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IASB
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UNITED KINGDOM

Le Président

JFL/VC/DC

n°70

Dear Madam, dear Sir,

I am writing on behalf of the CNC to give you our views on the above-mentioned Exposure-Draft (ED). Our detailed responses to the questions in the ED are set out in the attached Appendix.

We are not in favour of the proposals set out in the ED and summarise our objections below.

We are strongly convinced that the debate on *how* to define fair value cannot be dissociated from the debate on *when* fair value is a relevant measurement basis. We are concerned that revising the definition of fair value, where currently used in IFRS, and defining it as an exit price, without discussing, in light of the needs of financial statements users, the measurement objective and the measurement basis of the standards affected may lead to conclusions that are not necessarily the most relevant. We are also of the view that the ED FVM, as the SFAS 157, presumes that efficient markets are available for most assets and liabilities. We believe, as it has been further illustrated by the recent financial crisis, that markets are not efficient and hence that the concept underlying this ED and the relevance of a fair value measurement can be challenged.

The issue of when to use fair value is an essential consideration in order to ensure that the measurement is determined in a manner which is consistent with the objective of using fair value in the first place.

MINISTÈRE DE L'ÉCONOMIE
DE L'INDUSTRIE ET DE L'EMPLOI

In our mind, in order to provide decision-useful information to the users of financial statements, fair value defined as an exit price should be used only when it reflects the manner in which the assets will be realised and the liabilities extinguished in accordance with the business model of the entity.

In our view, it is appropriate to consider separately financial and non-financial items.

For financial items

Where financial assets are subsequently measured at fair value (i.e. when this measurement reflects the manner in which the assets will be realised in accordance with the entity's business model), we consider that it is appropriate to recognise these items at an exit price both initially and subsequently.

Similarly, where financial liabilities are subsequently measured at fair value (i.e. when this measurement reflects the manner in which the liabilities will be extinguished in accordance with the entity's business model), we also consider that a measurement based on an exit value is appropriate. However, as stated in our response to the "Credit risk in liability measurement" DP, we do not agree with the proposed definition of exit value as we consider that the effects of the entity's credit risk should be included only in the initial measurement of the liability.

On the other hand, where financial assets and liabilities are not subsequently measured at fair value because this does not reflect the realisation/extinguishment of the items in accordance with the entity's business model, we consider that the transaction price is generally the most relevant for initial recognition, unless there is evidence that market participants would have transacted at a different amount.

For non financial items

Where non financial assets are subsequently measured at fair value (i.e. when this measurement reflects the manner in which the assets will be realised in accordance with the entity's business model), we consider that it is appropriate to recognise these items at an exit price both initially and subsequently.

Where non financial assets are not subsequently measured at fair value because this does not reflect the realisation of the items in accordance with the entity's business model, we believe that the initial measurement should reflect the transaction price for the acquisition of the items on a standalone basis in the principal market to which the entity has access. In the case of a business combination where it is necessary to allocate the transaction price to the individual assets and liabilities acquired, while the exit price may be considered a reasonable proxy for some items, we are not convinced that this would necessarily be the case for all items. Accordingly, we encourage the Board to proceed with field testing aimed at determining whether the exit price is necessarily appropriate (or whether in certain circumstances an entry price may be more relevant) and at identifying the practical difficulties that may arise in evaluating an exit price for such items.

We expect that most non financial liabilities would not be measured at fair value subsequently since we do not believe that this measurement typically reflects the manner in which non financial liabilities are extinguished. Accordingly, we believe that non financial liabilities should normally be measured based on their settlement amount. Only in the limited circumstances where the liability is extinguished through transfer in accordance with the entity's business model would the non financial liability be measured based on an exit price (subject to the caveat mentioned above with respect to inclusion of changes in credit risk in the measurement of financial liability).

Accordingly, we disagree with the IASB's proposal that the only circumstances in which fair value should be defined differently than as an exit price are the three situations noted in the ED.

