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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting:	**17 October 2007, London**
Project:	**Fair Value Measurement**
Subject:	**Staff Analysis of Comment Letters (Agenda Paper 2C)**

INTRODUCTION

1 The purpose of this agenda paper is to provide a summary and preliminary analysis of the comments received on the discussion paper. This analysis is meant to highlight the areas we think need to be considered in the deliberations.

2 We are not asking the Board to reach any tentative conclusions at this meeting on any of the matters raised. In the light of the comments received, we plan to undertake further research on nearly all of the issues before we ask the Board to reconsider its preliminary views (see Agenda Paper 2D on planning). A summary of the Board's preliminary views is in the appendix.

3 We received few responses from users. We therefore have sought feedback from members of the Analyst Representative Group and have considered their views when developing the preliminary project plan. We plan to undertake further consultation with user groups throughout the deliberations.

4 ***Please note***—most respondents focus on how fair value would apply generally. However, some of the focus on a single aspect of fair value measurement, such as its

application to financial instruments. Those who focus on financial instruments generally agree with FASB Statement of Accounting Standards No. 157 (SFAS 157) as it applies to financial instruments, but point out that they might not agree with it for non-financial assets and liabilities.

SUMMARY OF COMMENTS RECEIVED

5 The following paragraphs summarise the main comments received; it is not a comprehensive list. A working draft of the full comment letter summary is available to Board members upon request. During the deliberations, the staff will present the relevant sections from the full comment letter summary at each Board meeting.

General comments

6 Nearly all respondents agree that the project is needed. They think that establishing a single source of fair value measurement guidance would improve IFRSs. They also view the discussion paper as an important step toward convergence. Many respondents are concerned that divergence between US GAAP and IFRSs in fair value measurement guidance would be very difficult to explain to users. They encourage the IASB and the FASB to work together to resolve any differences.

7 However, many respondents are concerned that, because SFAS 157 was issued so recently, the FASB might be reluctant to change it, and they wonder whether the boards will be able to reach the objective of convergence if the IASB does not accept the Statement as it currently stands. Furthermore, many respondents interpret the issuance of a discussion paper based on a US standard as an indication that the IASB is adopting US GAAP.

Issue 1. SFAS 157 and fair value measurement guidance in current IFRSs

8 Issue 1 addresses the overall objective of the fair value measurement project to codify, clarify and simplify existing fair value measurement guidance that is dispersed widely throughout IFRSs.

Q1 In your view, would a single source of guidance for all fair value measurements in IFRSs both reduce complexity and improve consistency in measuring fair value? Why or why not?

9 Many respondents find it difficult to have a discussion about *how* an exit price should be measured without first discussing *when* it would be used in IFRSs. The proposal in the discussion paper to perform a standard-by-standard review to determine whether each incidence of 'fair value' in IFRSs represents an exit price or another measurement basis seems to have caused confusion. Respondents found it hard to comment on the application of an exit price to items that might or might not be measured as such. They think it is necessary to know what will be measured before deciding how it should be measured. Many also think the objectives of financial reporting need to be determined before commenting on whether an exit price is appropriate for IFRSs. Because of this, nearly half of the respondents believe the fair value measurement project should not be completed before the conceptual framework project. That staff notes that the conceptual framework project will develop a framework and foundation on which *future* decisions can be made rather than directly clarifying current IFRSs.

10 Because fair value is used more extensively in IFRSs than in US GAAP,[1] some respondents question whether a principles-based standard can be developed that is able to provide sufficient guidance on the broad range of assets, liabilities and transactions recorded at fair value under IFRSs without being overly complicated. These respondents suggest the following options:

a have a single source of general measurement guidance and include guidance for specific circumstances in each relevant standard;

b have a single source of guidance with a section for general guidance and separate sections to cover specific circumstances (eg a section on financial instruments and another section on other assets and liabilities);

c include the general guidance in the conceptual framework and have specific guidance in each individual standard in which fair value is used;

[1] The staff notes that the requirement in IFRS 3 and SFAS 141 *Business Combinations* to measure at fair value the assets acquired and liabilities assumed in a business combination effectively means that the breadth of the fair value requirements of both GAAPs is the same, at least for initial recognition in a business combination.

d provide all guidance, both general and specific, in each individual standard in which fair value is used. The general guidance could be standardised across all IFRSs; or

e provide guidance material instead of publishing an authoritative standard on fair value measurement.

Q2	**Is there fair value measurement guidance in IFRSs that you believe is preferable to the provisions of SFAS 157? If so, please explain.**

11 Many respondents think the guidance in IFRSs is preferable to that in SFAS 157 because each Standard addresses the issues pertinent to its own fair value measurement. Specific examples include:

a Appendix B of IFRS 2 *Share-based Payments*;

b paragraph B16 of IFRS 3 *Business Combinations* (issued 2004);[2]

c the guidance in IAS 40 *Investment Property* and IAS 41 *Agriculture* on the relationship between the unit of valuation and the unit of account.

d IAS 41's reference to the most relevant market in situations in which more than one market exists,

e the concepts of 'knowledgeable, willing parties in an arm's length transaction' in situations in which there is not an observable market (in contrast to 'market participants' in SFAS 157).

f IAS 39 *Financial Instruments: Recognition and Measurement*'s guidance for financial instruments; and

> If there is a valuation technique commonly used by market participants to price the instrument and that technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, the entity uses that technique (IAS 39.AG74).

g the value in use concept in IAS 36 *Impairment of Assets* because it takes into account the *use* of the asset or liability.

[2] The guidance in paragraph B16 will not be included in IFRS 3 (revised 2007).

12 However, many prefer some of the provisions of SFAS 157 to those in IFRSs, although these comments might stem from the fact that IFRSs currently do not have a standard on fair value measurement. For example, they think:

a SFAS 157 is more principles-based than IFRSs and provides a framework that can be used for the fair value measurement of *current* and *future* financial instruments (ie those that have not yet been developed); and

b SFAS 157 describes valuation concepts that are consistent with valuation practice and IFRSs are missing some of the factors that can affect the price paid for an asset.

