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Berlin, 07 September 2010

Sir David Tweedie  
Chairman of the  
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30 Cannon Street  
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United Kingdom

Dear Bob,  
Dear David,

**File Reference No. 1830-100 / 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.

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Prof. Dr. Rolf Nonnenmacher (Schatzmeister), Dr. Werner Brandt, Joe Kaeser, Dr. Jörg Schneider



When commenting on the IASB-ED in 2009, the GASB expressed some significant conceptual concerns. With respect to those comments, we repeat the following main concerns, since they were addressed to the IASB only (for the entire comment letter, see Appendix B to this letter):

- The exit notion for all items and the transfer notion for liabilities do not seem appropriate. This refers to the definition and to the understanding of transactions.
- The most advantageous market does not seem well elaborated. This refers to the reference market concept and to the understanding of transactions.
- The approach of highest and best use bears several weaknesses. This refers to the valuation premise. It also raises problems with respect to the conceptual difference of the unit of account and the unit of valuation.

Our comments in this letter focus on how these concerns are reflected in the FASB-ED. 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 extent, we analyse and question the reasons for these changes, but not without considering the essential, which is, whether the proposals are ultimately appropriate.

### General comments

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 varying 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.

In the following, the GASB provides 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 A 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 important enough to be discussed again. For this reason, our answers in Appendix A provide further details on only some of the issues set out below.



(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. 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 use the terms “current exit price” or “current entry price”, and to distinguish between both accordingly.
- 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.
- 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. Most notably, we see a weakness as this concept uncouples the measurement from the item to be measured.

(b) The following requirements that were subject to changes (compared to the IASB-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 (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. This seems to be 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 goodwill recognised within a business combination, or some assets initially recognised under IAS 41, or some plant, equipment or technical know-how in the defence industry measured under IAS 20 – should be excluded 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. As long as the boards retain the exit notion within the FV definition, and since a transaction price has always an entry notion, the transaction price will not equal the FV in most cases – hence, the recognition of day-one-gains/losses is possible.
  - 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 that 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 benefit of disclosing the FV level might be. It even seems unlikely that there are potentially different FV levels for similar items.
- (c) However, the GASB 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: 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: We basically support the measurement uncertainty analysis disclosures. We are also 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. In particular, we appreciate the clarification that entities are not expected to make extensive ef-



forts in analysing all markets regarding their advantageousness that the entity does not have access to or might never trade in.

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.

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

Yours sincerely,

*Liesel Knorr*  
President



## Appendix A – 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 varying adequacy. As already set out, we identified some proposals to be reasonable, others to be an improvement but only in 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 requirements that, to a differing degree, need further consideration or lack appropriateness. Instead of answering this question 1, which asks for rather overall and unspecified comments, we refer to our general remarks in this letter which are complemented 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.

We believe that the concept of highest and best use generally lacks appropriateness as it 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 in 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 forms the basis for recognition and measurement principles within IFRS and even US-GAAP. We would support eliminating this inconsistency.



### 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. Thus, we basically agree with permitting some financial items to be measured as a group or portfolio under the specific condition mentioned above.

Notwithstanding the above, the conceptual weakness of the valuation premise remains. We would prefer if premiums or discounts were applicable, under specific conditions, at any FV level when measuring financial instruments and other assets or liabilities. Given the case that an entity, when transacting, may take into account certain information that is not available to the market, this entity should be able to adjust the market price, hence, to consider a premium/discount even at FV level 1. The most evident example is a situation, when an entity holds financial instruments that represent a share in a listed entity allowing for control of which the market is not informed. Considering a "control premium/discount" should be applicable at any FV level. Accordingly and for consistency reasons, permitting premiums/discounts in specific situations should not be limited to Level 2 or 3 measurements. This would, in some cases, allow for reflecting that the instrument is used within a unit of items.



### 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.
  - 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.
- 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 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 has been 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.