Moreover, even in the limited circumstances in which we favour the use of an exit price based measurement, we have the following specific concerns with the Board's proposals:

- We consider that an exit price measurement should assume that the transaction takes place in the principal market in which the entity transacts (refer to question 3);

- We are not in favour of the application of the highest and best use principle for measuring the assets in the statement of financial position as it is required in the ED, except in very limited circumstances. Consistently, we are not in favour of the disclosure requirements stated in paragraph 60 of the ED (refer to our answer to questions 5 and 6);

- We consider that the guidance regarding non financial items is not sufficient and should be enhanced to cover specific examples in the light of the different standards where an exit price measurement is appropriate (refer to our answer to question 10);

- We consider that a Day 1 gain or loss should only be recognised when an exit value measurement is based on observable market data and to the extent that the item is subsequently measured at fair value. We would welcome clarifications by the Board on Day 2 measurement (refer to our answer to question 9).

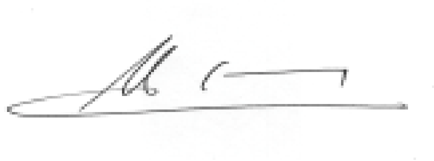
More globally, we observe that the proposals of the ED are very theoretical and as a result may be unworkable in certain circumstances. In addition, we consider that the ED does not adequately discuss the conceptual and informative merits of exit price compared to other measurement attributes. We observe that level 3 measurement contains a significant amount of entity-specific assumptions on what a hypothetical market would be. As such, we question how the Board reconciles this fact with the conclusion that such a measurement does in fact represent an exit price measurement. In fact, we are definitely not convinced that a measurement based on a hypothetical market participant on a hypothetical market can be considered as a market value, due to the level of entity's own assumptions involved.

In addition, we recommended in our comment letter to the Request for views (FSP FAS 157-e), that the IASB explores, as part of its Fair Value Measurement project, some of the proposals on the guidance initially proposed in the FSP FAS 157-e., such as aspects on liquidity and hypothetical markets. We regret that the Board has decided not to explore this route. We remain convinced that additional work should be done on these topics in order to clarify how entities should measure items that are not traded in active markets in order to ensure that the application of this guidance is consistent and results in relevant information for users.

Our more detailed comments on the proposals are set out in the appendix to this letter.

We understand that the Board plans to hold round-table meetings on the ED. We confirm that we are interested in attending one of these meetings.

Yours sincerely,



Jean-François Lepetit

Appendix 1

Definition of fair value and related guidance

Question 1

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?

1. We are strongly convinced that the debate on *how* to define fair value cannot be dissociated from the debate on *when* fair value is a relevant measurement basis. The issue of when to use fair value is an essential consideration in order to ensure that the measurement is determined in a manner which is consistent with the objective of using fair value in the first place.

2. In our mind, in order to provide decision-useful information to the users of financial statements, fair value defined as an exit price should be used only when it reflects the manner in which the assets will be realised and the liabilities extinguished under the entity's business model..

3. Accordingly, we believe that revising the definition of fair value, where currently used in IFRS, and defining it as an exit price, without discussing the measurement objective and the measurement basis of the standards affected, in light of the needs of financial statements users, may lead to conclusions that are not necessarily the most relevant.

4. The comments provided in this letter reflect our view that measuring assets and liabilities at an exit price provides decision-useful information to the users of financial statements only in certain circumstances.

Financial items

5. Where financial assets are subsequently measured at fair value (i.e. when its measurement reflects the manner in which the assets will be realised in accordance with the entity's business model), we believe that it is appropriate to recognise these items initially and subsequently at a fair value defined as an exit price. To illustrate, we refer to our response to the ED IAS 39, Financial Instruments: Classification and Measurement, in which we consider that fair value through profit and loss is the most appropriate measurement attribute for financial assets effectively actively traded by the entity as it better reflects the future cash flows associated with the business model.

