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Berlin, 07 September 2010

Mr. Bob Herz
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Dear David,

Dear Bob,

**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 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 the Re-ED.

<u>Introductory remarks</u>

The GASB welcomes that the IASB and FASB have concluded their deliberations on the Fair Value Measurement (FVM) topic. We appreciate that both boards were able to agree on all issues. When reviewing the resulting Re-ED published by the IASB, we were, however, surprised about the very limited scope of new proposals re-exposed. Given the fact that the IASB's view on several issues has changed in comparison to the IASB ED/2009/5 "Fair Value Measurement" (herein referred to as 'ED'), we would have expected some other deliberated issues to be re-exposed. While commenting on those issues in more detail later in this letter, we first provide the GASB's view on the particular proposals contained in the Re-ED.

General Comments on the Re-ED

The GASB basically agrees with the proposal in the Re-ED. We acknowledge several changes compared to the ED, par. 57(e), that we consider an improvement. 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.

In addition, we follow the IASB's explanation how to distinguish between a sensitivity analysis and a measurement uncertainty analysis and, hence, agree with the term chosen in this regard.

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 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. In particular, correlations between unobservable and observable inputs might need further consideration.
- An exemption 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 (par. 1, 2 of the Re-ED) 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.

Furthermore, we doubt that the conceptual difference between a measurement uncertainty analysis (as in Re-ED, par. 2(a), meant to replace ED, par. 57(g) and, thus, IFRS 7.27B(e)) and a sensitivity analysis (as in IFRS 7.40-41, and not subject to changes by the ED or Re-ED) is or has been clear enough to all constituents. Albeit both are methodically different from each other, in order to fulfil the requirement in IFRS 7.27B(e) entities might prepare an analysis that is actually a sensitivity analysis and not a measurement uncertainty analysis. It seems predictable that Re-ED, par. 2(a) might, in some cases, not be applied the way it is intended by the IASB. We urge the IASB to clarify the difference or add further guidance.

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

Additional Comments on FVM issues not covered by the Re-ED

As mentioned above, the GASB 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 requirements under the FVM topic were changed, some slightly, some more fundamentally. Even if convergence often seems to be the reason behind these changes, these issues should have been 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.

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. In addition, we refer to our comment letter on the FASB Exposure Draft on Fair Value Measurements and Disclosures (herein referred to as 'FASB-ED'), which has been submitted separately and is addressed to both boards.

(a) The following requirements 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 application of the business model which increasingly drives recognition and measurement principles within IFRS and even US-GAAP.

(b) The following requirements that were subject to changes (compared to the ED) represent, to our view, no improvement and therefore are deemed inappropriate:

- 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.
- Market participants: We continue to disagree with the exclusive focus on market participants, since this ignores the perspective of the reporting entity representing the counterparty in a market transaction. However, we agree (i) with the proposal that transactions between related parties are now relevant as far as they are orderly and (ii) with the change to assume a *"reasonable understanding"* (instead of *"sufficient information"*).
- 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 not 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.

(c) However, the GASB 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: Basically, the valuation premise for fair value measurements does not seem conceptually sound. In order to overcome this deficiency, we consider it reasonable that, as an exception, some offsetting portfolio effects as well as certain premiums/discounts are applicable, under specific conditions, when measuring financial instruments. This would, in some cases, allow for reflecting that the instrument is used within a unit of items.
- 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.

(d) Finally, we agree with and acknowledge an improvement on the following proposal:

- 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.

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.

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 exposure draft**

**Question 1**

Are there circumstances in which taking into account the effect of the correlation between unobservable inputs (a) would not be operational (e.g. for cost-benefit reasons) or (b) would not be appropriate? If so, please describe those circumstances.

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.

Bearing this in mind, we propose to reconsider whether correlations between unobservable and observable inputs should 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 believe that the notion of *"if such correlation is relevant"* determines such a boundary sufficiently. Any additional specification would have a rule-based character.

**Question 2**

If the effect of correlation between unobservable inputs were not required, would the measurement uncertainty analysis provide meaningful information? Why or why not?

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 answer to question 1). After all, the more correlation is taken into account, the more meaningful the information is, but – assumed – the less do benefits justify the costs.

**Question 3**

Are there alternative disclosures that you believe might provide users of financial statements with information about the measurement uncertainty inherent in fair value measurements categorised 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.