Issue 2A. Exit price measurement objective

13 Issue 2A considers the potential differences between entry and exit prices and how an exit price definition of fair value might be different from the neutral exchange definition in current IFRSs.

Q3	**Do you agree that fair value should be defined as an exit price from the perspective of a market participant that holds the asset or owes the liability? Why or why not?**
Q4	**Do you believe an entry price also reflects current market-based expectations of flows of economic benefit into or out of the entity? Why or why not? Additionally, do you agree with the view that, excluding transaction costs, entry and exit prices will differ only when they occur in different markets? Please provide a basis for your views.**

14 Although many respondents agree with the definition of an exit price, they believe it describes only one aspect of fair value measurement (and that it relates mainly to financial instruments). They think many fair value measurements in IFRSs are closer to an entry price concept than an exit price concept and think a ‘one size fits all’ approach might not be appropriate.

15 Many respondents think SFAS 157 presumes that active, liquid markets exist for all assets and liabilities and that perfect market information will always be available from which to base fair value measurements. They think these presumptions hold for most financial instruments, but that the presumptions do not hold for many non-financial assets (eg specialised assets) and most, if not all, non-financial liabilities (eg performance obligations). They are concerned that using an exit price for all

measurements currently labelled ‘fair value’ in IFRSs would not consider situations in which an asset or liability is used in the business or when there is not an active market. They think an entry price or another measurement basis (eg a form of ‘value in use’) might reflect better the circumstances of such items, particularly when the fair value measurement is based on level 3 inputs. Furthermore, some think of an exit price as a liquidation value or fire sale even though SFAS 157 refers to an orderly transaction. Some respondents in the insurance industry note that Solvency II uses the concept of an exit price in the valuation of insurance liabilities.

16 Many respondents think a current entry price is just as relevant as a current exit price. They think the objective should be not only to indicate the inflows of economic benefit, but the economic resources actually incurred or spent by the entity. They think an entry price is more appropriate than an exit price in the following circumstances. For example:

a when there is a transaction price for the asset or liability;

b when fair value is used as a substitute for historical cost or when no historical cost information is available;

c when the item will not be measured subsequently at fair value; and

d when the asset will be held or used in the business.

17 However, some respondents disagree with the use of an entry price, mainly on the basis that it reflects the circumstances specific to the entity.

18 Many respondents agree that entry and exit prices will differ only when they occur in different markets, excluding transaction costs. However, some respondents think differences can arise even within the same market when the market is not perfectly competitive. For example:

a when a market does not have sufficient liquidity and activity, prices will not have reached an equilibrium level between buyers and sellers and arbitrage opportunities will exist.

b when there is a difference in the level of information available to the market participants (ie when asymmetric information exists), such as different competitive advantages, expectations of futures cash flows and appetites for risk. In other words, they think the entry price and exit price could differ because the expectations of the entity would be considered in the entry price, but not in the exit price.

Q5	**Would it be advisable to eliminate the term 'fair value' and replace it with terms, such as 'current exit price' or 'current entry price', that more closely reflect the measurement objective for each situation? Please provide a basis for your views.**

19 Many respondents consider 'fair value' to be a family of measurement bases and recommend replacing that term with more descriptive terms such as 'current exit price' and 'current entry price'. Some of these constituents consider the term 'fair value' to imply that anything that is not labelled 'fair value' is, by default, an 'unfair value'. However, the staff thinks that 'fair value' is not the emotive term, nor is 'exit price'. Rather, it might be the combination of the two terms (ie asserting that fair value should be defined as an exit price) that has caused concern.

20 Some respondents think the term 'fair value' should be retained because:

a they think there is no real difference between an entry price and an exit price and therefore see no reason to change the terminology;

b 'fair value' is widely used and understood; and

c IFRSs and in US GAAP need to use the same terms with the same meaning for convergence purposes. Because 'fair value' is used in SFAS 157, they think IFRSs should also use the term 'fair value'. Otherwise, they are concerned that constituents might be confused if different terms are used (eg 'fair value' in US GAAP and 'current exit price' in IFRSs) even if they have the same meaning.

Q6	**Does the exit price measurement objective in SFAS 157 differ from fair value measurements in IFRSs as applied in practice? If so, which fair value measurements in IFRSs differ from the measurement objective in SFAS 157? In those circumstances, is the measurement objective as applied in practice an entry price? If not, what is the measurement objective applied in practice? Please provide a basis for your views.**

21 Respondents argue that the following differences exist between SFAS 157 and IFRSs as applied in practice:

IFRS	**Practical differences**
IFRS 2 *Share-based Payment*	▪ Uses an entry price notion.
IFRS 3 *Business Combinations*	▪ Uses the transaction price, or entry price, rather than an exit price.
IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*	▪ Allows the use of a negotiated price (not necessarily a final contractual price) as an indicator of fair value.
IAS 16 *Property, Plant and Equipment*	▪ Allows the use of the current replacement cost valuation technique in estimating fair value, which is an entry price notion. However, this technique is not strictly consistent with an exit price measurement basis although SFAS 157 lists a current replacement cost as a valuation technique and the concepts are reconcilable. It is too soon to say whether this will become a difference in practice. ▪ Non-monetary transactions imply an entry price because the entity will exchange the asset only when the value of the consideration received equals or exceeds the entry price. This is also an entity specific value because it depends on the benefits that will flow to the entity.
IAS 17 *Leases*	▪ Uses an entry price notion.
IAS 18 *Revenue*	▪ Uses an entry price notion.
IAS 19 *Employee Benefits*	▪ IAS 39 is applied to the plan assets.
IAS 26 *Accounting and Reporting by Retirement Benefit Plans*	▪ IAS 39 is applied to the plan assets.
IAS 38 *Intangible Assets*	▪ Uses the transaction price, or entry price, rather than an exit price. ▪ Outside of a business combination, the valuation can only be performed if there are level 1 inputs.
IAS 39 *Financial Instruments: Recognition and Measurement*	▪ Uses the transaction price, or entry price, rather than an exit price, when there is not an observable market for all inputs. Subsequent measurement is at exit price.