6. On the other hand, where financial assets are not subsequently measured at fair value, because this does not reflect the realisation of the items in accordance with the entity's business model, we consider that the transaction price is generally the most relevant measurement attribute at initial recognition. In such a case, we have not found in the ED any compelling arguments supporting the conclusion that an exit price would be superior to the transaction price i.e. the amount of resources incurred or received upon entering into the arrangement, unless there is evidence that market participants would not transact at this price or that the transaction was not made on an arm's length basis,, for example because of the identity of the counterparty (e.g. employee, government). To illustrate, loans and receivables held for the purpose of collecting cash-flows that are measured subsequently at amortised cost should be initially measured at the transaction price with the presumption that market participants would have originated these loans and receivables at the same contractual interest rate. The use of a hypothetical exit price may generate irrelevant Day one gains or losses.

7. For financial liabilities, we consider that the measurement should reflect the manner in which the issuer extinguishes the liability under the business model, which is usually through settlement or performance or, in limited circumstances through a transfer.

8. As such,

   a. Where financial liabilities are subsequently measured at fair value (i.e. when the measurement reflects the manner in which the liabilities will be extinguished in accordance with the entity's business model), we also consider that a measurement based on an exit value is appropriate. However, as stated in our response to the DP "Credit risk in liability measurement", we do not agree with the proposed definition of exit value as we consider that the effects of the entity's credit risk should be included only in the initial measurement of the liability (stated otherwise, the subsequent measurement of those financial liabilities should not incorporate the effects of the changes in the entity's credit risk).

   b. Where financial liabilities are not subsequently measured at fair value, because this does not reflect the extinguishment of the items in accordance with the entity's business model, we consider that the financial liabilities should be measured initially at the transaction amount, unless there is evidence that market participants would have issued these liabilities at a different amount.

Non financial items

9. Where non financial assets are subsequently measured at fair value (i.e. when this measurement reflects the manner in which the assets will be realised in accordance with the entity's business model), we consider that it is appropriate to recognise these items at an exit price both initially and subsequently. To illustrate, for investment properties acquired in a business combination to which a fair value model is subsequently applied, the exit price is the most appropriate measurement attribute as it better reflects the future cash flows associated with the business model.

10. Where non financial assets are not subsequently measured at fair value because this does not reflect the realisation of the items in accordance with the entity's business model, we believe that the initial measurement should reflect the transaction price for the acquisition of the items on a standalone basis in the principal market to which the entity has access (refer to our answer to question 3 for more details on the reference market). In the case of a business combination where it is necessary to allocate the transaction price to the individual assets and liabilities acquired, while the exit price may be considered a reasonable proxy for some items, we are not convinced that this would necessarily be the case for all items. Accordingly, we encourage the Board to proceed with field testing aimed at determining whether the exit price is necessarily appropriate (or whether in certain circumstances an entry price may be more relevant) and at identifying the practical difficulties that may arise in evaluating an exit price for such items.

11. We expect that most non financial liabilities would not be measured at fair value subsequently since we do not believe that this measurement typically reflects the manner in which non financial liabilities are extinguished. Accordingly, we believe that non financial liabilities should normally be measured based on their settlement amount. Only in the limited circumstances where the liability is extinguished through transfer in accordance with the entity's business model would the non financial liability be measured based on an exit price (subject to the caveat mentioned above with respect to inclusion of changes in credit risk in the measurement of financial liability).

Scope

Question 2

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?

12. In addition to our concerns expressed in our response to question 1, we agree with the approach proposed by the IASB in the three contexts identified in the ED. However, in order to assist constituents in evaluating whether any other instance justifies a similar treatment, we believe that the IASB should make available the result of its standard-by-standard review of the references to fair value in IFRS as well as the result of the case study involving the valuation of identifiable assets acquired and liabilities assumed in business combinations mentioned in paragraph BC20.