**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.



## Appendix B – GASB comment letter to the IASB-ED “Fair Value Measurement” (May 2009)

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Sir David Tweedie  
Chairman of the  
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30 Cannon Street

Berlin, 25 September 2009

London EC4M 6XH  
United Kingdom

Dear David,

### Exposure Draft ED/2009/5 ‘Fair Value Measurement’

On behalf of the German Accounting Standards Board (GASB) I am writing to comment on the IASB Exposure Draft ED/2009/5 ‘Fair Value Measurement’ (herein referred to as ‘ED’). We appreciate the opportunity to comment on the Exposure Draft.

IFRSs require certain assets, liabilities and equity instruments to be measured at fair value or to be measured on a fair value basis (for example fair value less costs to sell). However, IFRSs do not provide a comprehensive and consistent guidance for determining fair values. By developing ED/2009/5 the IASB aims at resolving this issue. The second goal is to achieve an increased level of transparency and decision usefulness by establishing comprehensive disclosure requirements.

We strongly support these intentions and believe an important milestone has been achieved by issuing the ED. However, we have some significant conceptual concerns.

The IASB states that the whole project as well as the ED exclusively address the question of how to determine fair value while the issue of when to use a fair value measurement is explicitly out of scope. From a conceptual point of view a discussion about definition and determination of fair value cannot be held by completely ignoring the question of when to use fair values. We believe the Board is aware of that as well, because the Board proposes to exclude some circumstances from the scope of the ED. Therefore, we doubt that the question of when to use fair values is out of the scope of the project and the ED.

The Board proposes to define fair value as an exit price in a hypothetical transaction on a market on which the asset or liability is traded. Based on the current scope of fair value measurements we do not deem this concept to be the right one even if we take the proposed scope exemptions into account.

1. We see other circumstances in which a transaction and a market cannot even hypothetically arise, because the trading of the asset is legally prohibited (e.g. circumstances in the scope of IAS 20). In such circumstances a fair value measurement should be excluded from the scope as well.



2. According to the ED a fair value measurement at initial recognition assumes an exit notion even in scenarios in which the transaction to be accounted for is actually an entry scenario. We believe that notion is not right.
3. Furthermore, we understand the ED to require reporting entities to ignore entity specific circumstances to a large extent, for example by focusing on hypothetical transactions which the entity may not even intend to enter into. That causes reported information being based on too many hypotheses (for example the exit hypothesis or the notion of the highest and best use of an asset). We do not believe that information to be decision-useful.

Even if one would agree with the exit notion we see further difficulties in application since we do not deem the results of the exit notion, such as the highest and best use concept or the most advantageous market concept, to be of high practicability.

Please find our detailed comments on the questions raised in the ED in the appendix to this letter. If you would like to discuss our comments further, please do not hesitate to contact me.

Yours sincerely,

*Liesel Knorr*  
President



## Definition of fair value and related guidance

### Q1:

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?

We do not agree with the general notion saying that fair value measurements have to be based on an exit assumption.

Basically, the market perspective can be deemed to be the right approach to limit subjective discretion or judgment. But applying that perspective with the general exit notion ignores the actually intended use of the recognised assets and liabilities and, therefore, bears the risk that a measurement based on fictitious elements will not appropriately reflect what it is supposed to reflect which causes the information not being decision-useful. This is the case particularly with regard to circumstances in which the exit scenario is not relevant for the reporting entity. We see many situations in which the reporting entity does not intend a sale or in which a sale is simply not possible. Thus, if the IASB were to finally implement the proposed definition of fair value in IFRSs the scope should be further reduced. Please see our further comments on question 2.

Different circumstances demand different measurement objectives and, therefore, the measurement should be based on either an exit notion or an entry notion, depending on the underlying transaction or event that is to be accounted for. Concluding, we recommend omitting the term “fair value” and using terms instead that indicate the basis and the objective of the measurement more clearly than “fair value”, such as “current exit price” or “current entry price”.