IFRS	Practical differences
	▪ Assumes that the transaction price equals the fair value upon initial recognition in the absence of evidence to the contrary. Day one gains and losses are deferred, although the treatment in practice differs across firms. SFAS 157 does not assume that the transaction price equals the fair value, and requires that day one gains and losses be recognised. Furthermore, some respondents are concerned that, because SFAS 157 in principle allows day one gains and losses on non-financial assets and liabilities, it might change practice for IFRSs since IFRSs use fair value more broadly. ▪ In the valuation of liabilities, IAS 39 refers to a settlement price rather than a transfer price. ▪ IAS 39 refers to the credit risk of the instrument and SFAS 157 refers to the non-performance/credit risk of the entity. ▪ Refers to the most advantageous market and SFAS 157 refers to the principal market or, in the absence of a principal market, the most advantageous market. ▪ Uses bid pricing for assets and ask pricing for liabilities and the use of mid prices for net open positions. SFAS 157 allows an entity to estimate fair value based on the most representative price within the bid-ask spread.
IAS 40 *Investment Property*	▪ Refers to the market in which the entity transacts or expects to transact and SFAS 157 refers to the principal market.
IAS 41 *Agriculture*	▪ Refers to the market in which the entity transacts or expects to transact and SFAS 157 refers to the principal market. ▪ Deducts point-of-sale costs, which would be excluded under SFAS 157 as transaction costs.

Issue 2B. Market participant view

22 Issue 2B considers the market participant view as articulated in SFAS 157 and how this view might be different from the notion of ‘knowledgeable, willing parties in an arm’s length transaction’ in current IFRSs.

Q7 Do you agree with how the market participant view is articulated in SFAS 157? Why or why not?

Q8 Do you agree the market participant view in SFAS 157 is consistent with the concepts of 'knowledgeable, willing parties' and 'arm's length transaction' as defined in IFRSs? If not, how do you believe they differ?

23 Many respondents agree that the market participant view in SFAS 157 is consistent with the concepts of 'knowledgeable, willing parties' and 'arm's length transaction' in IFRSs. However, many find the term 'market participants' misleading if there is no market (ie when the market is hypothetical), in which case entities must rely on unobservable inputs. In such situations, they believe the concepts of 'knowledgeable, willing parties' and 'arm's length transaction' are more appropriate than SFAS 157's market participant view because they think the IFRS concept implies a hypothetical transaction whereas SFAS 157 implies an actual transaction. In fact, the staff believes that both presume a hypothetical transaction.

24 Many respondents question how a market participant view can be relevant when there is little or no market activity for the asset or liability. They question the representational faithfulness of measurements based on 'the entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability' (SFAS 157.30). They think 'hypothetical assumptions about hypothetical market participants in hypothetical markets' do not provide useful information. They also think that they are not 'allowed' to use entity-specific assumptions and that they must perform an exhaustive search for the assumptions market participants would use. However, the staff believes SFAS 157 did not intend to preclude entities from using their own assumptions as a starting point and only requires that entities make adjustments to their assumptions if they are significantly different from those of market participants.

25 Respondents also wonder how to identify market participants since it is unlikely that all would have a common view regarding inputs they would use in pricing an asset or liability. However, the staff believes SFAS 157 does not require entities to identify all potential market participants, nor does it assume that all market participants have a single view.

Issue 2C and Issue 6. Transfer versus settlement of a liability and Valuation of liabilities

26 Issue 2C considers the potential differences between the transfer and settlement of a liability and how the transfer notion in SFAS 157 might result in a different fair value than the settlement notion in current IFRSs.

27 Issue 6 addresses the effect on the fair value of a liability of the risk that an obligation will not be fulfilled (ie its non-performance risk).

Q9	**Do you agree that the fair value of a liability should be based on the price that would be paid to transfer the liability to a market participant? Why or why not?**

28 Many respondents question the relevance of measuring liabilities at fair value. Even if liabilities are measured at fair value, they favour a settlement price over a transfer price. However, they disagree on whether a settlement price should reflect settlement in due course (ie the present value of a future settlement value) or an immediate settlement (ie a current settlement value).

29 Many think the fair value of a liability should be based on its transfer price only when:

a there is an active market on which to base the transfer price;

b the entity has the intention of transferring the liability; and

c the entity has the ability to transfer the liability.

30 They think the concept of highest and best use for an asset could be applied also to liabilities. They think business settle liabilities by extinguishing them (either in due course or immediately) or by transferring them and that criteria could be developed to assist in determining which amount to recognise.

31 Many respondents question whether an entity could use the quoted price to measure the transfer price of its financial liabilities because presumably the market price for traded debt securities is the price at which the entity could settle its obligation by buying back the securities (ie current settlement). However, some note that the quoted market price is based on the expected settlement characteristics of the instrument,

which reflects a settlement at maturity rather than a current settlement. Respondents differ in how they think SFAS 157 would apply in this case:

a some think SFAS 157 would require an entity to use this price to measure the fair value of the liability, because it is a quoted price in an active market.

b others think SFAS 157 would prohibit an entity from measuring the fair value of the liability based on the quoted market price because it is the price in an asset trading market, not a transfer market. They note that there is a difference between an exit price to the *holder of the asset* (which might be readily observable) and a transfer price from the *issuer of the liability* (which rarely will be observable).

Q10	**Does the transfer measurement objective for liabilities in SFAS 157 differ from fair value measurements required by IFRSs as applied in practice? If so, in practice which fair value measurements under IFRSs differ from the transfer measurement objective in SFAS 157 and how do they differ?**

32 Many respondents think the measurement objective for liabilities in IFRSs is based on a settlement notion, not a transfer notion, particularly for non-financial liabilities and view a transfer price as a change to current practice. They think the fair value measurement in IFRSs would be based on the entity's own expected costs to settle the liability. However, respondents differ as to whether the settlement notion in IFRSs is based on a current or future settlement.

