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Mr Hans Hoogervorst
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Our ref MV/288

23 September 2017

Dear Mr Hoogervorst

Request for information

Post-implementation Review: *IFRS 13 Fair Value Measurement*

We appreciate the opportunity to comment on the Request for Information Post-implementation Review: IFRS 13 Fair Value Measurement (RFI). We have consulted with, and this letter represents the views of, the KPMG network.

We believe that IFRS 13 generally provides appropriate principles-based guidance related to the measurement of fair value. We understand that the application of IFRS 13 requires significant use of judgment, especially where there is limited market data and valuation experts have different views as to how to address emerging issues. Accordingly, different applications may arise in practice. However, we believe overall that the guidance in IFRS 13 reduces complexity and improves consistency in the measurement of fair value, thereby enhancing the comparability of information in financial statements. We are not in favour of a standard prescribing a set of rules.

In responding to this RFI, for each issue that we highlight we have provided what we believe is sufficient information for the Board to assess its next steps: take no further steps; continue monitoring the implementation of IFRS 13; develop or facilitate the development of further guidance, such as education material; or revise IFRS 13. We have not sought to provide specific solutions to individual issues in all cases, which will emerge as part of any subsequent projects. We have highlighted several practical issues in response to Question 8, **Other matters.** We believe these can be addressed through education material, additional examples or the Annual Improvement Process, depending on the issues.

In compiling this response, we have sought to highlight practical issues that we believe can be actioned by the Board in the short to medium term through targeted projects. We also encourage the Board to seek out practical solutions that provide relevant and

useful information, but which also increase consistency in the application of the standard and reduce the cost of preparing financial information.

This covering letter discusses the major areas that we believe require further consideration by the Board. Our points are discussed in more depth in the Appendix, in which we answer the specific questions asked in the RFI.

We support the Board's initiative to revisit and rethink some of the disclosure requirements. We generally believe that the disclosures required for Level 3 fair value measurements provide useful information to the users of financial statements. However, we recognise that if disclosure requirements require excessive volume or detail, this creates a risk of useful information being obscured and the burdens on preparers being unduly onerous. Therefore, if the IASB decides to enhance the required disclosures (for example, disclosures related to the valuation approaches and inputs used in Level 3 fair value measurements), we suggest not increasing the volume of disclosures but instead focusing on improving the usefulness of the current disclosures. We also encourage the Board to consider the specific question on fair value measurement disclosures in the broader context of the Board's Disclosure Initiative. In particular, the Board should obtain a better understanding of the information that users value. This should be at the heart of determining which disclosures are relevant and why.

We believe that the extent and level of aggregation of the Level 3 disclosures depend on the specific facts and circumstances. We believe that guidance on the factors to consider in determining the appropriate level of aggregation and illustrative examples would be very helpful and increase consistency and usefulness.

We believe that when considering the fair value of an investment that conveys control / joint control / significant influence from market participants' perspectives, fair value should reflect how much a market participant would be willing to pay for the entire investment, rather than how much a market participant would pay for each individual share in separate transactions. We believe the Board should make it clear that the whole investment in a subsidiary, joint venture or associate is the unit of account and that it should be measured accordingly.

Although in most cases the current use of a non-financial asset is also its highest and best use, when it is not, challenges may arise when determining the fair value: We believe additional guidance should be provided.

We welcome the proposal to prepare education material in areas where measuring fair value is challenging, such as biological assets and unquoted equity instruments. We believe that education material for measuring the fair value of insurance contracts within the scope of IFRS 17 *Insurance Contracts* would be helpful, especially in applying the fair value transition approach under that Standard.

We believe that it is very important to maintain convergence with US GAAP regarding fair value measurement. In our view, maintaining convergence aids comparability and avoids potential confusion and unnecessary costs that would otherwise be incurred by preparers and users in identifying and assessing GAAP differences.

We have consulted with, and this letter represents the views of, the KPMG network.

Please contact Mark Vaessen +44 (0)20 7694 8871 or Wolfgang Laubach +49 30 2068-4663 if you wish to discuss any of the issues raised in this letter.

Yours sincerely

KPMG IFRG Limited

KPMG IFRG Limited

Appendix: Questions in the RFI

Question 1 – Your background and experience

KPMG is a global network of professional firms providing audit, tax and advisory services. We have extensive experience in the interpretation and application of IFRS 13 in our roles as auditors and advisors.

Question 1B—Your experience			
How extensive is your experience in relation to the measurement of the following items at fair value (including the measurement of their recoverable amount on the basis of fair value less costs of disposal)?			
Type of item	**The extent of your experience with fair value measurements**		
	Little	**Some**	**Much**
Property, plant and equipment			X
Intangible assets including goodwill			X
Investment properties			X
Biological assets		X	
Investments in subsidiaries, joint ventures or associates			X
Financial instruments			X
Other (please specify which)			

Our experience in measuring the fair values of biological assets varies from region to region.

