A F E P

Association Française des Entreprises Privées

IASB
30 Cannon Street
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Paris, September 25, 2009

Re: *Exposure Draft on Fair Value Measurement*

We welcome the opportunity to comment on the Exposure Draft on Fair Value Measurement.

We understand that the IASB is attempting to define how fair value should be measured, independently from whether it should be used in financial reporting. After the discussions we have had in commenting the IASB DP, and the on-going thinking in monitoring the Board's deliberations in preparation of the ED, we do not think that this approach is the right approach. The main objective of *any* IFRS is to improve the quality and relevance of financial reporting. The objective of the forthcoming IFRS is, as we understand it, to ensure that financial reporting can benefit from initial and subsequent market-based measurements consistent with a clear measurement objective and comparable across entities. Therefore, each and every attribute that potentially characterises a market-based measurement attribute should be assessed from a financial reporting perspective, not on the basis of whether it characterises "fair value". Such a detailed assessment should help characterise the IFRS market-based measurement attribute. Whether this attribute is fair value should be part of the conclusion and is of no great significance, in our view.

Having adopted the above described approach to the proposals presented in the ED, we have concluded the following:

- the definition of the IFRS market-based measurement attribute should refer to the "price" of a transaction on the entity's "entry" market;

- the IFRS market-based measurement attribute should be consistent with the entity's premise, whether "in-exchange" or "in-use";

- the IFRS market-based measurement should not reflect changes in non-performance risk in the valuation of liabilities;

- transaction prices should be deemed the best market-based measurement for assets and liabilities at inception, except when there is objective evidence to the contrary or when transactions are not concluded at arm's length;

- the guidance on how to determine fair value in inactive markets sounds circular; while it is highly probable that transaction prices reflect distressed sales and therefore should not be assessed as relevant bases for valuation, using current market conditions (including the current liquidity premium) in modelling the fair value of assets provides a good estimate of the price the entity would obtain if it was forced to sell…

We have also quite strong reservations about the scope of the IFRS. The decisions made by the Board imply changes in the existing practice. We believe that any change in practice needs to undergo a full due process before the decision triggering the change is finalised. A full due process means that the Board explains every decision it makes. In the circumstances, the Board should consider every circumstance in which a "fair value" measurement is required or permitted and explain why and how fair value as defined in the proposed IFRS should apply.

In addition to these main comments, answers to the detailed questions of the invitation for comment are provided in the appendix.

Should you wish any supplementary comment or explanation, please do not hesitate to contact us.

ACTEO	AFEP	MEDEF
Patrice MARTEAU Chairman	**Alexandre TESSIER** Director General	**Agnès LEPINAY** Director of economic and financial affairs

Appendix to our letter on IASB Exposure Draft on Fair Value Measurements

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?

We do not agree with the definition of fair value proposed because we believe that it will not lead to relevant measurements in all circumstances where fair value, a market-based notion, could contribute to useful and meaningful financial reporting.

We would tend to agree with the Board that entry and exit prices are equal, if observed on the same market at the same time. Therefore the identification of the appropriate market where those prices are to be measured is paramount in the relevance and the meaningfulness of the measurement. We agree that the market be selected from the perspective of the entity (paragraph 9). In that context, we believe that the notions of "exit price" and "sale or transfer" transactions place an undue emphasis on the "exit market" for the entity. Such an emphasis is reinforced by the notion of "principal" market, i.e. the market on which the entity usually transacts.

We believe that the existing definition in IFRS is superior; while it is in many ways equivalent to the proposed definition, it does not put undue emphasis on the "exit market" for the entity.

In our answer to the DP "Fair value measurement" we had commented the following:

"We also see that in the vast majority of circumstances, the entry price has more relevance than the exit price. FAS 157.17 states that "in many cases, the transaction price will equal the exit price and therefore [in accordance with the definition proposed] represent the fair value of the asset or liability. We believe that that statement is flawed. In most circumstances, we believe, assets are acquired on markets different from the markets in which they are sold, and in many circumstances the assets are purchased in a different state from which they will be sold. This is indeed how entities add value for their customers. Hence in most cases entry price (transaction price) will differ from exit prices. In those cases, the use of exit prices would lead to profit recognition at inception, and, in our view, distorted performance measurement".