33 Some respondents note that IAS 39 allows entities

Q16	**Do you agree that the risk of non-performance, including credit risk, should be considered in measuring the fair value of a liability? If not, why?**

34 Some respondents think it is appropriate to reflect the risk of non-performance (including credit risk) in a fair value measurement because liabilities are priced on the basis of the risk that the issuing entity will not perform. However, many are concerned that reflecting non-performance risk in the fair value leads to counterintuitive results when there is a change in credit standing and the liability is remeasured at fair value. Some respondents in the insurance industry note that Solvency II does not allow insurance companies to include the effects of 'own credit' in the valuation of insurance liabilities.

35 Many respondents are unsure what is meant by 'non-performance risk', in addition to credit risk, and ask for guidance.

Issue 3. Transaction price and fair value at initial recognition

36 Issue 3 addresses day one gains and losses and whether the guidance in SFAS 157 and IFRSs would lead to a group of instruments being valued on a portfolio basis or as individual instruments.

Q11	**In your view is it appropriate to use a measurement that includes inputs that are not observable in a market as fair value at initial recognition, even if this measurement differs from the transaction price? Alternatively, in your view, in the absence of a fair value measurement based solely on observable market inputs, should the transaction price be presumed to be fair value at initial recognition, thereby potentially resulting in the deferral of day-one gains and losses? Please give reasons for your views.**

37 Some respondents think the transaction price is the best evidence of fair value and assets and liabilities should not be recognised at another amount on initial recognition, unless circumstances indicate that it should be (eg it is not at arm's length, the transaction did not take place in the principal (or most advantageous) market or there is clearly a bargain purchase or overpayment). They question the appropriateness of 'earning something without doing anything' and are concerned about the reliability of fair value measurements using unobservable inputs when the measurement differs from the transaction price. These respondents think it is inappropriate to recognise day one gains and losses.

38 On the other hand, some respondents think the transaction price is *not* always the best indicator of fair value because entities transact in order to make a profit. Therefore they think day one gains and losses should be recognised even when the measurement uses unobservable inputs. They think the principle underlying a particular measurement attribute should not be compromised solely because some people do not agree with the consequences. They think it is inconsistent to prevent the recognition of day one gains or losses when the measurement is based on unobservable inputs when fair value can be estimated using those same inputs. They think that, if the Board is concerned about the recognition of day one gains or losses, it should not allow fair value to be measured on a basis that could give rise to such gains and

losses. As one respondent states, ‘If a fair value is a reliable measurement for the balance sheet, it should be a reliable measurement for the income statement’.

39 Furthermore, some note that deferring day one gains and losses simply defers them to another period, when the remeasurement is performed. If the item is remeasured at fair value using an exit price, these respondents think there is no reason not to recognise the gain or loss initially. They think it is inconsistent to allow remeasurement using unobservable inputs, but not initial measurement. Conversely, some think that if unobservable inputs are not allowed at initial recognition, they should not be allowed for subsequent measurement because it would result in a day two gain or loss.

Q12	**Do you believe that the provisions of SFAS 157, considered in conjunction with the unit of account guidance in IAS 39, would result in a portfolio-based valuation of identifiable risks of instruments considered in aggregate, or an in-exchange exit price for the individual instruments? Please give reasons for your views.**

40 Many respondents think SFAS 157 and IAS 39, together, would result in an in-exchange exit price for the individual instruments when there is an active market. However, many think that, when there is no active market, the guidance in IAS 39 and SFAS 157 supports a portfolio approach. However, many respondents think the unit of account should be addressed in the fair value measurement standard to enable greater consistency in application.

Issue 4. Principal (or most advantageous) market

41 Issue 4 addresses the reference market in estimating the fair value of an asset or liability.

Q13	**Do you agree that a fair value measurement should be based on the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability? Why or why not?**

42 Many respondents agree that the principal market should be used, and in its absence the most advantageous market. Others think that rational, profit-seeking entities will always use the most advantageous market (after allowing for transaction costs). They do not agree that a fair value measurement should be based on the principal market when a more advantageous market exits.

43 However, many prefer the approach in IAS 41, which refers to 'the most relevant' market, for example 'the market expected to be used'. They think the appropriate market is the one in which the entity usually transacts or expects to transact, and think it would be strange to use a different market from that in which the transaction for the asset or liability took place originally, or will take place upon eventual sale or transfer. Some think the principal market *is* the market in which the entity usually transacts.

44 Some respondents ask for clarity on what constitutes a 'market', for example the distinction between retail and wholesale markets and what to do when there is no market (eg in level 3).

Issue 5. Attributes specific to the asset or liability

45 Issue 5 considers whether attributes specific to an asset or liability should be considered in the fair value measurement and whether transaction costs are one of those attributes (or an attribute of the transaction itself).

Q14	**Do you agree that a fair value measurement should consider attributes specific to the asset or liability that market participants would consider in pricing the asset or liability? If not, why?**

46 Nearly all respondents agree that a fair value measurement should consider attributes specific to the asset or liability. As one respondent states, 'Otherwise, a different item is being valued'. However, many are unsure how to determine which attributes a market participant would consider in pricing the item. What a market participant considers to be an attribute might not be the same as what the reporting entity considers to be an attribute.

Q15	**Do you agree that transaction costs that would be incurred in a transaction to sell an asset or transfer a liability are an attribute of the transaction and not of the asset or liability? If not, why?**

47 Many respondents agree with SFAS 157 that transaction costs incurred in a transaction to sell an asset or to transfer a liability are an attribute of the transaction and not of the asset or liability. However, many respondents understood this to mean that transaction costs always will be expensed. Rather, the Board's preliminary view is that transaction costs are separate only from the fair value measurement and that the

treatment of transaction costs will be addressed in each IFRS (in other words, it does not mean that they always will be expensed).

48 However, many ask for clarification on what constitutes a transaction cost. They think anything taken into account in the pricing process is an attribute of the asset or liability and should be included in the fair value measurement.

Issue 7. 'In-use valuation premise' vs 'value in use'

49 Issue 7 addresses the difference between the in-use valuation premise in SFAS 157 and value in use in IAS 36.

Q17 Is it clear that the 'in-use valuation premise' used to measure the fair value of an asset in SFAS 157 is different from 'value in use' in IAS 36? Why or why not?