13. The CNC questions why the IASB has not carried out a full consultation process on these findings. The CNC considers that such an approach, that results in shifting the "burden of proof " on constituents, without providing them with all the background material used by the IASB in reaching its conclusions, is not appropriate.

The transaction

> ## Question 3
>
> 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?

14. No, we do not agree with this approach. We do not believe that the Board has demonstrated why it is reasonable to assume that the market in which an entity normally transacts should typically be considered the most advantageous and why the most advantageous approach is superior.

15. In fact, we consider that an exit price measurement should assume that the transaction takes place in the principal market (i.e. the market with the greatest volume and level of activity for the asset or liability or similar instruments). We believe that the principal market is the most liquid market and therefore provides the most representative input for a fair value measurement.

16. Regarding the most advantageous market approach set out in the ED, we also note that the presumption set out in the paragraph 10 of the ED[1] implies for the entity to undertake a search – even if not exhaustive - of all possible markets. If the Board retains its most advantageous market approach, we recommend that the Board removes any reference to the need to search for the reference market and states simply that "it is presumed that the entity would normally enter into a transaction for the asset or liability is the most advantageous market".

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[1] Paragraph 10 states that "an entity need not undertake an exhaustive search of all possible markets to identify the most advantageous market. The market in which the entity would normally enter into a transaction for the asset or liability is presumed to be the most advantageous market"

17. Moreover, we recommend that the IASB clarifies:

a. What "access to the reference market" means: We consider that the IASB should provide guidance on the nature of the restrictions that would prevent an entity to have access to the reference market (either the principal or the most advantageous market), including whether these restrictions are linked to physical access to the market, to legal access or to other types of restrictions such as the capacity of the market to absorb the volume of items.

b. At which level the most advantageous market should be determined within a consolidated group. We note that paragraph 9 of the ED states that "therefore, the most advantageous market shall be considered from the perspective of the reporting entity". However, we do not understand the practical implications of this requirement: is it meant to be applied from the perspective of the entity that holds the item or from the perspective of the parent company?

Question 4

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 ?

18. In the circumstances in which we are in favour of an exit price measurement, we broadly agree with the description of market participants. However, we are of the view that the assumption, in paragraph, 13 that the market participants are not related parties should be modified and replaced by guidance to the effect that a transaction price associated with a related party transaction, which was consummated at arm's length and was evidenced by other market quotes, may be representative of fair value.

Application to assets: highest and best use and valuation premise

Question 5

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?

19. We have the following concerns with the proposals:

20. We believe that the analysis and the examples provided by the Board are overly simplistic and theoretical. The determination of highest and best use is a complex exercise that cannot ignore the interaction of factors such as the costs necessary to use an asset in a manner different than its current use and the fact that many assets may be used in conjunction with other assets

21. Additionally, we question the decision-usefulness for users of the resulting information when the entity does not have a realistic expectation of using the asset differently in regard to its business model, as this information has no predictive value. The only circumstance where the resulting information would be relevant is when an entity acquires an asset, that will not be used in conjunction with others, with the intent of using it in a manner that differs from the manner in which it would be used by other market participants that operate using an overall similar business model. This is the situation noted in paragraph 19 of the ED.

22. Further, we recommend the elimination of the requirement to measure the fair value of a commodity assuming its highest and best use by market participants for the same reasons as those given in the ED to explain why this requirement does not apply to financial assets.

23. Therefore, we are not in favour of the application of the highest and best use principle for measuring the assets in the statement of financial position as it is required in the ED. In the same manner, we are not in favour of the disclosure requirements stated in paragraph 60 of the ED (refer to question 11).

24. If the Board retains the requirement to measure assets reflecting their highest and best use, the guidance provided will need to address the complexities resulting from this requirement. With respect to the costs necessary to use an asset in a manner different from its current use, we would expect the guidance to explain which costs should be considered (e.g. do they include dismantlement, employee termination benefits). Also, we note that the example provided in IE7 of the ED does not address whether there would be a need to back out the profit margin expected on these conversion costs. In light of the commercial orientation of an entity's activities, we would expect that this is also an adjustment that would need to be considered in determining the fair value of an asset based on the value of the asset in another form. With respect to assets used in conjunction with other assets, please refer to our response to Question 6.