The existing IFRS definition focuses for assets on a transaction price (in which indeed the selling price is equal to the purchase price) and has the merit of introducing no bias on the identification of the relevant market. That definition could be supplemented by guidance on how to select the appropriate market where the market price has to be measured.

The appropriate market would be the entry market for assets:

- where the entity buys and sells (or would buy or sell) assets on the same market; in these circumstances, the outcome would be the same as required by the definition proposed,
- where the entity does not buy and sell (or would not buy or sell) assets on the same market, or does not buy and sell assets on the same market without transformation, the outcome would be different, and in our view, more relevant, as it would overcome the difficulty we highlighted in our earlier letter of comments.

We believe indeed that choosing fair value as a current measurement attribute should not lead to eliminating the earnings notion in the measurement of performance. This issue is to us of the utmost importance (please refer to our cover letter commenting on the DP "Fair value measurement").

In forming the above-expressed view, we are fully aware of the analysis contained in BC61-63. We however do not believe that the conclusions drawn in those paragraphs stem easily and without controversy of the proposed standard and related guidance. We need positive, clear guidance instead of bases for conclusions explaining that words in the standard are not intended to mean what they mean (such as it is OK to place the reporting entity in an exit premise because it does not prevent from putting the hypothetical market participant in an entry position…)

Were the bias of the reference to an exit market to remain, the scope of application of the final IFRS would have in our view to be severely restricted.

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 form 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?

As defined, we believe that the scope of application of the final IFRS would have to be severely restricted, much further than in the three cases mentioned above.

1- <u>The exceptions proposed by the Board</u>

We agree with the Board that fair value as referred to in IFRS 2 and in relation to reacquired rights in IFRS 3 is not aligned with the definition proposed by the Board for the reasons explained in BC 29.

We disagree with the decision made regarding financial liabilities with a demand feature. The exception proposed is one way not to deal with a long-standing concern and inconsistency in the Board's decisions. We believe that the IASB should analyse the issue in-depth and conclude to either apply fair value or designate the measurement attribute retained differently, explicating the rationale for a different measurement attribute.

2- <u>The exclusion of all liabilities</u>

We disagree with any liability – including quoted debt instruments- being scoped in the final IFRS for subsequent measurement. We indeed disagree with non-performance risk being reflected in the measurement of liabilities (please refer to our answer to the DP "Credit risk in liability measurement").

3- <u>How to deal with existing standards requiring or permitting "fair value" measurements</u>

The remaining areas of disagreement lie in the existing standards that today either require or permit fair value measurement. Both decisions made and the approach followed by the Board raise substantive concerns.

One substantive issue in the Board's project was to identify whether fair value as applied in practice today in compliance with existing standards was the same measurement as the Board's proposals call for. The assumption was that the new IFRS should not change any measurement in practice. In that context we were expecting a positive analysis of how standards are applied in practice today. We are aware that the Board has conducted a survey. The conclusions of that survey should be an integral part of the basis for conclusions (and not be vaguely mentioned only in BC 27). Instead of such an analysis, the Board has opted for an exception-based approach, i.e. identified the circumstances in which they believe the future standard should not apply. The Board hence assumes that fair value has been up to now applied in accordance with the proposals, although the Board is fully aware that it is not the case. Those decisions supplement the decision made by the Board to eliminate the measurement guidance included in IFRS 3 (appendix B16), first step taken by the Board to implement their proposals in a complete breach of due process.

We believe that proper analysis and debate need to take place prior to any application of the final standard in IFRS.

Furthermore we are of the view that fair value as defined in the proposed standard is unlikely to provide for relevant measurement of non financial assets and liabilities.

We therefore object to the application of the final standard in IAS 16, IAS 38, IAS 40, IAS 41 and IAS 36. We believe that its application to IFRS 3R needs to be revisited and restricted.

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?

