further assess current practice and pervasiveness of the fair value measurement of quoted investments, together with any circumstances in which current practice does not seem to provide relevant information to investors;

(c) *applying highest and best use when measuring the fair value of non-financial assets*, in order to better understand the issues with applying the highest and best use concept and their pervasiveness; and

(d) *applying judgements in specific areas when measuring fair value*, in order to assess why there are difficulties in applying specific judgements in IFRS 13 and identify support that may be required.

5 The majority of input was gathered through surveys that were completed on an anonymous basis which placed some limitations on the results collected.

Detailed comments- Users

User respondents

6 EFRAG received views from more than 25 users through a questionnaire designed for users, user-targeted outreach and discussion with bodies such as EFRAG User Panel. The respondents came from 10 European jurisdictions. Most of the survey respondents were buy-side equity analysts. The respondents had experience in the materials, chemicals, consumer, financial and real estate sectors.

Part 1 – Effectiveness of disclosures on fair value measurements

7 Overall user-participants held a positive view on the disclosures provided by fair value measurements. Users noted that the most important objective is for entities to ensure users of financial statements are able to understand the fair values disclosed and how they were determined. This includes the methodologies and inputs used. Users noted that inputs or parameters used have a significant impact on the outcome of fair value measurement. Therefore, clear information in this area is key in understanding the financial position and performance of the entity.

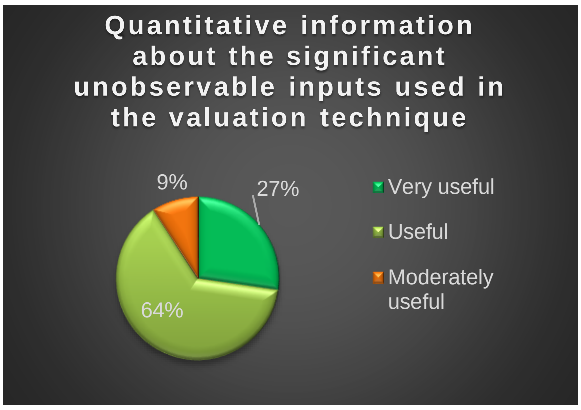
8 Participants made the following additional comments:

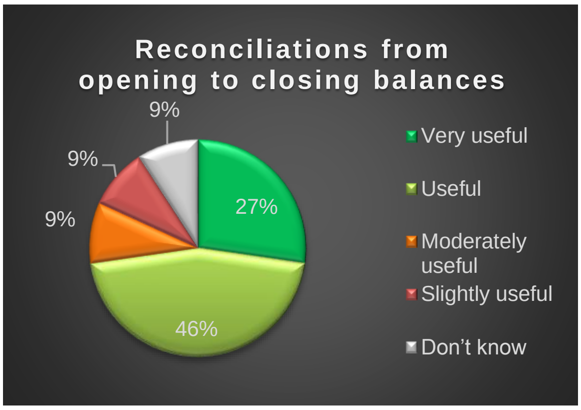
(a) In some cases the key unobservable inputs are missing or not sufficiently disclosed by entities.

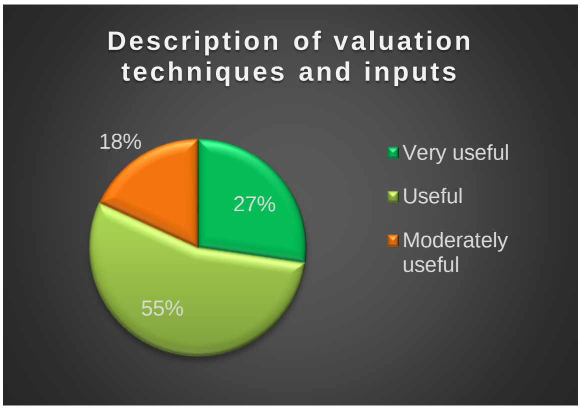
(b) Variances in the amount of information disclosed on the valuation techniques and inputs used for intangible assets measured at fair value.