Question 2 – Fair value measurement disclosures

a) *How useful do you find the information provided about Level 3 fair value measurements? Please comment on what specific information is useful, and why.*

We generally believe that the disclosures required for Level 3 fair value measurements provide useful information to users of financial statements.

However, we hear from preparers of financial statements that they find the current disclosure requirements excessive and in some cases unduly onerous, especially for preparers in the financial sector. These entities think that the costs outweigh the benefits, particularly with respect to the sensitivity analysis required per IFRS 13.93(h)(i) and (ii) and the reconciliation from the opening balances to the closing

balances required per IFRS 13.93(e) for Level 3 measurement. We support the Board's initiative to revisit and rethink some of the disclosure requirements.

Based on discussions with some users, the most useful information for them appears to be the quantitative and qualitative information on the significant unobservable inputs and the valuation techniques applied. This information enables users to evaluate the reasonableness of the techniques and assumptions used by management. This information is meaningful to users when it is sufficiently disaggregated (refer to question 2(b) for our comment on the aggregation).

b) In your experience of Level 3 fair value measurements:

(i) *how do aggregation and generic disclosure affect the usefulness of the resulting information? Please provide examples to illustrate your response.*

The extent and level of the aggregation of disclosures of quantitative information about the significant unobservable inputs used in fair value measurements will affect the usefulness of the information. Disclosures that are aggregated too highly can obscure important information about the risks associated with the fair value measurements. However, disclosures that provide excessive detail can be burdensome and may not provide meaningful information to users of the financial statements.

IFRS 13.92(c) states that consideration should be given to how much aggregation or disaggregation should be undertaken to meet the objective described in paragraph 91. IFRS 13.94 provides high level guidance on the determination of appropriate classes of assets and liabilities and BC 193 states that "…the boards concluded that the meaningfulness of the disclosure of quantitative information used in Level 3 fair value measurements will depend on an entity's determination of its asset and liability classes". We believe that additional guidance would help in applying judgment to determine the appropriate classes of assets and liabilities, which could include the factors to consider in making the determination and illustrative examples.

Aggregation may impact the width of the range of unobservable inputs presented. For example, assume that a class of assets includes 100 derivatives, 90 of which are valued using a volatility input of 20% per annum, with the remaining 10 valued using a volatility input of 50% per annum. If the entity only discloses the range of volatilities used (20%–50%), it would not indicate that the significant majority of the inputs used are at the low end of the range.

In this case, the entity should consider whether the disclosure of unobservable inputs should be disaggregated to a level of two smaller classes, one with 90 derivatives and one with 10. If the entity determines that disclosure at the level

of the class that includes all 100 derivatives is appropriate, then because the range of values for an unobservable input is wide, the entity should consider disclosing the weighted average of the inputs. This is because disclosing information about a range without an average provides no information about how the inputs used are distributed within that range.

(ii) are you aware of any other factors (either within or outside IFRS requirements) affecting the usefulness of the information? Please provide examples to illustrate your response.

IFRS 13.93(f) requires disclosure of unrealised gains and losses relating to those assets and liabilities held at the end of the reporting period that are included in profit or loss for the period. BC 198 describes why the IASB has decided to use the terms “realised” and “unrealised”. However, the standard does not define what “realised” means. We believe that it should be defined. BC198 states that “unrealised” refers to gains and losses related to changes in the fair value of an asset or liability that is held by the entity at the reporting date; however, some gains or losses related to such items may be received or paid in cash and those receipts or payments may occur in a period after a gain or loss was included in profit or loss.

Even in the absence of a clear definition of terms, the determination of the amount of unrealised gains or losses included in profit or loss may be straightforward for certain instruments subject to recurring fair value measurements categorised within Level 3 of the fair value hierarchy. However, identifying the change in unrealised gains or losses included in profit or loss is difficult for those instruments that are subject to periodic cash settlements. In many situations, periodic cash settlements constitute both a realisation of gains or losses arising in prior periods (i.e. settlement of the initial carrying amount) and a realisation of gains or losses arising in the current period. Furthermore, we understand that there is diversity in practice regarding the manner in which unrealised gains and losses are determined when interim cash flows occur.

If the IASB decides to keep the disclosure requirement to be consistent with US GAAP, we believe that additional guidance is needed to help distinguish between “realised” versus “unrealised” gains or losses. It would be important to define what “realised” means.

(iii) do you have suggestions on how to prevent such factors from reducing the usefulness of the information provided?

Please refer to our responses to items (i) and (ii) above.

(i) It would be useful to add guidance to help in applying judgment to determine the appropriate level of aggregation such as factors to consider and illustrative examples. This would increase consistency.
Also the addition of an explicit requirement to disclose the distribution (or weighted average) for unobservable inputs for which the range used is wide would be helpful.

(ii) Defining "realised" and providing additional guidance on the determination of unrealised gains or losses would help to increase comparability.

