DRSC e. V. • Zimmerstr. 30 • 10969 Berlin

Telefon +49 (0)30 206412-12
Telefax +49 (0)30 206412-15
E-Mail info@drsc.de

EFRAG
Françoise Flores
35 Square Meeûs

B-1000 Brussels

Berlin, 27 August 2010

Dear Françoise,

EFRAG's Draft Comment Letter on the IASB Exposure Draft ED/2010/7 "Measurement Uncertainty Analysis Disclosures for Fair Value Measurements – Limited re-exposure of proposed disclosure"

On behalf of the German Accounting Standards Board (GASB), I am writing to comment on EFRAG's draft comment letter on the IASB Exposure Draft ED/2010/7 "Measurement Uncertainty Analysis Disclosures for Fair Value Measurements – Limited re-exposure of proposed disclosure" (herein referred to as 'Re-ED'). We appreciate the opportunity to comment on EFRAG's draft comment letter.

<u>EFRAG's preliminary general comments</u>

The GASB basically agrees with the proposal in the Re-ED. We acknowledge several changes compared to the IASB ED/2009/5 "Fair Value Measurement" (herein referred to as 'ED'), par. 57(e), that we consider an improvement. In particular, we consider it appropriate to

- restrict the measurement uncertainty analysis to <u>unobservable</u> input factors,
- include relevant effects of <u>correlation</u> between specific inputs, and
- limit the resulting effects on fair value measurements on <u>significant</u> differences only.

For these reasons, the GASB agrees with many points raised by EFRAG in its draft comment letter. In particular, we support EFRAG's positive statement, specified by the issues mentioned under (a) to (c) in the draft comment letter. In the light of our positive assessment of the third matter above, we ask EFRAG to add this to its comment letter.

In addition, we follow the IASB's explanation how to distinguish between a sensitivity analysis and a <u>measurement uncertainty analysis</u> and, hence, agree with the term chosen in this regard. Since we guess that EFRAG has a different understanding of these terms and how to distinguish between both, we explain our view in further detail below within our remarks on EFRAG's preliminary response to question 2.

However, the GASB is also aware of some issues within the Re-ED that still lack clarity or otherwise need improvement. We acknowledge that EFRAG did not mention these issues yet. As such we want to mention the following:

- There are <u>circumstances</u> that should be <u>excluded</u> from the scope of the analysis and corresponding disclosures, under which this analysis is not operational or not useful for cost-benefit-reasons. To give one example, already mentioned by comments on the ED and acknowledged by the IASB, there are situations where entities' measurements rely on prices from third party pricing services which often use proprietary models. Under those circumstances, details on unobservable inputs used and possible correlations are unknown.
- Further guidance is needed to clarify or limit the <u>extent of correlation</u> that has to be taken into account. In particular, correlations between unobservable and observable inputs might need further consideration.
- An <u>exemption</u> for certain items from the requirement of such analysis disclosures may arise only if another IFRS explicitly excludes an item. However, this "escape clause" is not mentioned in the main text of the Re-ED (par. 1, 2) but in the basis for conclusion (BC 8, 12, 23) only. Rather, we would prefer if any exemption is incorporated in the scope section of the IFRS for FVM.

We ask EFRAG to consider adding these issues to its comment letter.

<u>EFRAG's preliminary responses to the questions and the notes for EFRAG's constituents</u>

Question 1

We like to express our concern that EFRAG is not aware of any specific circumstances in the context of Question 1. To our view, there are indeed circumstances that should be addressed as set out below. We ask EFRAG for modifying its answer to question 1 accordingly.

We are aware of limits with regard to practicability. Correlations may be multifarious, depending on the number or variety of inputs, in particular those that are unobservable. In an extreme case, changing one unobservable factor might cause all other factors – unobservable and even observable ones – or not a single factor to be changed due to relevant correlation.

Having this in mind, we propose to reconsider whether correlations <u>between unobservable and observable inputs</u> shall be included or not. As we understand the Re-ED, those correlations are excluded although they might be the more relevant ones. From our perspective, this leads to an analysis being fragmentary with regard to correlations.