50 Nearly all respondents agree that the 'in use' valuation premise in SFAS 157 is different from 'value in use' in IAS 36, although many think using similar terms is confusing.

51 Many respondents used this question as an opportunity to voice their concerns about the concept of highest and best use.

52 The staff notes that many respondents use the term 'value in use' to reflect a 'fair value based on the entity's use (not sale) of the asset or liability' rather than the entity-specific notion in IAS 36.

Issue 8. Fair value hierarchy

53 Issue 8 deals with the three-level fair value hierarchy in SFAS 157.

Q18 Do you agree with the hierarchy in SFAS 157? If not, why?

Q19 Are the differences between the levels of the hierarchy clear? If not, what additional information would be helpful in clarifying the differences between the levels?

54 Most respondents agree with the hierarchy in SFAS 157 and like that it prioritises the use of market inputs. However, many think there might be practical difficulties in its application.

55 Respondents request guidance on the following:

a what constitutes an ‘active’ market;

b distinguishing between observable and unobservable inputs in levels 2 and 3;

c applying the concept of ‘using the entity’s own assumptions about assumptions that market participants would use in pricing the asset or liability’ in level 3;

d the interaction between the hierarchy, the principal market, and highest and best use; and

e the interaction between the hierarchy and the use of valuation techniques.

56 Some respondents think the values derived using level 3 inputs are not in fact ‘fair values’ and that a *fair value* measurement must be based on observable information.

Issue 9. Large positions of a single financial instrument (blocks)

57 Issue 9 addresses the appropriateness of blockage discounts in situations in which large positions of a single financial instrument are held by an entity.

Q20	**Do you agree with the provision of SFAS 157 that a blockage adjustment should be prohibited for financial instruments when there is a price for the financial instrument in an active market (Level 1)? In addition, do you agree that this provision should apply as a principle to all levels of the hierarchy? Please provide a basis for your views.**

58 Respondents’ views are mixed on whether SFAS 157, considered with IAS 39, would result in a portfolio-based valuation or an in-exchange price for individual instruments. Many think that in an active market the unit of valuation would be the individual instruments. However, some consider the lack of guidance in situations in which there is no active market to mean that the unit of valuation is the portfolio. Financial institutions note that they manage their business on a portfolio basis and suggest that the unit of valuation reflect this. Many suggest that the unit of account guidance be more specific, whether it is in a fair value measurement standard or in each relevant IFRS.

59 Many note that some non-financial assets are valued on a portfolio basis. For example, customer contracts and relationships and biological assets and agricultural produce.

60 Very few respondents agree with a prohibition on blockage discounts when an entity holds a large position of a financial instrument. Blockage factors represent the reduction in the price of a security that might be realised if an entity were to dispose of its entire holding at one time because of the market's inability to absorb the sale of the quantity held. Those who agree with the prohibition of blockage factors do so mainly because of the perceived subjectivity of calculating the discounts. They also think comparability will be reduced because entities will need to ask 'how many shares do I need to have before I have a block?'.

61 Those who disagree do so for the following reasons:

a the prohibition is a rule rather than a principle; and

b it is inconsistent with an exit price because it does not reflect the amount that would be realised by selling the holding. They think a fair value measurement excluding blockage discounts is meaningless.

62 Whether or not there is a prohibition, many think the provision should be applied at all levels of the hierarchy. They are unsure why there would be a difference between level 1 and levels 2 and 3.

Issue 10. Measuring fair value within the bid-ask spread

63 Issue 10 addresses whether fair value should be based on the bid price, the ask price or another price within the bid-ask spread and whether it matters if the prices are observable (levels 1 or 2) or not (levels 2 or 3).

Q21	**Do you agree that fair value measurements should be determined using the price within the bid-ask spread that is most representative of fair value in the circumstances, as prescribed by paragraph 31 of SFAS 157? Alternatively, do you believe that the guidance contained in IFRSs, which generally requires assets to be valued at the bid price and liabilities at the ask price, is more appropriate? Please explain the basis for your view.**

64 Many respondents think fair value should be based on the price within the bid-ask spread that is most representative of fair value. They think this is a principles-based approach. However, some ask for guidance on how to select the place within the bid-ask spread that is most representative.

Q22 Should a pricing convention (such as mid-market pricing or bid price for assets and ask price for liabilities) be allowed even when another price within the bid-ask spread might be more representative of fair value? Why or why not?

65 Many disagree with allowing a pricing convention (eg mid-market pricing or bid prices for assets and ask prices for liabilities) unless the difference in fair value is immaterial. However, some think a pricing convention increases consistency and comparability amongst firms. Furthermore, some think choosing 'the most representative price' is inconsistent with an exit price notion.

Q23 Should bid-ask pricing guidance apply to all levels of the hierarchy, including when the fair value measurement includes unobservable inputs? Why or why not?

66 Many think the bid-ask spread guidance should be applied in all levels of the hierarchy, although some wonder how it could be applied outside level 1.

Issue 11. Disclosures

67 Issue 11 addresses the disclosure requirements related to items measured at fair value.

Q24 Do the disclosure requirements of SFAS 157 provide sufficient information? If not, what additional disclosures do you believe would be helpful to users and why? Alternatively, are there disclosures required by SFAS 157 that you believe are excessive or not beneficial when considered in conjunction with other disclosures required by IFRSs? Please provide a basis for your view.

68 Some respondents think it is too soon to address the disclosures that a fair value measurement standard might require. They think that too many items need to be addressed (including which items will be measured at the 'new' definition of fair value) for them to be able to comment at this time.

69 Many respondents caution against requiring large amounts of disclosure, particularly given the disclosures currently required by IFRS 7 *Financial Instruments: Disclosures*. They suggest that the Board take from the SFAS 157 disclosures and the IFRS disclosures to create the clearest presentation of the information.

70 Some respondents foresee a large amount of disclosures for entities in emerging markets since most of the fair values for those entities will be in levels 2 and 3.