We agree with the Board that the most advantageous market should prevail and believe that the accompanying paragraphs (9-11) are appropriate to avoid burdensome quests for various data and assumptions. We believe that referring to the principal market emphasises the "exit" bias included in the definition.

We wish however to formulate additional, important comments:

- we understand that a fair value measurement is intended to be a measurement, "*at the measurement date*" (paragraph 1)*;*

- We therefore disagree with paragraph 12, i.e. That the entity does not need to have the ability to sell or transfer at the measurement date; fair value is intended to measure the economic benefits embodied in assets and liabilities *of* the entity and *to/from* the entity "in an orderly transaction between market participants at the measurement date";

- For the same reason, we disagree with BC35 and the Board's reasoning in rejecting blockage factors. Indeed a measurement of what the entity would perceive in a sale of *all its assets at the measurement date* should not ignore that the entity is holding a block of instruments.

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?

- We agree with paragraph 13, equivalent we believe of the existing IFRS fair value requirements.

- A standard on fair value measurement in IFRS should develop how to implement a market-based measurement likely to be useful in financial reporting, and not develop a definition and measurement requirements of fair value in abstracto. A measurement is useful in financial reporting if it helps best reflecting an entity's financial position at a reporting date. Market based assumptions are helpful to bring objectivity – and hence comparability - in a current measurement notion.

However using a market-based measurement for assets and liabilities of an entity should remain driven from the perspective of the entity. As a result the market participant notion should be restricted to market participants operating in the same sector as the entity and having the same overall strategy.

Measuring assets and liabilities independently from those objective and pervasive assumptions is in our view, at best useless, at worse misleading, when depicting an entity's financial position. The above justifies why we believe that non financial assets and liabilities should be scoped out of the proposed standard (see our response to question 2).

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 of 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?

We disagree with proposals (a) and (b). Our answer to question 5 follows the logic of our answer to question 4. It cannot be denied that fair value calls for assets to be measured on the basis of their highest and best use. The purpose however of an IFRS on "Fair value measurement" is to provide guidance on how to measure assets and liabilities at current market-based values that can prove useful in financial reporting. As we have already explained, those values have predictive value within an entity's financial position only if they are determined from the entity's perspective, within the context of its core operations and overall strategy. The values at which individual assets could be realised, item by item, are not indicative of the entity's future cash flows, if running the operations of the entity makes those assets necessary in their present state and use, or if selling those assets would generate higher costs to the entity than the increment in value between their market-based value in use (from the entity's perspective) and their fair value as determined in compliance with the proposed standard.

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 fo the assets assuming their current use and (b) the amount by which that value differs from the fair value of assets (i.e. 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 andBC55 of the Basis for Conclusions). Is the proposed guidance sufficient and appropriate? If not, why?

In the context of the Board's decision (with which we disagree), we agree with the guidance provided and believe it is necessary to ensure consistent implementation of the standard.

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 transaction 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 (i.e. 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?

We disagree that liabilities be measured on the basis of a transfer scenario in the entity's financial statements of the entity's bearing the liability. As the Board's current deliberations easily demonstrate (insurance contracts, liabilities…), the transfer scenario is not workable in the absence of a market. Except for financial instruments which are held for trading, fair value as defined in the proposed standard is not a measurement attribute likely to provide useful information for financial reporting purposes on a wide scale.

We also disagree with (b). We do not believe that the holder of an asset and the bearer of a liability are in the same economic circumstances regarding the asset or liability. Credit risk of the issuer has an impact on the collection of the asset whereas it does not diminish in any fashion the obligation to repay the liability. We do not believe that own credit risk should be reflected in the valuation of liabilities, even if those liabilities are quoted. We do not believe the issuer that repurchases its own debt realises a gain: if the credit spread has increased, the issuer is likely to be in a worse financial position as it was at the time it contracted the liability. Therefore the liability is likely to be repurchased while a new debt is being contracted, at a higher rate. However we believe it is interesting to note that the principle underpinning (b) calls for the asset to be measured on the entry market for the reporting entity.