We also underline that there is a need for a boundary or threshold for correlations that has to be taken into account. We acknowledge that the notion of *"if such correlation is relevant"* determines such a boundary; yet, we assume it not being precise enough.

Finally, we like to point out that under the circumstance that an entities' fair value measurements rely on prices from third party pricing services using proprietary models, details on unobservable inputs used and possible correlations are unknown. In those situations, considering correlations is neither operational nor appropriate. Moreover, the entire analysis is not operational, which constitutes a strong case for a scope exemption.

Question 2

First, the GASB basically agrees with EFRAG's draft response to question 2, but we see some difficulties regarding details of the correlation issue; hence, we propose to expand the answer.

We consider a measurement uncertainty analysis and corresponding disclosures to be generally more meaningful since correlations are taken into account. Hence, we agree with the corresponding requirement. Depending on the degree or complexity of correlations, it is certainly not trivial to judge in a general way, whether such analysis still provides useful information without correlations taken into account. Thus, instead of a "yes-or-no" question we would prefer a principle or threshold to stipulate "how much" correlation should be considered when performing the analysis (see our comments to the answer on question 1). After all, the more correlation is taken into account, the more meaningful the information is, but – assumably – the less do benefits justify the costs.

Second, as already mentioned, the GASB assumes that EFRAG has a different or maybe not final understanding of the terms "sensitivity analysis" and "measurement uncertainty analysis" and the difference between both. To our view, this understanding affects EFRAG's draft response to question 2 as well as the notes for EFRAG's constituents (par. 1, 2, 4, 5). Our understanding of the issue is set out below; and we propose to take this view also into account while modifying the response to question 2.

The IASB has discussed and explained (see Re-ED, BC24) what is different between a "Measurement Uncertainty Analysis" (which, in brief, shows what different measurement could result if using different past inputs) and a "Sensitivity Analysis" (which, in brief, shows what different measurement could result if using different future-scenario-based inputs). As IFRS 7 requires two different analyses' – one in IFRS 7.27(e) and the other in IFRS 7.40-41 – the IASB stated that both are of different nature. While the latter is methodically a "sensitivity analysis" and has been labelled accordingly, the first one has not been labelled at all.

Having said this, we are of the opinion that EFRAG should not use the term “sensitivity analysis” at all within its comment letter, since it would be inappropriate. The first type of analysis was subject of the ED of May 2009 (herein par. 57(g)), being named a sensitivity analysis, but in B102 only. It is still subject of the Re-ED (herein par. 2(a)), now being named a “measurement uncertainty analysis”. Hence, the term ”sensitivity analysis” does not fit and did not fit the analysis that is proposed in the Re-ED, par. 2(a) – meant to replace ED, par. 57(g) and, thus, IFRS 7.27B(e). In contrast, this term is very appropriate for the (methodically different) analysis that was and still is mentioned under IFRS 7.40-41 – but is not subject to changes by the ED or Re-ED.

Question 3

We have no comment on this question and agree with EFRAG’s draft answer.

Additional Comments

Despite our support for the specific proposals in the Re-ED, the GASB does not agree with the Re-ED in terms of its limited scope. We would have expected some other issues deliberated including some new views taken by the IASB to be re-exposed. We are aware that after the joint deliberations not all issues are subject to changes (in comparison to the ED), and that there are selected issues which have even not been deliberated by both boards. However, several issues under the FVM topic were changed, some slightly, some more fundamentally. Even if convergence often seems to be the reason behind these changes, we are not satisfied that those issues are not re-exposed. Accordingly, we do not agree with the conclusion set out by the IASB, which is (according to the IASB Meeting on 8 April 2010): If proposals after deliberations deviate from those in the ED, but (i) changes have been made only in response to suggestions by respondents, or (ii) the IASB did not identify any substantial issues (aside from correlations) or (iii) there were no such new insights that have not been considered yet prior to the ED in 2009, there is no need for re-exposure. At least the findings by the IASB’s Expert Advisory Group (EAP) are indeed new insights that explicitly influenced some issues (e.g. measurement in inactive markets and measurement of financial instruments) and, obviously, resulted in changed proposals.