We do not support the general notion of liabilities to be measured based on a transfer assumption, since in the vast majority of cases liabilities are not transferred. A measurement which is based on a notion that is far away from actual practice can hardly be decision-useful. If the IASB were to stick to the transfer notion further scope exemptions would become necessary.

From our point of view a fair value measurement of liabilities should be based on the question of how the entity can dispose of the liability most advantageously. This approach comprises a settlement. Therefore, we recommend altering the definition accordingly, i.e. to change to “to settle a liability”.

## Scope

### Q2:

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?

We agree with the exemptions proposed but we see further circumstances in which the reference to an exit scenario does not appear to be appropriate to us. The IASB should consider similar scope exemptions for situations in which a transaction is a priori impossible either due to legal restrictions or due to the absence of markets. In addition, we do not agree to assume an exit notion in an entry situation or when an exit transaction is not intended.

#### Transaction a priori impossible:

Fair value measurements are based on a hypothetical transaction. We understand from the ED – also in the context of measuring assets – that the intent of the entity regarding the transaction is not relevant for fair value measurements. We see circumstances in which a transaction is a priori impossible, even in a hypothetical view, and, therefore, the existence of both a transaction and a market is unimaginable. An example is a defense industry entity which has obtained plant and equipment or technical know-how from the state. In this case a fair value measurement of the assets should not be allowed since neither the sale of these assets is intended or possible nor does a market exist. IAS 20.23 allows measuring those assets at fair value or at a nominal amount. Since the reference to a non-existing market is not appropriate, the Board should consider an exemption from the scope of the ED.

Furthermore, we fail to imagine an exit market for goodwill recognised in the context of a business combination according to IFRS 3. Since there is no market existing for goodwill, an exit view is not appropriate.

#### Transaction not intended:

In our view, it is not appropriate to assume an exit scenario in situations in which an exit scenario is of no relevance to the reporting entity. For example, IAS 41 requires agricultural produce harvested from an entity's biological assets to be measured at its fair value less

costs to sell at the point of harvest. A measurement based on an exit scenario might be appropriate for agricultural produce according to IAS 41, since those assets are predominantly produced for selling them. In contrast, the exit assumption is not the right concept at initial recognition of biological assets (for example assuming the potato crop at the moment of sowing) which are used to output agricultural produce. This is because the agricultural produce (harvested potatoes) is subject to a sale but not the biological asset (potato crop).

#### Exit scenario not appropriate in entry situations:

We do not agree with an exit price based fair value measurement at initial recognition since assuming an exit scenario in an entry situation is not logical. According to IAS 39, 41 and IFRS 3 a fair value measurement is already required at initial recognition. Furthermore, we understand the fair value measurement at initial recognition in IAS 39 to be geared rather to a buying market than to a sales market since par. 43 of IAS 39 requires a fair value measurement plus transaction cost. We therefore recommend considering further scope exemptions in this respect.

## Transaction

### **Q3:**

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?

The GASB supports the IASBs efforts to limit subjective scope of discretion by referring to the most advantageous market. However, we doubt that the most advantageous market concept as proposed in the ED is well elaborated yet, since we have concerns regarding the practicability as well as we see conceptual issues.

#### Practicability

As the ED proposes general requirements for fair value measurement, it should be applicable to a broad area of circumstances. The concept of the most advantageous market as proposed might be the right one for financial instruments; however, we believe the concept is of low practicability when measuring assets which are assigned to a specific market. In our view a value based on a market on which the asset will surely never be sold is not relevant. Therefore, we propose to consider the market which the asset is assigned to, when measuring such “assigned assets” at fair value.

Given the fact, that assets to be measured at fair value are not assigned to a specific market yet, the ED leaves open how to consider the fact that an entity is aware of all existing markets for an asset without carrying an exhaustive search. Is the entity required to analyse all these different markets regarding their advantageousness?

