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Berlin, XX September 2010

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Dear Bob,
Dear David,

FASB Exposure Draft "Proposed Accounting Standards Update – Fair Value Measurements and Disclosures (Topic 820)"

On behalf of the German Accounting Standards Board (GASB) I am writing to comment on the FASB Exposure Draft "Proposed Accounting Standards Update – Fair Value Measurements and Disclosures (Topic 820)" (herein referred to as 'FASB-ED'). We appreciate the opportunity to comment on the FASB-ED.

Introductory remarks

We address our comments to both boards since the deliberations leading to the FASB-ED were undertaken jointly. In addition, we are aware that all proposals in this FASB-ED are fully supported by the IASB and are meant to be incorporated entirely and equally into the expected IFRS "Fair Value Measurements" (FVM). Having this in mind, we underline that our analysis of and comments on the FASB-ED were taken from a view that compares all (joint) proposals with those in the IASB Exposure Draft ED/2009/5 "Fair Value Measurement" in May 2009 (herein referred to as 'IASB-ED'). Due to that reason, our letter does not focus on whether, or to what degree, the proposals within the FASB-ED differ from the current Topic 820.

As far as the (joint) proposals equal those in the IASB-ED of 2009, our comments in this letter might replicate those we had made in our comment letter on the IASB-ED. As far as the (joint) proposals in the FASB-ED deviate from those in the former IASB-ED, we realise that the IASB obviously has changed its mind. To this extend, we made efforts in analysing and questioning the reasons for why these changes have emerged, but not without considering the essential, which is, whether the proposals are ultimately appropriate.

General comments on the FASB-ED

The GASB welcomes that the IASB and FASB have concluded their deliberations on the FVM topic. We appreciate that both boards were able to agree on all issues. The outcome of these deliberations comprises proposals that demonstrate extensive efforts undertaken by both boards. However, the GASB takes the view that the (joint) proposals are of differing adequacy. On the one hand, we agree on certain proposals that we consider being reasonable and, in case of proposed changes, being an improvement. On the other hand, there are several issues where the corresponding proposals are not yet appropriate, at least in part.

The GASB now highlights its view on specific proposals of the FASB-ED. In addition, we provide some more details within our answers on the questions raised in the FASB-ED (see appendix to this letter). However, as already outlined, we consider all joint proposals from an IFRS constituents' perspective only. Due to this fact, we are commenting on several proposals which do not generate changes to current Topic 820 and, hence, are not subject of this FASB-ED's questions, but which we consider severe enough to be discussed again. For this reason, our answers in the appendix of this letter provide further details on only some of the issues we are highlighting right now.

(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. *In particular, we appreciate the clarification that entities are not expected to make extensive efforts in analysing all markets regarding their advantageousness that the entity does not have access to or might never trade in. [siehe DSR-SN 2009, Antwort zu Q3, 3. Abs]*
- 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"). *However, this exclusive focus ignores the perspective of the reporting entity representing the counterparty in a market transaction. [siehe DSR-SN 2009, Antwort zu Q4]*

Kommentar [JVG1]: ALLE NACHFOLGENDEN KURSIVEN, GELB GEFÄRBTEN PASSAGEN: Ergänzende Details/Argumente des DSR, teils aus Stellungnahme zum ED. Sollen diese so oder so ähnlich eingefügt bleiben?

(b) The GASB also appreciates the boards' 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: We basically support the measurement uncertainty analysis disclosures. We are in favour of disclosing fair value changes arising from credit risk for financial liabilities only. ~~In contrast, 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.~~ ~~*Although the latest disclosure effects only few non-financial items (within IFRS, e.g. investment properties, particular interests in joint ventures or associates, property/plant/equipment), we question what the additional use of disclosing the FV level might be, if ever there are potentially different FV levels for similar items.*~~

(c) The following issues that were also subject to changes (compared to the IASB-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 (or Codification Topic) were replaced, instead of excluding those items from the FVM scope. *Moreover, retaining the fair value notion in an IFRS (or topic) that is subject to a FVM scope exclusion, because the particular understanding of this term is different from the general understanding of "fair value" within the IFRS FVM (or FVM topic) may be confusing, as seems now the case for share-based payments and leases. In addition, there are circumstances under which an exit scenario is not appropriate, e.g. entry situations, or a transaction is not intended or impossible. When retaining the exit notion in the FV definition, such circumstances – to mention only a goodwill recognised within a business combination, or some assets initially recognised under IAS 41, or some plant, equipment or technical know-how in the defense industry recognised under IAS 20 – should be excluded from the FVM scope. [siehe DSR-SN 2009, Antwort zu Q2]*
- 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") ~~whatsoever~~. 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. *As long as the boards retain the exit notion within the FV definition, and since a transaction* *price has always an entry notion character, the transaction price will not equal the FV in most cases – hence, the recognition of day-one-gains/losses is possible. [siehe DSR-SN 2009, Antwort zu Q9]*