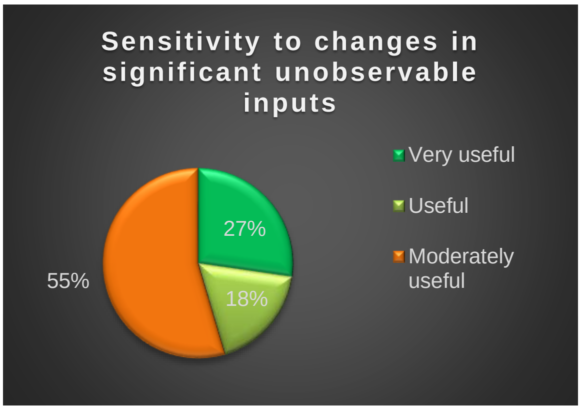
9 In relation to the usefulness of the information provided by IFRS 13*:*

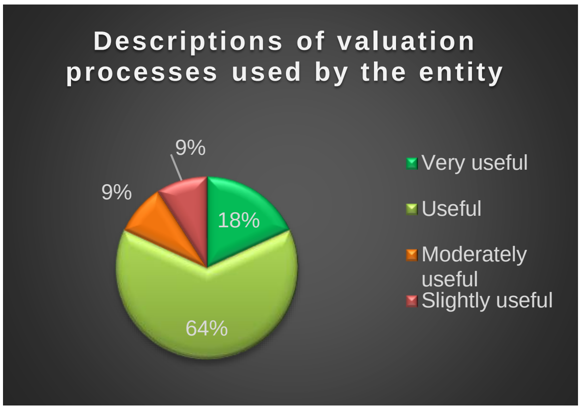
(a) most respondents indicated that they find the information about Level 3 fair values useful. The data summarised below identifies the perceived usefulness of specific disclosures.











(b) In relation to the impact of aggregation and generic disclosures, most respondents indicated that information that is not entity specific impaired the usefulness of the disclosures.

(c) Some users indicated that sensitivity analyses and liquidation curves could be useful where financial instruments are linked to the enterprise value. Instruments with an equity linkage often have a range of outcomes linked to an enterprise value with preference structures which create paybacks which are non-linear. Users indicated that current sensitivity disclosures do not provide this information in a useful and understandable manner.

(d) Some users recommended distinguishing realised gains from unrealised ones for Level 1 and 2 fair value measurements as is required for Level 3. Separate presentation of realised and unrealised gains and losses in the financial statements was important information in particular for the determination of distributable reserves.

(e) Some users recommended that gains and losses of a different nature should not be aggregated.

Part 2 – Unit of account and fair value measurement of investments that are quoted in an active market

10 The majority of users indicated that, for investments that are quoted in an active market, they preferred the measurement at PxQ because it was less subjective. It had the advantage of being observable with little or no management bias included in the measurement. Some users commented that they prefer to start with PxQ and make their own adjustments in their analysis. Finally, some users stated that they would still want the control premium/discount to be disclosed if an item is measured at PxQ.

Part 3 – Applying highest and best use when measuring the fair value of non-financial assets

11 Respondents had mixed views with regards to the application of highest and best use for non-financial assets. Users expressed the view that they found the concept of highest and best use very theoretical and highly subjective whenever there are any obstacles to changing the use of the asset.

12 Some users identified that entity-specific values based on how an entity intends to use an asset provide the most useful information to users wishing to make assessments about the entity's future cash flows. However, some users indicated that management is responsible for maximising the value of an asset and it is only possible for users to assess this if the highest and best use is disclosed.

Part 4 – Applying judgements in specific areas when measuring fair value

13 No comments received.

Part 5 – Effects and convergence

14 Users had mixed views on whether IFRS 13 improved their ability to assess the future cash flows of an entity. Users that found the disclosures useful noted that the fair value of all non-operating items is critical in their analysis and fair value disclosures enables them to adjust their valuations through time as capital markets move and influence these items. In addition, they noted that distinction between Levels 1, 2, and 3 helps when determining the risk inherent in valuations of financial instruments.