Furthermore, we understand the wording in par. 8 saying that the entity must have access to these markets, therewith indicating that basically all markets in which the entity theoretically could transact have to be taken into account. We believe this condition not being consistent



with the wording in par. 10 (“*the market in which the entity would normally enter into a transaction*”). In our view the concepts are different. An entity can have access to a specific market, but access does not necessarily mean that the entity normally would enter into a transaction on this market. Since the number of markets which an entity can access may be very high, the number of markets to be considered in fair value measurement should be limited. One practical expedient might be to limit the number of to be considered markets down to those the entity frequently accesses.

#### Conceptual issues

We do not think it is appropriate to exclusively focus on the maximum price for an asset (adjusted for transaction and transportation costs) when determining the most advantageous market. In our view, when determining the most advantageous market some more elements should be taken into account. Given a market A on which an entity can sell commodities at 20 CU per item and a market B on which the entity can sell at 19 CU per item and assuming that transportation costs and transaction costs are not differing, market A would be the most advantageous market according to the proposals in the ED. Assuming further that the entity can sell 10.000 pieces in market A and 20.000 pieces in market B, we doubt that market A can still be deemed to be the most advantageous market.

There will be many more elements to be considered when determining the most advantageous market and we acknowledge that a comprehensive and robust definition may be hard to find but we believe the IASB should put further work into that.

#### **Q4:**

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?

From a conceptual point of view the focus on the market participants’ perspective appears to be consistent with the definition. Furthermore, we understand the ED applying the proposed fair value definition with an exclusive focus on the market participants. We do not deem this concept to be neither appropriate nor practicable since it completely ignores the perspective of the reporting entity representing the counterparty in a market transaction.



## Application to assets: highest and best use and valuation premise

### Q5:

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?

### Highest and best use

We understand the approach of the highest and best use to be a further measure to objectify accounting information. The entity shall not base fair value measurements on a suboptimal use of assets. We basically support such an approach. Furthermore, the highest and best use concept appears to be a consistent application of the fair value definition.

However, in our view the concept as proposed bears several weaknesses. The concept requires a measurement which is not linked to the item subject to measurement. Furthermore, it ignores significant interdependencies with other important facts and finally, it leaves open how to consider market participants that significantly differ from each other.

### *Measurement and the item to be measured*

Even if the entity does not need to perform an exhaustive search for other potential uses in case there is no evidence to suggest that the current use of an asset is not its highest and best use (par. 18), we see the risk that entities understand the ED that it requires an entity to challenge its complete business model. To a large extent the concept appears to be based on the notion of optimisation of the entity's resources. In other words, the concept as worded requires measuring an asset by explicitly ignoring its current use. In our view a fair value measurement should exclusively depend on the asset subject to measurement and its characteristics which significantly depend on the asset's current use. In contrast, the application of the highest and best use concept as proposed means to uncouple the measurement and the item subject to measurement.

Example: An entity engaged in the automotive business (construction of vehicles) owns a construction factory located on its own property. The entity is (without an exhaustive search) aware of the fact that another use of the building and the premises (for example using it as a



leisure park) would result in a higher value of both land and building. According to the ED the entity is forced to measure its assets based on a business model which is different from the entity's current business model. We do not believe that to be decision-useful; however, we doubt that the IASB intended such an accounting. Based on these concerns, we believe that the fair value measurement has to be based on the current use, exclusively.

#### *Unclear how to consider economically relevant interdependencies*

Even if the highest and best use concept does not have to be understood in the manner mentioned above, a further weakness of the concept becomes apparent. The current use of an asset, which is suboptimal based on viewing the single asset only, might be motivated by other economic benefits resulting from that current use. We believe it might even be possible that a suboptimal use assessed on the level of the single asset might be the highest and best use from the entire entity's point of view. In our view, the ED does not address those circumstances. Therefore, we recommend clarifying in the ED how an entity should consider economically relevant interdependencies when assessing whether the current use of an asset is its highest and best use.

#### *Differing market participants*

The ED is silent about how to consider the use concepts of other market participants if these market participants differ from each other. The ED might be understood in a way that a consistent application of the concept would be to assume an average market participant who, therefore, does not necessarily exist in reality. If that is the case, the measurement would be based on too many hypothetical elements, which we cannot agree with.