Question 6

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?

25. As discussed in the question 5, we are not in favour of the highest and best principle for non financial assets.

26. However, should the IASB retains its proposal, we do not believe that the guidance provided would be sufficient in particular in situations where more than one depreciable asset is involved. In that respect, the example provided in the ED is simplistic since it considers a situation simply involving land and a single depreciable asset. Further, we recommend that the IASB clarifies how the concept of components in IAS 16 might apply in a situation where it is a depreciable asset that is not currently used at its highest and best use (how would the excess fair value be applied to the various components of a factory when the highest and best use of the factory would be to convert it into a condominium).

Application to liabilities: general principles

Question 7

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?

Assumption that a liability is transferred to a market participant

27. As stated in question 1, we consider that the measurement attribute of liabilities should be consistent with the manner in which the issuer extinguishes the liability under its business model, which is usually through settlement or performance and only in limited circumstances through transfer.

28. As such, a measurement *based* on an exit price would be appropriate for example, in the circumstances where financial liabilities are effectively actively traded by the entity. However, in such a case, as stated in our response to the DP “Credit risk in liability measurement”, we do not agree with the proposed definition of exit value as we consider that the effects of the entity’s credit risk should only be included in the initial measurement of the liability (stated otherwise, the subsequent measurement of those financial liabilities should not incorporate the effects of the changes in the entity’s credit risk).

29. However, if the Board was to retain its position that the subsequent measurement of liabilities at fair value should reflect a transfer value rather than a settlement value, it will need to consider the additional guidance necessary to compensate for the fact that, in practice, few liabilities are transferred to another party. Such guidance will be particularly welcomed for non financial liabilities such as provisions for litigations.

Use of an observed price for an asset to measure a financial liability when there is an active market for transactions between parties who hold a financial instrument

30. We disagree. As stated in question 1, we consider that the measurement attribute of liabilities should be consistent with the manner the issuer extinguishes the liability, which is usually through settlement or performance. In the circumstances in which there is no observable market for the liability, the issuer is definitely not in a position to transfer the liability and, as such, measuring the liability at its exit price, as derived from the asset price, is not consistent with the manner the issuer will extinguish its obligation.

If there is no corresponding asset for a liability, an entity estimates the price that market participants would demand to assume the liability using present value techniques or other valuation techniques

31. We disagree. As stated in question 1, we consider that the measurement attribute of liabilities should be consistent with the manner the issuer extinguishes the liability, which is usually through settlement or performance. In these circumstances, an exit price derived from a hypothetical market is not consistent with the manner the issuer would extinguish the liability.

32. Further, we believe that the proposals in paragraph 28 would be difficult to apply and require a great deal of judgement. If the Board retains its proposal, additional guidance would be needed to address, for example, the determination of the risk premium that a market participant would demand and the appropriate sources for the information required to estimate the price that a market participant would demand to assume its liability in the absence of any market.

Application to liabilities: non-performance risk and restrictions

Question 8

The exposure draft proposes that:

- 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).
- 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?

Non-performance and credit risk

33. In as much as non-performance risk represents credit risk, as stated in our comment letter on the "Credit risk in Liability Measurement" DP, we are:
    a. In favour of including own credit risk upon initial recognition in the case of liabilities generated in exchange transactions,
    b. And against including an entity's own credit risk in the measurement of its liabilities following initial recognition and therefore against recognising the effects of the change in own credit risk in profit or loss.