15 Some users noted that IFRS 13 marginally improved the comparability of fair value measurements between different reporting periods. However, there was no consensus on whether it improved the comparability between different entities.

16 Some users considered that the convergence of IFRS 13 with US GAAP was helpful, but did not consider that this convergence was very important. One user noted that it was not helpful for a conservative investor, but it did increase comparability.

Part 6 – Other matters

17 One respondent noted that in some cases the current market price for Level 1 and Level 2 assets can be unrealistic when, for example, equity markets or real estate markets are clearly overpriced. The user argued that in this case it could make sense to adjust the measurement bases in order to explain to users of the financial statements that the values in the market are not realistic at valuation date for a particular asset. This could be appropriate if, for example, the value of an asset had dropped 20% between the closing date and when the annual report is finalised. The user noted that this would make fair value measurement very judgemental, and it is something that is worth taking into consideration.

Detailed comments- All other respondents

Other respondents

18 EFRAG received views from more than 15 non-user respondents through a general questionnaire, outreach events and discussion with bodies such as EFRAG Working Groups. The respondents came from 5 European jurisdictions.

Part 1 – Effectiveness of disclosures on fair value measurements

19 Constituents found the disclosures of Level 3 fair value measurements overall moderately useful. However, some respondents indicated that the aggregation of disclosures impaired the usefulness of information. There were mixed views on whether information that is not entity-specific, such as Level 1 fair values, had the same effect. Preparers were of the view that compiling the disclosures was costly and time consuming.

20 Respondents indicated that the following additional disclosures could be helpful:

(a) Values of the unobservable parameters in order to understand the assumptions used; and

(b) Information on the quantitative interaction of unobservable parameters, because joint sensitivity parameters could help in understanding whether or not sensitivities are additive.

21 One preparer respondent made the following detailed comments regarding the cost to prepare fair value measurement disclosures:

(a) It can be helpful to users of financial statements that financial instruments are assessed and disclosed by different levels, as this granularity provides users with some information on the level of uncertainty which could arise from instruments measured at fair value. However, the reconciliation of Level 3 instruments required by IFRS 13, paragraph 93(e) is very costly to prepare.

(b) The disclosure objectives of IFRS 13, paragraph 93(e) could be met efficiently by limiting the disclosure to the information required by sub-paragraphs (i) and (ii) (gains and losses recognised in profit or loss or in other comprehensive income); and to qualitative disclosures on major changes in the amount and types of financial instruments that are classified as Level 3, compared to the previous reporting date.

(c) The requirements of paragraph 97 of IFRS 13 as well as paragraph 25 of IFRS 7 *Financial Instruments: Disclosures* that requires disclosure of items not carried at fair value is not relevant where these items are held in a long-term business model and where financial statements are based on the assumption that the entity will continue its operations for the foreseeable future. Disclosure requirements should be aligned with the business model and operations of the entity. For financial instruments that are not measured at fair value in the statement of financial position, recognised gains or losses are not driven by their fair value and therefore neither the fair value, nor the level of judgment to measure their fair value had an impact on profit or loss. The notes should highlight elements of financial statements and provide users with additional information to enable them to primarily understand the statement of financial position and the statement of comprehensive income.

Part 2 – Unit of account and fair value measurement of investments that are quoted in an active market

22 An auditor that responded to the survey expressed a preference for the measurement at PxQ because it was not subjective. It had the advantage of being observable with little or no management bias included in the measurement. He noted that adjustments for premiums or discounts would mean it is an entity-specific value and it would be better to require this information only as a disclosure.