- 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 IASB's Expert Advisory Panel (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. *Although the latest disclosure affects only few non-financial items (within IFRS, e.g. investment properties, particular interests in joint ventures or associates, property/plant/equipment), we question what the additional use of disclosing the FV level might be, if ever there are potentially different FV levels for similar items.*

(d) The following issues were ~~not changed by the boards~~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. *Exit scenarios are not relevant, if a sale is either not intended or simply not possible. A transfer notion is often not appropriate as most liabilities will never be transferred.* Moreover, there are entry situations and liabilities that can only be settled, *which both are not reasonably covered by the given term and definition. We propose again to better use the terms "current exit price" or "current entry price", and to distinguish between both accordingly. [siehe DSR-SN 2009, Antwort zu Q1]*
- Transaction price: Due to the above, the fair value often would equal a bid price (in case of an asset) or an ask price (in case of a liability), instead of being the most representative value within this spread. *Whereas the boards propose to refer to a price within the bid-ask spread, we consider this not to be consistent with the exit price objective. [siehe DSR-SN 2009, Antwort zu Q2]*
- 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. *Most notably, we see a weakness as this concept uncouples the measurement from the item to be measured. [siehe DSR-SN 2009, Antwort zu Q5, 3. Abs]*

Having said this, the GASB provides some more detailed comments that are linked with the issues raised in the questions of this FASB-ED. Therefore, please find our further comments on these questions in the appendix to this letter.

Kommentar [JVG2]: JP-Vorschlag: Streichen, da „Issues" nicht geändert werden können. JVG-Frage: Aussage, dass keine Änderungen seit ED, ginge verloren, damit auch Abgrenzung zu (c), dort nämlich Änderungen und dennoch nicht sachgerecht.

Additional comments on FVM issues relevant for the IASB only

The GASB is concerned about the decision of the IASB not to re-expose all changed proposals on all issues under the FVM topic. We are aware that after the joint deliberations not all issues are subject to changes (in comparison to the IASB-ED), and that there are selected issues which have even not been deliberated. However, most issues under the FVM topic were changed from the IASB's perspective, some slightly, some more fundamentally. Even if convergence often is 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 the 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 IASB-ED, there is no need for re-exposure. At least the findings by the 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.

In this regard, we also refer to our remarks within the 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 'IASB-Re-ED').

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

Yours sincerely,

Liesel Knorr
President

Appendix – Answers to the questions of the FASB-ED

> **Question 1**
> This Exposure Draft represents the Board´s commitment toward developing common fair value measurement guidance with the IASB. Do you think the proposed amendments:
> a. Would improve the understandability of the fair value measurement guidance in U.S. GAAP? If not, why not?
> b. Would result in any unintended consequences on the application of the proposed amendments? If so, please describe those consequences.

As mentioned in our general comments, the GASB welcomes the efforts of both boards to conclude its joint deliberations, and to agree on all issues in the FVM area. However, we take the view that the (joint) proposals are of differing adequacy. As already set out, we identified some proposals to be reasonable, others to be an improvement but only it part, with the need for further consideration, and some that are not appropriate – whether changed or not.

Having said this, we see several issues that do not improve understandability or would result in unintended consequences. As we have already set out in this letter and will further explore in this appendix, there are different issues that, to a different degree, need further consideration or lack appropriateness. Instead of answering this question 1, which asks for rather overall and unsophisticated comments, we refer to our general remarks in this letter which are completed by the remainder of this appendix.

> **Question 2**
> The Board has decided to specify that the concepts of highest and best use and valuation premise are only to be applied when measuring the fair value of nonfinancial assets. Are there situations in which those concepts could be applied to financial assets or liabilities? If so, please describe those situations.

Having analysed the FASB-ED, we consider it difficult to comment on this issue since we believe that the concept of highest and best use generally lacks appropriateness. This concept fails to reflect the use of the item by only maximising its value. As stated before, uncoupling the item/unit of recognition and the item/unit of valuation, as well as ignoring interdependencies of different items, that are considered separately for measurement purposes, prove the weaknesses of this concept. Put it another way, we see an inconsistency resulting from this measurement concept (focussing on exchange instead of current use) versus the increasing application of the business model (focussing on the use of an item) which increasingly is the basis for recognition and measurement principles within IFRS and even US-GAAP. We would be supportive if this inconsistency was eliminated.

Question 3
Do you agree with the proposed guidance for measuring the fair value of an instrument classified in shareholders´ equity? Why or why not?

We have no comments.

Question 4
The Board has decided to permit an exception to fair value measurement requirements for measuring the fair value of a group of financial assets and financial liabilities that are managed on the basis of the reporting entity´s net exposure to a particular market risk (or risks) (that is, interest rate risk, currency risk, or other price risk) or to the credit risk of a particular counterparty.

a. Do you think that proposal is appropriate? If not, why not?
b. Do you believe that the application of the proposed guidance would change the fair value measurements of financial assets and financial liabilities that are managed on the basis of the reporting entity´s net exposure to those risks? If so, please describe how the proposed guidance would affect current practice.