Issue 12. Application guidance

71 Issue 12 addresses whether the application guidance in SFAS 157 is sufficient, including for emerging markets, or whether additional guidance is needed.

Q25 Does the guidance in Appendices A and B of SFAS 157 sufficiently illustrate the standard's principles and provisions as they would apply under IFRSs? If not, please specify what additional guidance you believe is needed and why.

Q26 Does the guidance in Appendices A and B of SFAS 157 sufficiently illustrate the standard's principles and provisions as they would apply in emerging or developing markets? If not, please specify what additional guidance you believe is needed and the most effective way to provide this guidance (for example, through additional implementation guidance or through focused education efforts)?

72 Respondents differ in whether they think the amount of application guidance is too much, too little or just right. However, many respondents request further examples illustrating the measurement of non-financial assets (eg property, plant and equipment and intangible assets), financial liabilities (ie estimating the transfer price), non-financial liabilities (eg performance obligations and pension obligations) and the application of level 2 and level 3 inputs. They also ask for guidance on distinguishing between 'observable' and 'unobservable' inputs.

73 Furthermore, many respondents note the inter-relationship between some aspects of SFAS 157 (for example, the reference market, highest and best use, the hierarchy and valuation techniques) and ask for additional examples that illustrate this inter-relationship.

74 Some respondents think the examples in Appendix A are sufficient, but suggest modifying some of them to provide clarity.

75 The staff understands that fair value measurement poses particular issues for entities operating in emerging markets, although many of these issues also are relevant for entities in developed markets.[3] Respondents note that entities operating in emerging markets:

[3] The staff uses the term 'emerging markets' rather than 'emerging economies' to focus on the differences between emerging and developed *markets* rather than emerging and developed *economies*. Emerging markets can exist in both developed and emerging economies and they have unique issues regardless of the nature of the economy as a whole.

a have a need for education and training. Many entities in emerging economies do not have the expertise available to estimate fair value, particularly in the absence of an active market (or any market at all). One respondent (from a developed economy) states:

> [T]he premise behind the requirement for focused education efforts in emerging or developing markets is on one hand patronising, implying a lower capability, but on the other enlightened since such markets are the ones most likely to require level 2 and level 3 options and therefore face greater compliance costs and greater complexity than advanced economies which enjoy a greater range and depth of active markets.

b have unique regulatory issues. For example, the valuation activity in some countries is regulated by the government and often is based on International Valuation Standards (IVSs) issued by the International Valuation Standards Committee (IVSC). Although this is not something the Board needs to address specifically, it should be aware that any divergence between fair value measurement guidance in IFRSs and that in the IVSs might create practical difficulties for entities in such countries.

Issue 13. Other matters

76 Issue 13 provides respondents with the opportunity to comment on any other matters they might want to raise with regard to the discussion paper and the fair value measurement project in general.

Q27	**Please provide comments on any other matters raised by the discussion paper.**

77 Some respondents note that the discussion paper does not include the Board's views on whether the transitional provisions of SFAS 157 would be adopted or the Board's views on effective dates and early adoption (many financial institutions would like the Board to allow early adoption). Some respondents think transitional provisions will be needed for day one gains and losses since the treatment in SFAS 157 is different from that in IAS 39.

78 Some respondents also note that the discussion paper does not include the Board's views on reliability thresholds or practicability exceptions and ask that these be included in an exposure draft of an IFRS on fair value measurement.

79 Many respondents think the accounting should be aligned with the circumstances of the business or the transaction. For example, they state that:

a ‘the value should represent the price actually obtainable in the principal market’.

b ‘all valuations are estimates of the price that would be obtained for an asset if it were to be sold’.

c ‘we find it useful to think in terms of what happens in an actual sale of an asset or a transfer of a liability. If the accounting measure is different from the price in the transaction, it is the result of a difference between estimated values and realised values or an inherent difference created by the accounting requirements. The former is understandable and practically speaking unavoidable for level 3 measures. The latter is anomalous and contrary to the fundamental concepts underlying fair value measurement and should be avoided’.

d ‘the use of judgment and estimates which are not…readily observable are frequent to a number of existing [IFRSs] and…fair value measurement should not be different in this respect’.

80 Lastly, some respondents note that the discussion paper provides the Board with an opportunity to learn from the experiences of the companies adopting SFAS 157 and can take these into account before publishing an exposure draft (and an IFRS) on fair value measurement.

QUESTIONS FOR THE BOARD

81 **Are there additional comments that the Board would like the staff to consider?**

APPENDIX: THE BOARD'S PRELIMINARY VIEWS IN THE FAIR VALUE MEASUREMENT DISCUSSION PAPER

Issue	Question	Board's preliminary view
Issue 1. SFAS 157 and fair value measurement guidance in current IFRSs	Q1 In your view, would a single source of guidance for all fair value measurements in IFRSs both reduce complexity and improve consistency in measuring fair value? Why or why not? Q2 Is there fair value measurement guidance in IFRSs that you believe is preferable to the provisions of SFAS 157? If so, please explain.	Because SFAS 157 establishes a single source of guidance and a single measurement objective that can be applied to all fair value measurements, it is an improvement on the disparate guidance in IFRSs. The Board has not reached preliminary views on all provisions of SFAS 157.
Issue 2A. Exit price measurement objective	Q3 Do you agree that fair value should be defined as an exit price from the perspective of a market participant that holds the asset or owes the liability? Why or why not? Q4 Do you believe an entry price also reflects current market-based expectations of flows of economic benefit into or out of the entity? Why or why not? Additionally, do you agree with the view that, excluding transaction costs, entry and exit prices will differ only when they occur in different markets? Please provide a basis for your views. Q5 Would it be advisable to eliminate the term 'fair value' and replace it with terms, such as 'current exit price' or 'current entry price', that more closely reflect the measurement objective for each situation? Please provide a basis for your views. Q6 Does the exit price measurement objective in SFAS 157 differ from fair value measurements in IFRSs as applied in practice? If so, which fair value measurements in IFRSs differ from the measurement objective in SFAS	The majority of Board members believe that a fair value measurement with an exit price objective is consistent with the definitions of assets and liabilities in the conceptual framework because it reflects current market-based expectations of flows of economic benefit into or out of the entity. Other Board members agree with this view, but in their view an entry price also reflects current market-based expectations of flows of economic benefit into or out of the entity. These Board members suggest replacing the term 'fair value' with terms that are more descriptive of the measurement attribute, such as 'current entry price' or 'current exit price'. Some Board members are of the view that an entry price and an exit price would be the same amount in the same market, assuming that transaction costs are excluded. However, an entity might buy an asset or assume a liability in one market and sell that same asset or transfer that same liability (ie without modification or repackaging) in another market. In such circumstances, the exit price in SFAS 157 would be likely to differ from the entry price.