23 Some preparers had the opposite view and preferred a measurement that included a control premium. This is based on the view that it is fundamental to keep consistency between the unit of account and fair value measurement. The unit of account for investments within the scope of IFRS 10 *Consolidated Financial Statements*, IAS 27 *Separate Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures* should be the investment as a whole rather than the individual financial instruments included within that investment. As a consequence, they noted that it would not be appropriate to measure the fair value of an investment as a whole by applying PxQ, as there are no Level 1 inputs for the investment as a whole and such a formula does not consider the key characteristics of the asset being measured.

24 Preparers also noted that there should be no difference in fair value measurement requirements for investments that are listed in active markets and those that are either listed in markets that are not active or are not listed where a control premium or discount can be included.

Part 3 – Applying highest and best use when measuring the fair value of non-financial assets

25 Respondents preferred that the highest and best use of non-financial assets simply be disclosed if it differs from the current use of the asset. Two respondents stated that the concept of highest and best use is very theoretical, hard to verify and not consistent with the business model the entity applies. The majority of respondents noted that it is also not practical to implement and not conceptually sound. However, some respondents considered that there were limited instances where the highest and best use of a non-financial asset differed from its current use.

Part 4 – Applying judgements in specific areas when measuring fair value

26 Respondents indicated that it was easy to assess whether a market was active for:

(a) Property, plant and equipment;

(b) Investments in subsidiaries, joint ventures or associates - Quoted investments;

(c) Other financial instruments - Quoted investments; and

(d) Other financial instruments - Unquoted investments.

27 Respondents indicated that it was difficult to assess whether an input was unobservable and significant to the entire measurement for intangible assets. Some preparers from non-financial institutions also had difficulty in distinguishing whether measurements were Level 2 or Level 3, which affected the disclosures they needed to provide.

28 There were mixed views on the difficulty of assessing whether a market was active and whether an input was unobservable and significant to the entire measurement for other items that are measured at fair value.

Part 5 – Effects and convergence

29 Respondents had mixed views on whether IFRS 13 improved their ability to assess the future cash flows of an entity and if it improved the comparability of fair value measurements between different reporting periods and between different entities. Respondents considered the convergence of IFRS 13 with US GAAP was helpful and important.

Part 6 – Other matters

30 Some respondents noted that the issue of valuation adjustments on derivative contracts had been brought into the spotlight with the adoption of IFRS 13. As there are no specific requirements for valuation adjustments, entities need to apply judgement in selecting the most appropriate method in the circumstances based on the requirements in IFRS 13. Specifically, the calculation of a funding valuation adjustment in long-dated swaps was mentioned as being the subject of internal debate as well as with the auditors because it had a material impact on the financial statements. The complexity and judgement involved in selecting and consistently applying a method require entities to provide additional disclosures to assist users of financial statements. These constituents noted that additional detailed illustrative examples and guidance would be helpful.

31 One respondent noted that a valuation based on exit price is a theoretical concept when instruments are not quoted and illiquid (e.g. assuming a liquidity discount within a Level 2 or Level 3 valuation is often arbitrary). If the instrument has been classified out of a trading book, fair value would not reflect the real intention of the entity (i.e. to hold the instrument until maturity). The respondent suggested that for such instruments, it would be better if IFRS 13 required a theoretical value (i.e. limiting the exit price notion to Level 1 instruments) and then disclosing the potential discount estimated in case the instrument is sold.

32 One respondent stated one of the issues with IFRS 13 is that it does not reflect the way derivatives are managed. Some financial institutions manage a net position rather than as individual contracts.

33 One respondent noted that they use material issued by the European Private Equity & Venture Capital Association for fair value measurement guidance on their medium to long term unquoted equity instruments. They expressed some concern on the relevance of educational material issued by the IASB, as it could go beyond the principles of IFRS 13 without following a due process. Some other constituents expressed similar concerns on the use of other valuation standards that might not be in line with IFRS 13.

34 Some respondents noted that the detailed fair value disclosures provided by some non-financial entities can obscure other material information. They understand the need for financial institutions to have detailed fair value measurement disclosures, but recommend that the IASB target simplified fair value disclosures for non-financial entities.