

Technical Director
International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

20 April 2009

Email: aclifford@uk.ey.com

Dear Sir/Madam

Request for views on FASB amendments to fair value measurement and other-than-temporary impairment of debt instruments

Ernst & Young is pleased to submit its views on the following final FASB Staff Positions (FSPs) issued by the FASB on 9 April 2009:

- (i) FSP FAS 157- 4, *Determining Fair Value When the Volume and Level of Activity for an Asset or Liability has Significantly Decreased and Identifying Transactions that are Not Orderly*, and
- (ii) FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*.

We continue to support the joint efforts of the two Boards in accomplishing comprehensive solutions through due process. As we stated in our comment letter to the FASB, we are troubled by the FASB's decision to unilaterally issue the above FSPs. We believe that, in an era of convergence between U.S. Generally Accepted Accounting Principles (US GAAP) and IFRS, unilateral actions by either the IASB or the FASB could lead to opportunities for accounting arbitrage as well as for pressure on one standard setter to match changes made by the other; potentially resulting in competing changes that would not result in high quality standards for the accounting for financial instruments. Although we understand that the demands being placed on the FASB and IASB are due to the extraordinary nature of current market conditions, given the magnitude of the issues that need to be addressed, we would urge the two Boards to work together, to the greatest extent possible.

Fair value measurement

In October 2008, the IASB's Expert Advisory Panel (EAP) agreed that in most situations, based on guidance in effect at that time, there should not be a difference between a fair value determined for a financial instrument under US GAAP and IFRS. There has been considerable discussion in the marketplace regarding the extent to which FSP FAS 157-4 changes the existing requirements or whether it represents a fundamental shift in the way in which fair value will be determined for assets and liabilities that trade in markets that are no longer active. To some degree, this confusion may have stemmed from the guidance that was initially proposed by the FASB in the draft FSP.

The final version of FSP FAS 157-4 emphasises that “even if there has been a significant decrease in the volume and level of activity for the asset or liability and regardless of the valuation technique (s) used, the objective of a fair value measurement remains the same” ie, the price which would be received to sell an asset or transfer a liability in an orderly transaction between market participants under current market conditions. The FSP also reiterates an important principle that “the reporting entity’s intention to hold the asset or liability is not relevant in estimating fair value. Fair value is a market-based measurement, not an entity-specific measurement”. Accordingly, we do not believe the FSP represents a significant change to US GAAP. In our view, FSP FAS 157-4 builds upon the guidance contained in FSP FAS 157-3 (issued by the FASB in October 2008), which clarified the application of fair value measurement in markets that are not active and stressed the need for professional judgment when estimating fair values.

We believe the guidance in the FSP is broadly consistent with the guidance contained in the EAP report. In particular, both emphasise the same objective for fair value measurement and both stress, in reasonably clear terms, the need for the use of significant judgement when estimating fair values in an inactive market or when there has been a significant decrease in the volume and level of activity for a financial instrument.

We do note certain differences in the detail of the documents, for example, the EAP report provides guidance on fair value measurement of financial instruments in markets that are no longer active, whereas the FSP aims to help identify whether there has been a significant decrease in volume and level of activity for the asset or liability. However, we believe a reasonable analysis of the guidance in the EAP report and the FSP should not lead to different application in the majority of circumstances.

Based on responses received from the EAP members and other constituents, if the IASB concludes that the guidance in the EAP report and the FSP are in principle the same, and that there are no major differences, we recommend that the Board states this explicitly, for instance in a press release, so as to help prevent any ambiguity on this issue.

On the other hand, if based on the feedback from EAP members and other constituents, the Board concludes that there are significant differences in the detail of the guidance contained in the FSP and the EAP document; these differences should be addressed, so as to avoid a perception that IFRS and US GAAP are not consistent on this subject. Given that the FSP made changes to SFAS 157, we recommend that the IASB incorporates these changes into the Fair Value Measurement Exposure Draft, even if this might mean that issue of the ED is delayed by a few weeks. Also, while it would be inappropriate to rewrite the EAP document to reflect the FSP wording, there may be value in the EAP making small amendments to the document to ensure that there is consistency of tone and message.

Other-than-temporary impairment of debt instruments

In the final FSP FAS 115-2, the FASB has excluded equity securities from the scope of this amendment. We therefore believe that there is still a need for further clarification on the meaning of 'significant or prolonged' in the context of impairment of available for sale (AFS) equity instruments, as detailed in our submission to the IFRIC.

With respect to AFS debt securities, there are a number of differences between the impairment model under IFRS and the model currently applied in US GAAP. For instance, IFRS does not have the other-than temporary-impairment (OTTI) concept or the need to determine whether an entity intends to sell, or more likely than not will be required to sell, a security before recovering its cost basis. Whilst we believe it is not desirable or necessary to incorporate all these concepts into IFRS, the FSP does address one of the key concerns of financial statement preparers in the current market environment - ie., for AFS debt instruments to be able to segregate and recognise only credit losses (based on the present value of the cash flows expected to be collected) in the income statement and so report the remaining fair value changes in equity.

The recognition in profit or loss of only the credit losses on impaired AFS debt securities is consistent with a recommendation we made in our response to the IASB Discussion Paper - *Reducing complexities in reporting financial instruments*. We wrote that impairment should be 'calculated on a consistent basis for all debt instruments that are not recorded at fair value through profit or loss (ie, AFS debt instruments, loans and receivables, loan commitments and financial guarantees), based on projected cash flows rather than fair value losses as determined by the market, so as to be consistent with the objective to report separately those gains and losses that are likely to be realised as cash flows and those that may not'.

We believe that standard-setting is best conducted on a comprehensive basis with full consideration of all related issues and appropriate consultation with stakeholders and due process. We commend the Board in its efforts to resist undue pressures and we agree, in principle, that piecemeal changes should be avoided. Further we understand that the Board is developing proposals for a comprehensive overhaul of IAS 39 *Financial Instruments: Recognition and Measurement* and so it would be especially inappropriate to make additional adjustments in the very short term.

However, if the IASB expects that the results of the comprehensive project will not be effective for 2009, but only for subsequent years, we would support a specific, focused, amendment to IAS 39 this year on this particular issue. We believe it would not only be technically superior but, in the current circumstances, would help reporting entities to communicate more effectively their performance to users of financial statements. We would advocate a limited amendment to base impairment recorded in the income statement on projected cash flows rather than fair value losses, without the need to import any of the other US GAAP security impairment literature into IFRS, such as the linkage of impairment measurement with management intent or any changes to the treatment of securities classified as held to maturity. If the amendment were made so as to be available for entities reporting for the year to 31 December 2009, there would be time for adequate due process.

Should you wish to discuss the contents of this letter with us, please contact Tony Clifford at the above address or on +44 (0)20 7951 2250.

Yours faithfully

Ernst & Young