We have general and strong conceptual concerns with the proposed valuation premise since this leads to uncoupling the use of an item from its measurement. In order to overcome this deficiency, it is reasonable to reflect the specific (current) use of an item, in particular if an item is used within a group or portfolio, via using premiums/discounts or allowing offsetting effects to be taken into account.

Given this conceptual weakness, we would prefer if premiums or discounts (with blockage factors amongst it) are allowed, under certain conditions, to be taken into account when measuring financial instruments and other assets or liabilities. Via this "method", it would be possible to reflect the particular use of an item (i.e. if it's a group or offsetting positions) in its measurement, at least to some degree and in a way that seems compatible with the given FV definition. For consistency reasons, this should not be limited to Level 2 or 3 measurements. Seen from another angle, if a Level 1 measurement (which is a quoted price in any market) would not reflect a premium/discount, but that an entity considers appropriate, this might justify an adjustment to the quoted price, probably leading to a Level 2 measurement by definition.

Furthermore, we consider it reasonable that some offsetting portfolio effects are applicable, under specific conditions, when measuring financial instruments. Even though this also 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.

Question 5

The Board has decided to clarify the meaning of a blockage factor and to prohibit the use of a blockage factor when fair value is measured using a quoted price for an asset or a liability (or similar assets or liabilities). Do you think that proposal is appropriate? If not, why not?

We refer to our answer on question 4.

Question 6

The Board has decided to specify that other premiums and discounts (for example, a control premium or a noncontrolling interest discount) should be taken into account in fair value measurements categorized within Level 2 and Level 3 of the fair value hierarchy when market participants would take into account those premiums or discounts when pricing an asset or a liability consistent with the unit of account for that asset or liability.

a. Do you think that proposal is appropriate? If not, why not?
b. When the unit of account for a particular asset or liability is not clearly specified in another Topic, how would you apply that proposed guidance in practice? Please describe the circumstances (that is, the asset or liability and the relevant Topic) for which the unit of account is not clear.

We refer to our answer on question 4.

Question 7

The Board has decided to require a reporting entity to disclose a measurement uncertainty analysis that takes into account the effect of correlation between unobservable inputs for recurring fair value measurements categorized within Level 3 of the fair value hierarchy unless another Topic specifies that such a disclosure is not required for a particular asset or liability (for example, the Board has decided in its project on the accounting for financial instruments that a measurement uncertainty analysis disclosure would not be required for investments in unquoted in equity instruments). Do you think that proposal is appropriate? If not, why not?

We basically agree with this proposal. In particular, we consider it appropriate to

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

However, the GASB is also aware of some issues that still lack clarity or otherwise need improvement. As such we want to mention the following:

- There are circumstances that should be excluded 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 IASB-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 extent of correlation that has to be taken into account. The reasons behind this view are as follows:
  - 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 between unobservable and observable inputs 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~~ve~~ 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.
- An exemption for certain items from the requirement of such analysis disclosures may arise only if another topic (or IFRS) explicitly excludes an item. However, this "escape clause" is not mentioned in the main text but in the basis for conclusion (BC68 of the FASB-ED, and BC8, 12, 23 of the IASB-Re-ED) only. Rather, we would prefer if any exemption is incorporated in the scope section of the FVM topic (or IFRS FVM).

Finally, we like to point to an issue not mentioned in the FASB-ED but which presumably has been deliberated on jointly. We follow the IASB's explanation (set out in the IASB-Re-ED only) how to distinguish between a sensitivity analysis and a measurement uncertainty analysis and, hence, agree with the term chosen in this regard. However, we doubt that the conceptual difference between a measurement uncertainty analysis and a sensitivity analysis is or was clear enough to all constituents. For further details on the reasons behind our doubt, and since this distinction is not set out in the FASB-ED, we refer to our comment letter on the IASB-Re-ED.

Kommentar [JVG3]: JP-Hinweis: Aussage wenig inhaltsreich, Vorschlag des DSR sollte formuliert werden!

Question 8

Are there alternative disclosures to the proposed measurement uncertainty analysis that you believe might provide users of financial statements with information about the measurement uncertainty inherent in fair value measurements categorized within Level 3 of the fair value hierarchy that the Board should consider instead? If so, please provide a description of those disclosures and the reasons why you think that information would be more useful and more cost-beneficial.

We have no additional comments.

Question 9

The Board has decided to require limited retrospective transition. Do you think that proposal is appropriate? If not, why not?

We have no comments.

Question 10

There is no link to the transition guidance for the proposed amendments that the Board believes would not change practice. Are there any proposed amendments that are not linked to the transition guidance that you think should be linked? If so, please identify those proposed amendments and why you think they should be linked to the transition guidance.

We have no comments.

Question 11

The amendments in this proposed Update would apply to public and nonpublic entities (that is, private companies and not-for-profit organizations). Should any of the proposed amendments be different for nonpublic entities? If so, please identify those proposed amendments and describe how and why you think they should be different.

We have no comments.

Question 12

How much time do you think constituents would need to prepare for and implement the amendments in this proposed Update?

We have no comments.