We support the fulfilment value as described in c) as a way of fair valuing liabilities (without taking into account the entity's own credit risk).

APPLICATION TO LIABILITIES: NON-PERFORMANCE RISK AND RESTRICTIONS

Question 8

The exposure draft proposes that:

(a) The fair value of a liability reflects non-performance risk, i.e. the risk that an entity will not fulfil the obligation (see paragraphs 29 and 30 of the draft IFRS and paragraphs BC73 and BC74 of the Basis for Conclusions)

(b) The fair value of a liability is not affected by a restriction on an entity's ability to transfer the liability (see paragraph 31 of the draft IFRS and paragraph BC 75 of the Basis for Conclusions).

Are these proposals appropriate? Why or why not?

We disagree that fair value designed as a measurement attribute for financial reporting reflect non-performance risk. Please refer to our answer to the IASB DP "Credit Risk in the measurement of liabilities".

We also disagree that the fair value of a liability in financial reporting does not reflect restrictions on an entity's ability to transfer the liability. If the information is to have predictive value, restrictions to the entity's ability to transfer an instrument need to be taken into account. Otherwise financial reporting would not have predictive value from the entity's perspective or would not be a faithful depiction at the measurement date if those restrictions are to be lifted at some point in the future. The same applies, we believe, to financial assets.

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 situations would it not be appropriate and why?

The four cases detailed in paragraphs 36-37 are not of the same nature. In the first two cases where transactions are not at arm's length, we believe that gains and losses should be recognised at inception, if the asset or liability is to be fair valued at inception (we assume that fair value can be estimated reliably and that fair value would be the relevant attribute).

In the other cases we do not believe that there is better evidence of fair value than the transaction price, in the absence of objective evidence to the contrary. We therefore oppose to the recognition of any gain or loss at inception. In the case the transaction takes place in a different market from the market in which the entity would usually sell or transfer the instrument, we believe that the market in which the instrument is measured is not appropriate (please refer to our response to question 1).

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 fo Appendix B, paragraphs BC80-BC97 of the Basis for Conclusions and paragraphs IE10-IE21 and IE28-IE38 of the draft illustrative examples).

Is this proposed guidance appropriate and sufficient? Why or why not?

We believe that the guidance provided is both appropriate and sufficient. However we are concerned by the guidance on how to measure fair value of a financial asset in an inactive market. Indeed this guidance seems circular. While it is highly probable that transaction prices reflect distressed sales and therefore should not be assessed as relevant bases for valuation, using current market conditions (including the current liquidity premium) in modelling the fair value of assets provides a good estimate of the price the entity would obtain if it was forced to sell…We understand that such a guidance may be consistent with the definition of fair value.

Here again we believe that either there should be an exception to measurement of financial assets at fair value, or the IFRS guidance should be altered, for the sake of relevant financial reporting.

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).

Disclosures proposed mirror the additional disclosure requirements related to fair value measurement of financial assets and liabilities that have been issued by the IASB as an exposure draft amending IFRS 7 early this year.

We had commented on IFRS 7 proposals in 2008 and our views on this issue have not changed. Basically we understand and therefore agree with the disclosures proposed, except for:

- those requiring that the portion of unrealised gains and losses recognised in P/L during the period be separately identified,
- detailed information relative to fair value measurements of instruments carried at amortised cost. We observe that upon finalisation of last IFRS 7 amendment, the IASB has decided against including that supplementary information. We believe the same decision should apply in this circumstance.

We are opposed to the disclosures related to highest and best use and non-performance risk because we do not believe that these two items should be reported in the financial statements.

CONVERGENCE WITH US GAAP

Question 12

The exposure draft differs from 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 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?

Our answer to this question is encapsulated in our comments responding to the various questions dealing with the scope of the ED (we recommend it be limited to financial assets and liabilities), D1 gains and losses (we approve of the choice by the IASB), reference market (ditto), highest and best use (we believe the guidance is useful in the context of the Board's tentative decision).

Beyond these issues which are significant, we have no other comment to provide.

OTHER COMMENTS

Question 13

We do not have any further comment to provide.