#### In-use versus in-exchange

We understand the differentiation between in-use and in-exchange specifying the highest and best use concept. When determining the highest and best use of an asset the entity shall analyse whether a stand-alone use or a use in combination with other assets or liabilities maximises the value of the asset being measured. Therefore, we refer to our comments on the highest and best use concept in the chapter above.

In addition, we have further strong conceptual concerns regarding this differentiation. A measurement model that refers to market prices is a model which is based on the exchange of assets. This model aggregates the willingness to pay shown by several potential buyers of an asset and results in a single market price for the asset. In doing so, the model considers the differing market participants' opportunities for diversification. However, the individual willingness to pay shown by the potential buyers is a function of their individual (mostly differing) intentions how to use the asset. Even if some of these intentions might be to resell the asset, it does not seem appropriate to assume a sustainable and continuing resale of the asset. In contrast, from our point of view, every asset will finally be put to a use other than resale. Concluding, every market price is finally based on an asset's use other than resale. Hence, in-use and in-exchange cannot be understood to be differing use concepts since in-exchange is based on in-use. We therefore propose to abandon this differentiation.

#### Highest and best use not to be applied to liabilities and financial assets

We agree that the highest and best use and the valuation premise are not relevant for liabilities.



The GASB does not find it appropriate to measure financial assets exclusively by applying the in-exchange premise. We have explained our concerns in the chapter above. Even if we accept the proposed differentiation between in-use and in-exchange, we see circumstances in which a measurement based on in-exchange does not lead to decision-useful information.

Example: An entity A owns a minority interest in another entity B. Entity B is a big player in a certain regional market which entity A strongly intends to enter since it expects growth and profits by an engagement in that market. Therefore, the interest is of strategic relevance to entity A. According to the wording of the ED, entity A measures the interest assuming a stand-alone use or a sale of the interest (in-exchange) would be the highest and best use for market participants. Given the fact that holding that interest is of less strategic relevance for other market participants that, therefore, would not be willing to pay more than the price quoted on an exchange, the strategic advantage of owning the interest and having the possibility to enter into that market would be ignored and the value of the interest would not be the right one in our view. One could argue that this issue could be solved by saying that the relevant market is not the stock exchange but a hypothetical market for strategic investments but we fail to see any proper guidelines for that in the ED.

The GASB holds the opinion that the proposed concept of the highest and best use is going too far in many aspects. The exclusive focus on market participants' views and disregarding entity specific circumstances and intentions (such as business model, interdependencies to other factors) cause an inappropriately high level of objectification because the model is geared to an implied optimisation goal and, therefore, does not lead to relevant, reliable and decision-useful information.

**Q6:**

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?

The proposal is based on the highest and best use concept which we cannot agree with. Therefore, we do not agree with the proposal of question 6, either.



## Application to liabilities: general principles

### Q7:

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 notion

We refer to our comments on question 1.

In an active market the observed price represents the fair value of the issuer's liability

We agree.

Fair value of liabilities in absence of observable market prices for a transfer but a corresponding asset exists for the liability

The IASB proposes to measure liabilities in absence of observable market prices based on the methodology that the counterparty would use to measure the fair value of the corresponding asset (BC71).

As already expressed in our answer to question 4 we deem exclusively referring to the reporting entity's counterparty to be neither appropriate nor practicable since it completely ignores the perspective of the reporting entity representing one of the counterparties in a market transaction. Therefore, we propose an approach saying that the reporting entity shall measure the liability based on the methodology which the reporting entity would use when measuring the corresponding asset at fair value.



### Fair value of liabilities when there is no corresponding asset

We basically agree with the proposal. Unfortunately, this concept is limited to those liabilities for which a corresponding asset does not exist (e.g. decommissioning liabilities). We recommend basing the fair value measurement in general on cash flows incurred at a settlement of a liability unless the liability can be deemed to be the counter position of a financial instrument for which an observable market price exists.