Issue	Question	Board's preliminary view
	157? In those circumstances, is the measurement objective as applied in practice an entry price? If not, what is the measurement objective applied in practice? Please provide a basis for your views.	
Issue 2B. Market participant view	Q7 Do you agree with how the market participant view is articulated in SFAS 157? Why or why not? Q8 Do you agree the market participant view in SFAS 157 is consistent with the concepts of 'knowledgeable, willing parties' and 'arm's length transaction' as defined in IFRSs? If not, how do you believe they differ?	The market participant view is generally consistent with the concepts of a knowledgeable, willing party in an arm's length transaction that are currently contained in IFRSs. However, the proposed definition more clearly articulates the market-based fair value measurement objective in IFRSs.
Issue 2C. Transfer versus settlement of a liability	Q9 Do you agree that the fair value of a liability should be based on the price that would be paid to transfer the liability to a market participant? Why or why not? Q10 Does the transfer measurement objective for liabilities in SFAS 157 differ from fair value measurements required by IFRSs as applied in practice? If so, in practice which fair value measurements under IFRSs differ from the transfer measurement objective in SFAS 157 and how do they differ?	The term 'transfer' more accurately describes the fair value measurement objective in IFRSs than does 'settlement'. This is based on existing guidance in IFRSs, which refers to market-based objectives for measuring the fair value of liabilities. Such a market-based objective is consistent with a transfer notion because it excludes entity-specific efficiencies or inefficiencies that might be included in a settlement notion. Rather, a transfer notion reflects market participants' views on settlement of a liability. Market participants that would assume a liability at the measurement date would also assume the obligation to settle with the counterparty to the liability. Therefore, the price that market participants would require in order to assume the liability reflects their views on the expected outflow of resources embodying economic benefits associated with the ultimate settlement with the counterparty.
Issue 3. Transaction price and fair value at	Q11 In your view is it appropriate to use a measurement that	The Board has not reached a preliminary view on this matter

Issue	Question	Board's preliminary view
initial recognition	includes inputs that are not observable in a market as fair value at initial recognition, even if this measurement differs from the transaction price? Alternatively, in your view, in the absence of a fair value measurement based solely on observable market inputs, should the transaction price be presumed to be fair value at initial recognition, thereby potentially resulting in the deferral of day-one gains and losses? Please give reasons for your views.	and sought the views of respondents. The Board discussed two views about the divergence between paragraphs 16 and 17 of SFAS 157:[4] View 1: The accounting required by IAS 39 should be maintained. Supporters of this view do not fully agree with the provisions of paragraphs 16 and 17 of SFAS 157. They believe that the transaction price is the best evidence of fair value in the absence of observable market informationor evidence to the contrary. Supporters of this view believe it is not appropriate to measure a financial asset or liability initially at an amount different from the transaction price unless the financial asset or liability can be valued at a different amount using only observable market information. View 2: Entry and exit prices are conceptually different. If fair value has an exit price objective, it should be used consistently whenever fair value is required by IFRSs, regardless of whether a fair value measurement can be corroborated by observable market information. Supporters of this view accept the recognition in profit or loss of a difference between a model-based estimate of fair value and the transaction price at initial recognition, even if the asset or liability cannot be valued using only market-based information. Supporters of this view argue that accounting for day one gains and losses separately from the subsequent changes in the model-

[4] Paragraph 16 states that entry and exit prices are different conceptually and paragraph 17 states that the transaction price (an entry price) would, in many cases, equal the exit price.

Issue	Question	Board's preliminary view
		based estimate of fair value provides users of financial statements with more relevant information and a better understanding of the economics of the transactions.
Issue 3. Transaction price and fair value at initial recognition	Q12 Do you believe that the provisions of SFAS 157, considered in conjunction with the unit of account guidance in IAS 39, would result in a portfolio-based valuation of identifiable risks of instruments considered in aggregate, or an in-exchange exit price for the individual instruments? Please give reasons for your views.	Some Board members are concerned that if the provisions of SFAS 157, which does not define the unit of account, were applied to IFRSs entities would measure the fair values of financial assets and liabilities on the basis of a portfolio of the separately identifiable risks held by the entity rather than as an in-exchange exit price for the individual instruments. These Board members observe that, based on the guidance in IAS 39, the objective of measuring fair value for financial assets and liabilities in IFRSs is to establish what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal business considerations for *the individual instrument*.
Issue 4. Principal (or most advantageous) market	Q13 Do you agree that a fair value measurement should be based on the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability? Why or why not?	The Board agrees with the guidance in SFAS 157 because it has observed that in most instances the principal market for an asset or liability will be the most advantageous market and that entities need not continuously monitor multiple markets in order to determine which market is most advantageous at the measurement date. Furthermore, the market on which an asset or liability is principally traded provides a more liquid, and therefore more representative, input for a fair value measurement.
Issue 5. Attributes specific to the asset or liability	Q14 Do you agree that a fair value measurement should consider attributes specific to the asset or liability that market participants would consider in pricing the asset or liability? If not, why?	It is appropriate to consider attributes specific to the asset or liability that a market participant would consider when pricing the asset or liability. When location is an attribute of the