Fair value of a liability is not affected by a restriction on an entity's ability to transfer the liability

34. We consider that the ED should clarify the wording of paragraph 31 and in particular the sentence which states that "a restriction on an entity's ability to transfer a liability ...does not affect the fair value of the liability" and explain the principles governing whether or not a separate adjustment should be made for contractual restrictions in determining the fair value of a liability.

Fair value at initial recognition

Question 9

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?

35. Regarding financial items, we consider that a Day 1 gain or loss should only be recognised when the exit price is determined using observable market data and to the extent that the item is subsequently measured at fair value. For example, consistently with our comment letter on ED IAS 39, Financial Instruments: Classification and Measurement, a Day 1 gain or loss would be appropriate for financial instruments actively traded by an entity.

36. In addition, as expressed in our comment letter to the Fair value Measurement, DP "there is currently considerable divergence in the way Day 1 gains or losses are recognised in practice (immediately, linear recognition etc.)". We therefore reiterate our request for clarification by the Board of the principle underlying the Day 2 measurement and for related guidance.

37. Regarding non financial items, consistently with our position on financial items, we consider that a Day 1 gain or loss should only be recognised when an exit value measurement is based on observable market data and to the extent that the item is subsequently measured at fair value. As for financial items, we would welcome clarifications by the Board on Day 2 measurement.

Valuation techniques

Question 10

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?

Valuation techniques

38. We consider that the guidance regarding non financial items is not sufficient and should be enhanced to cover specific examples in the light of the different standards where an exit price measurement is considered appropriate by the Board. We are of the view that providing specific guidance, like the guidance that was included in the previous IFRS 3, is useful as it helps promote consistent application of the requirement amongst constituents. In order to ensure that the guidance developed addresses the needs of constituents, we encourage the Board to proceed with field testing to identify these areas that are most likely to cause practical difficulties. In that respect and in regard with IFRS 3R, we consider that the Board should provide specific guidance on the measurement of unquoted minority interests at fair value (with regard to control premium for example).

39. In addition, we note that the ED proposes to remove the guidance currently provided by IAS 41 paragraphs 17 to 21 and 23 on the fair value measurement of biological assets. We consider that due to the specific nature of these assets and to the application issues encountered in practice when fair valuing these assets, including the treatment of Day 1 gain or loss, specific guidance should be provided in order to ensure that the fair value measurement requirements are applied consistently by entities.

40. We also note that the ED proposes to remove the guidance currently provided by paragraph 11 of IAS 18 regarding the determination of the imputed rate of interest to be used when determining the fair value of the consideration paid. We consider that the IASB should clearly explain the reasons why the guidance proposed in the existing IAS 18 is no longer appropriate (or necessary) to determine the fair value of the consideration paid.

41. We do not have strong views on whether this additional guidance should be included in the future standard on fair value measurement or in each relevant IFRS.

42. We suggest that the Board to consider the appropriateness of forming a panel of valuation experts, similar to the EAP Panel, which would help in dealing with future fair value measurement application issues.

Fair value hierarchy (level 1, level 2, level 3)

43. As stated in our response to the ED on the amendments to IFRS 7, we observe that the level 2 category results in a broad and heterogeneous category. In practice, classifications between level 2 and other levels are not always straightforward and may result in divergence of application. We recommend that the Board clarifies the underlying principle for measurement based on these levels.

44. As stated in our comment letter on the DP Fair Value Measurement, we observe that level 3 measurement contains a significant amount of entity-specific assumptions. As such, we question how the Board reconciles this fact with the conclusion that such a measurement does in fact represent an exit price measurement.

45. We are definitely not convinced that a measurement based on a hypothetical market participant on a hypothetical market can be considered as a market value, due to the level of the entity's own assumptions that are involved.

Bid and ask prices

46. As stated in our comment letter on the "Fair Value Measurement" DP, when a fair value is based on an exit value, we agree that, if an input used to measure fair value is based on bid and ask prices, the price within the bid-ask spread that is most representative of fair value in the circumstances shall be used to measure fair value, regardless of where the input is categorised in the fair value hierarchy.

