

Sir David Tweedie  
Chairman of the  
International Accounting Standards Board  
30 Cannon Street  
London EC4M 6XH  
United Kingdom

2 October 2008  
542/575

Dear Sir David

**Re.: Draft Document: IASB Expert Advisory Panel: Measuring and disclosing the fair value of financial instruments in markets that are no longer active**

We appreciate the opportunity to contribute to the ongoing debate on the issue of fair value measurement and to comment on IFRSs in the light of the recent period of market turmoil. We welcome the work undertaken by the IASB Expert Advisory Panel, resulting in useful educational guidance on the measurement and disclosure requirements of the IFRSs in general. However, we would like to submit the following comments:

Recently, a study has been published in Germany (Pellens, Sawazki, Zimmermann, Accounting does matter – IFRS-Fair Value Accounting: Fluch oder Segen?) which comes to the conclusion that in times of falling market prices fair value measurement can cause severe distortions and can induce a systematic downwards spiral. According to the findings of this study, fair value measurement is the most appropriate measurement base in efficient markets, however, it does not work as soon as an active market ceases to exist. The results of this research paper broadly corroborate the IDW's views on this issue. Admittedly, there is no bright line between active and inactive markets.

Taking into account the study's conclusion and the ongoing market turmoil, we would like to submit the following proposals which are, in our view, appropriate to avert or at least reduce the danger that the measurement requirements of IFRSs add to the tightening of a market

turmoil. We are convinced that our proposals will be able to contribute to reducing exaggerations in market fluctuations caused by short-term psychological effects:

- If the market of the respective financial instrument is inactive, in determining fair value, entities may not refer to market prices and transaction prices respectively, stemming from thinly-traded financial instruments or even a single transaction. Instead, a valuation technique should be used in these special circumstances, in particular models based on the discounted cash flow method, i.e., the cash flows resulting from a financial instrument would have to be forecasted and discounted.

Despite the concerns we have in general pertaining to the reliability and thereby the relevance of fair values determined by valuation techniques, we believe that in the context of thinly-traded financial instruments the reduced reliability of fair values based on valuation techniques has to be accepted in order to be able to obtain relevant measurements for the respective financial instruments. Market prices distorted by short-term psychological effects clearly are less relevant, even if they are more reliable.

- A reclassification of a financial instrument measured at fair value through profit or loss (held for trading) into a category measured at (amortised) cost should be allowed provided that both of the following conditions are met:
  - An active or liquid market does not exist (any more).
  - The business strategy or rather management's intent or ability pertaining to the respective financial instrument has changed as a consequence of market developments.

This proposal is supported by the above mentioned study which can be obtained via the following email-address: [presse@oppenheim.de](mailto:presse@oppenheim.de).

Up to now, IAS 39 allows for reclassifications in case of financial instruments classified as available-for-sale (cf. IAS 39.50 et seqq.). Therefore, in our opinion, it is consistent with current requirements on the classification of financial instruments on initial recognition to refer to the business strategy or rather management's intent or ability. Taking into account the condition of an absence of an active or liquid market ensures reliability and prevents abuse. Alternatively, we could imagine an obligation to reclassify financial instruments when an active or liquid market ceases to exist.

In case of a reclassification, the fair value carrying amount of the financial instrument on that date would be deemed as (amortised) cost, similar to the requirements in IAS 39.54. After reclassification, at the end of each reporting period, there would be an obligation to assess whether and to which extent the financial instrument is im-

paired or uncollectible (cf. IAS 39.58 et seqq.). In case of an impairment, the amount of the loss would have to be recognised through profit or loss.

We would be pleased to answer any questions that you may have or discuss any aspect of this letter.

Yours sincerely

Klaus-Peter Naumann  
Chief Executive Officer

Norbert Breker  
Technical Director  
Accounting and Auditing