Issue	Question	Board's preliminary view
		asset or liability, the price in the principal (or most advantageous) market should be adjusted for costs that would be incurred to transport the asset or liabilty from its current location to the principal (or most advantageous) market.
Issue 5. Attributes specific to the asset or liability	Q15 Do you agree that transaction costs that would be incurred in a transaction to sell an asset or transfer a liability are an attribute of the transaction and not of the asset or liability? If not, why?	Transaction costs are an attribute of the transaction rather than an attribute of the asset or liability. Thus, they should be considered separately from fair value, which is consistent with current IFRSs.
Issue 6. Valuation of liabilities	Q16 Do you agree that the risk of non-performance, including credit risk, should be considered in measuring the fair value of a liability? If not, why?	The Board observes that a requirement to consider non-performance risk when measuring the fair value of a liability extends to fair value meaurements of all liabilities the principle already established for financial liabilities in IAS 39. Also, the Board agrees with the position in SFAS 157 that the risk that an obligation will not be satisfied affects the value at which that obligation would be transferred. Therefore, the Board's preliminary view is that the fair value of a liability should reflect non-performance risk.
Issue 7. 'In-use valuation premise' versus 'value in use'	Q17 Is it clear that the 'in-use valuation premise' used to measure the fair value of an asset in SFAS 157 is different from 'value in use' in IAS 36? Why or why not?	The Board provided an analsyis of the differences between the concept of 'value in use' in IAS 36 and the concept of an 'in-use valuation premise' in SFAS 157 to get respondents' views on whether the differences between the concepts are clear.
Issue 8. Fair value hierarchy	Q18 Do you agree with the hierarchy in SFAS 157? If not, why? Q19 Are the differences between the levels of the hierarchy clear? If not, what additional information would be helpful in clarifying the differences between the levels?	Because IFRSs do not have a consistent hierarchy that applies to all fair value measurements, the Board favours a single hierarchy, such as the one in SFAS 157, to reduce complexity and increase comparability.
Issue 9. Large	Q20 Do you agree with the provision	The Board observes that blockage

Issue	Question	Board's preliminary view
positions of a single financial instrument (blocks)	of SFAS 157 that a blockage adjustment should be prohibited for financial instruments when there is a price for the financial instrument in an active market (Level 1)? In addition, do you agree that this provision should apply as a principle to all levels of the hierarchy? Please provide a basis for your views.	factors are often meant to adjust for the illiquidity of a large position of financial instruments that might be held by an entity. However, the illiquidity of an individual instrument is not affected by the size of a position held by an entity. If a financial instrument is not traded in an active market and the illiquidity affects the price that a market participant would pay for an individual financial asset or require for an individual financial liability the fair value measurement should reflect that illiquidity. However, the adjustment should not consider the size of the position held by the entity. Therefore, the Board's preliminary view is that a blockage factor adjustment should be prohibited at all levels of the hierarchy.
Issue 10. Measuring fair value within the bid-ask spread	Q21 Do you agree that fair value measurements should be determined using the price within the bid-ask spread that is most representative of fair value in the circumstances, as prescribed by paragraph 31 of SFAS 157? Alternatively, do you believe that the guidance contained in IFRSs, which generally requires assets to be valued at the bid price and liabilities at the ask price, is more appropriate? Please explain the basis for your view. Q22 Should a pricing convention (such as mid-market pricing or bid price for assets and ask price for liabilities) be allowed even when another price within the bid-ask spread might be more representative of fair value? Why or why not? Q23 Should bid-ask pricing guidance apply to all levels of the hierarchy, including when the fair value measurement includes unobservable inputs?	Fair value measurements should be determined using the price within the bid-ask spread that is most representative of fair value in the circumstances, as provided in paragraph 31 of SFAS 157. Different entities in different markets carry out transactions at different points within the bid-ask spread. The Board has not reached a preliminary view on whether it is appropriate to use mid-market pricing or another pricing convention as a practical expedient for fair value measurements within a bid-ask spread, even if the pricing convention is applied on a consistent basis. The Board also has not reached a preliminary view on whether bid-ask spread guidance should apply only when bid and ask prices are observable in a market or whether the concept should apply more broadly to fair value measurements in all levels of the hierarchy.

Issue	Question	Board's preliminary view
	Why or why not?	
Issue 11. Disclosures	Q24 Do the disclosure requirements of SFAS 157 provide sufficient information? If not, what additional disclosures do you believe would be helpful to users and why? Alternatively, are there disclosures required by SFAS 157 that you believe are excessive or not beneficial when considered in conjunction with other disclosures required by IFRSs? Please provide a basis for your view.	The Board will consider the disclosure requirements in SFAS 157 in conjunction with the disclosures required by other IFRSs when developing an exposure draft. The Board sought views on whether the dislosures in SFAS 157 are sufficient, or whether additional disclosures might be necessary. The Board also sought feedback on whether the disclosures in SFAS 157 are excessive when considered with the disclosure requirements in current IFRSs.
Issue 12. Application guidance	Q25 Does the guidance in Appendices A and B of SFAS 157 sufficiently illustrate the standard's principles and provisions as they would apply under IFRSs? If not, please specify what additional guidance you believe is needed and why. Q26 Does the guidance in Appendices A and B of SFAS 157 sufficiently illustrate the standard's principles and provisions as they would apply in emerging or developing markets? If not, please specify what additional guidance you believe is needed and the most effective way to provide this guidance (for example, through additional implementation guidance or through focused education efforts)?	IFRSs require assets and liabilities to be measured at fair value in situations in which US GAAP does not. Therefore, addional application guidance might be necessary to illustrate how the provisions of a standard on fair value measurements would be applied under IFRSs. The Board sought views from respondents on what additional application guidance might be needed. Furthermore, the Board believes the principles established should apply to all fair value measurements in all jurisdictions. However, it acknowledges that entities in emerging and developing economies might need additional guidance in order to apply the requirements of a fair value measurements standard. Such guidance could be provided through educational outreach or through additional implementation guidance that would accompany the final standard. The Board sought suggestions from respondents on how best to address the needs of entities in emerging and developing economies.
Issue 13. Other matters	Q27 Please provide comments on any other matters raised by the discussion paper.	The Board sought suggestions or feedback on any other matters relating to the discussion paper or the fair value measurement project.