Blockage factors [2]

47. As stated in our comment letter on the "Fair Value Measurement" DP, we disagree with the prohibition to take into account blockage factors. We consider that "blockage adjustments are designed to reflect the impact of the insufficient liquidity of markets when measuring large blocks of financial instruments. Where the size of the holding is superior to the capacity of the market, we believe that a blockage factor faithfully represents the market situation".

48. However, we agree that the measurement of blockage factors is a complex topic and that additional research and guidance is necessary on how to determine blockage factors in order to ensure a consistent measurement of blockage factors.

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2 ED BC.35. The Board proposes not to include blockage factors in a fair value measurement because:
(a) as specified in IAS 39, the unit of account represented by the exit transaction is the individual instrument; and
(b) market participant sellers will enter into a transaction at the most advantageous price for the instrument. A particular entity's decision to sell at a less advantageous price because it sells its entire holding rather than each instrument individually is a factor specific to that entity.

Markets that are not active

49. The CNC welcomes the inclusion in the ED of guidance based on the FSP FAS 157-4 “Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly » issued by the FASB.

50. However, the CNC observes that in the ED, unlike in FSP 157-4, this guidance applies not only to markets when the volume and level of activity have significantly decreased but more generally to “not active markets and transactions that are not orderly”. The CNC also notes that paragraph 12 of the FSP is now considered as being one of the factors indicating the circumstances where a market is not active.

51. The CNC recommends that the IASB analyses the practical effects of these changes and the extent to which they would give rise to differences in application between US GAAP and IFRSs.

52. In addition, we recommended in our comment letter to the “Request for views” (FSP FAS 157-e), that the IASB explores, as part of its Fair Value Measurement project, some of the proposals on the guidance initially proposed in the FSP FAS 157-e, such as aspects on liquidity and hypothetical markets. We regret that the Board has decided not to explore this route. We remain convinced that additional work should be done on these topics in order to clarify how entities should measure items that are not traded in active markets in order to ensure that the application of this guidance is consistent and results in relevant information for users.

Disclosures

Question 11

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?

53. We disagree with the requirement to provide the disclosures requested in paragraph 59, with regards to non-performance risk (including credit risk). As stated in our comment letter to the “Credit risk in Liability Measurement” DP, we consider that credit risk does not result in decision-useful information for users in their objective of assessing the amounts, timing and uncertainty of the cash outflows from its obligations. As such, we consider that disclosing this information in the notes to financial statements is not appropriate.

54. For the reasons mentioned in our response to question 5, we also disagree to provide the disclosures requested in paragraph 60, relating to "highest and best use". We consider that information about the highest and best use would not result in decision-useful information for users in their objective of assessing the amounts, timing and uncertainty of the cash flows of the entity where the entity has no realistic expectation of using the asset differently in regards to its business model.

Convergence with US GAAP

Question 12

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?

55. We note that unlike SFAS 157, the ED FVM states explicitly that the in-use valuation premise is not relevant to financial assets. Under US practice, we understand that it is considered that a portfolio approach to measuring the fair value of financial instruments is not prohibited and may be appropriate in certain circumstances (for example by taking into account master netting agreements). We consider that entities applying IFRS should be allowed to apply the same approach.

Question 13

Do you have any other comments on the proposals in the exposure-draft?

Reliability of the measurement of fair value

56. We observe that the ED does not consider the possibility of a reliability threshold or a practicability exception for the measurement of fair value. We remain convinced that in certain circumstances, when fair value cannot be assessed reliably, exceptions should be made to the recognition or the measurement principles. For instance,

a. As expressed in our response on ED "IAS 39 financial instruments" classification and measurement, we believe that the use of fair value is not relevant for unquoted equity instruments whose fair value is not reliable;

b. As expressed in our response on "IFRS 3 R", we believe that reliable measurement should be maintained as one of the criteria to recognise an intangible asset separately from goodwill.