### Application to liabilities: non-performance risk and restrictions

**Q8:**

The exposure draft proposes that:

- (a) the fair value of a liability reflects non-performance risk, ie 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?

The GASB affirms its view expressed in its comment letter on the IASB Discussion Paper DP/2009/2 'Credit Risk in Liability Measurement'.

Firstly, a fair value measurement at initial recognition should take the own credit risk into account if it is priced into the transaction that results in the initial recognition of a liability.

Secondly, changes in own credit risk should be considered at subsequent measurement **in two cases only:**

- The liability is a derivative financial instrument: The GASB believes that fair value is the most appropriate measurement basis for derivative financial instruments. Therefore, as far as own credit risk is reflected in fair value measurement it is consequently included in the subsequent measurement of liabilities that are derivative financial instruments.
- Management has the intent and the ability to settle the liability with the counterparty to realise gains and losses from fair value changes before maturity. The GASB believes that fair value is the most appropriate measurement basis for non-derivative liabilities when the entity intends to settle the liability. Therefore, as far as own credit risk is reflected in fair value measurement it should be considered in the subsequent measurement of a non-derivative liability if the reporting entity intends to settle the liability (e.g. repurchase of own debts).

In case the management has the intent and the ability to transfer the liability to a third party, the GASB is of the opinion that the buyer's future cash flows resulting from the assumed liability are not impacted by the entities' credit risk and, thus, the buyer will not be willing to consider the entities' credit risk in the purchase price of the liability.



## Fair value at initial recognition

### Q9:

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?

We refer to our comments on question 2: A measurement assuming an exit scenario is not the right measurement for initial recognition which represents an entry scenario.

However, if the IASB decides to stick to an exit price measurement at initial recognition it does not appear to be appropriate to assume that the transaction price represents fair value since the transaction price has always the notion of an entry price, not an exit price. When applying the exit price notion, that concept has to be consistently applied at initial recognition. Therefore, the recognition of day-one-gains-or-losses is possible in most cases.

## Valuation techniques

### Q10:

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?

We agree with the proposed guidelines regarding valuation techniques and markets that are no longer active.

In the case of bid-ask-spreads the Board proposes to refer to a price within the bid-ask spread. In our view this proposal is not consistent with the exit price objective. A consistent application would mean to base the measurement of assets on the bid price and to base the measurement of liabilities on the ask price.



## Disclosures

### Q11:

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?

We basically agree with the proposed disclosure requirements.

However, we do not support to require the disclosure of the fair value by the level of the fair value hierarchy for each class of assets and liabilities which are not measured at fair value in the statement of financial position, but for which the fair value is disclosed (par. 58). That information is not relevant in our view.

We basically agree with the presentation of a sensitivity analysis for fair value measurements categorised within Level 3 of the fair value hierarchy (par. 57g). However, we would recommend limiting that requirement to present only those sensitivities in the analysis which are likely to be significant to the financial statements of the entity.

We do not agree with the disclosure requirements with regard to assets used together with other assets when their highest and best use differs from its current use (par. 60) since we do not agree with the underlying concept (please see our comments on question 5).

## Convergence with US GAAP

### Q12:

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?

We support the objective of convergence of IFRSs and US-GAAP in order to achieve a single set of high-quality principle-based accounting standards. This requires a comprehensive discussion about the issues between both the IASB and the FASB and with their constituents. Taking SFAS 157 as a basis for developing the ED was an appropriate measure, in our view. We also agree with the IASB's statement saying that a deviation from this basis is necessary if it is motivated by a significant improvement, but such deviations should be reasonable and justified as well, which we feel has not been accomplished in the ED.



In the case of measurement of liabilities and equity instruments the ED provides guidance while SFAS 157 contains no or very short advice on those issues. Therefore, we refer to our comments on questions 7 and 8. Further, in our view, the remarks made in the Basis for conclusions of the ED regarding the other differences are not sufficient to evidence the improvements claimed by the IASB.