Having said this, the following represents a summary of the GASB’s view on the latest proposals after the ED but not being re-exposed by the IASB.

(a) We generally agree with and acknowledge an improvement on the following proposals:

- Reference market: We agree with the proposal that the principal market is the reference market, and the most advantageous market is assumed to be the principal market.

- Market participants: We agree with the proposal that transactions between related parties are now relevant as far as they are orderly, and with the change to assume a *"reasonable understanding"* (instead of *"sufficient information"*).

(b) The GASB also appreciates the IASB's efforts that led to certain other changed proposals which we consider an improvement in part, but with some room for further improvement:

- Measuring financial instruments: We consider it reasonable that some offsetting portfolio effects as well as certain premiums/discounts are applicable, under specific conditions, when measuring financial instruments. Even though this reflects that the instrument is used within a unit of items, this still does not seem conceptually sound, as the "unit of account" and the "unit of valuation" still differ.
- Disclosures: Apart from the disclosures in the Re-ED, which we support basically, we are in favour of disclosing fair value changes arising from credit risk for financial liabilities only.

(c) The following issues that were also subject to changes (compared to the ED) are, to our view, no improvement so far and therefore still lack appropriateness:

- Scope: We would have preferred that if the FVM requirements do not fit with particular items (such as leases or share-based payments), the fair value notion within the specific IFRS were replaced, instead of excluding those items from the FVM scope.
- Day one gains/losses: We do not agree with the boards' view that
  - (i) the circumstances (i.e. the fair value level) under which day one differences occur,
  - (ii) when to recognise them and
  - (iii) where to recognise them,

  are no matters of the FVM topic ("how to measure"). At least the question why and when such differences may occur is linked to FVM, since it relates to the question when the transaction price does not represent fair value, which indeed is part of the FVM topic.
- Inactive markets: With the change in focus towards verifying whether a transaction is orderly (instead of whether a market is active or inactive) it remains unclear why this ought to be a better approach and what would be different in practice. Whereas the EAP stated that there is no bright line between active and inactive markets, there is no "brighter" line to determine when a transaction is orderly or not.
- Disclosures: We do not agree with expanding the fair value *by level* disclosures on non-financial assets/liabilities not measured at fair value in the statement of financial position.

(d) The following issues were retained without modification but, from our perspective, are still inappropriately dealt with and need further consideration:

- Definition: We are of the opinion that an exit notion in general and a transfer notion for liabilities are not appropriate in all circumstances. Moreover, there are entry situations and liabilities that can only be settled, not transferred.

- Transaction price: Due to the above the fair value often equals a bid price or an ask price, instead of being the most representative value within this spread.
- Valuation premise: The concept of "highest and best use" is inappropriate since it does not reflect the use of the item, but only maximises the value. This is contradictory, in particular, with the increasing application of the business model which (increasingly) drives recognition and measurement principles within IFRS and even US-GAAP.

Finally, we like to point out two aspects that are not subject of the Re-ED, but seem to be important when the IASB finalises the IFRS "Fair Value Measurement":

- Initial application/Transition: Since the IASB refrained from any proposals within the ED and did not articulate whether the FASB's proposals for initial application will be adopted similarly – which seems to be inappropriate as the FASB only proposes changes to requirements that are already in place –, there is still no proposal on this issue.
- Consequential amendments: Such amendments were proposed in the ED. Since the boards agreed on several changed proposals for FVM, the consequential amendments provided in the ED are, in part, not suitable anymore (e.g. IFRS 2, IAS 17). We would appreciate if the IASB modifies them carefully.

We kindly ask EFRAG to consider incorporating additional remarks on the question of whether the IASB should have re-exposed at least some other important issues which have been changed during deliberations. In this respect, we would appreciate if our comments mentioned above form the basis for such additional remarks in EFRAG's comment letter.

If you would like to discuss our comments further, please do not hesitate to contact me.

Yours sincerely,

Liesel Knorr
President