If the IASB decides to enhance the disclosures related to valuation approaches and inputs used in Level 3 fair value measurements, we suggest to focus on improving the usefulness of the current disclosures.

c) *Which Level 3 fair value measurement disclosures are the most costly to prepare? Please explain.*

We believe that preparers of financial statements are best positioned to respond to this question.

d) Is there information about fair value measurements that you think would be useful and that IFRS 13 does not require entities to disclose? If yes, please explain what that information is and why you think it would be useful. Please provide any examples of disclosure of such information.

We do not have additional comments.

Question 3 –Prioritising Level 1 inputs or the unit of account

a) Please share your experience to help us assess:
(i) how common it is for quoted investments in subsidiaries, joint ventures and associates, and quoted cash-generating units to be measured at fair value (please support your comments with examples).

Although we have not done an outreach, based on our experience we believe that there are relatively few instances where quoted investments in subsidiaries, joint ventures or associates are measured at fair value and relatively few instances where the recoverable amount of a quoted cash-generating unit is measured at fair value for the purpose of impairment testing according to IAS 36.

However, the issue may arise more frequently in the case of investment companies (e.g. private equity funds) holding a controlling stake in a listed company.

(ii) whether there are material differences between fair value amounts measured on the

basis of P×Q alone (when P is the quoted price for an individual instrument and Q is the quantity of financial instruments held) and fair value amounts measured using other valuation techniques. Please provide any examples, including quantitative information about the differences and reasons for the differences

There can be material differences, as the market for very thinly traded companies that only provide the minimum required information to the public investors might not reflect the internal knowledge that management and the majority investor(s) have.

Example: A private equity (PE) fund purchases a majority stake (85%) of a listed company from the prior investor (at a premium to the quoted price at the time). The PE fund continues to value the investee company at a premium (compared to PxQ) based on its internal valuation analysis. The company only provides the minimum required public disclosures to the 15% public shareholders, but the PE fund may have access to additional information through its controlling stake that may not be available to the public shareholders.

Another example is a situation where the buyer can realise synergies that would not necessarily be available to minority shareholders and so are not reflected in the price of individual shares. A third example is a market with less developed corporate governance standards where minority shareholders discount the share price because of concern about the majority investor potentially abusing its position.

(iii) if there are material differences between different measurements, which techniques are used in practice and why.

A controlling shareholder may value the investee company based on an internal valuation model that includes an income (DCF) and market approach that reflects its best estimate of the unit's likely future performance and potential synergies. The controlling shareholder considers the reasonableness of the results of its fair value estimate in the light of the PxQ value based on reported control premiums for similar companies and also qualitative discussions of the performance and outlook of the investee company.

b) The Board has undertaken work in this area in the past (see Appendix 3). Is there anything else relating to this area that you think the Board should consider?

We believe that the Board should make it clear that the whole investment in a subsidiary, joint venture or associate is the unit of account and that it should be measured accordingly. Therefore, the fair value estimate should reflect how much a market participant would be willing to pay for the entire investment that conveys control / joint control / significant influence, rather than how much a

market participant would pay for an individual share.

We believe that measuring the fair value of such an investment on the basis of the investment as a whole provides more relevant information to users of financial statements. Therefore, even for investments that comprise instruments quoted in an active market, an alternative to the PxQ value would be acceptable if a market participant would arrive at a different value when pricing the investment as a whole. Please refer to our comment letter from 15 January 2015 on ED 2014/4, *Measuring Quoted Investments in Subsidiaries, Joint Ventures and Associates at Fair Value*. We believe that the guidance in IFRS 13 should be clarified to allow a premium for control when relevant, even if individual shares are quoted in an active market.

Appendix 3 of the RFI describes previous work carried out by the Board in the context of the ED. The additional steps the Board should consider could be to expand its outreach and review of literature and studies to gain more understanding of how these investments are valued by market participants and how the premiums are supported. The Appraisal Foundation in the US has a working group on "*The Measurement and Application of Market Participant Acquisition Premiums*" which includes a useful discussion of relevant issues.

Question 4 – Application of highest and best use for non-financial assets

Please share your experience to help us assess:

a) whether the assessment of an asset's highest and best use is challenging, and why. Please provide examples to illustrate your response.

In most cases, the current use of an asset is also its highest and best use. Extensive research is generally not required to identify circumstances where the current use of the asset is not its highest and best use. IFRS 13.29 states that an asset's current use is presumed to be its highest and best use unless market or other factors suggest that a different use by market participants would maximise its value. This approach reduces the risk that other hypothetical uses are examined when not relevant.

However, when the highest and best use of a non-financial asset is not its current use, the following challenges may arise:

– Identification of the asset group within which the asset is used. This could be interpreted to include only assets to which the subject asset is inextricably linked, such as the land on which a building is built. Alternatively, this could be extended from the underlying asset beyond inextricably linked assets to an

underlying business with which the asset will be used.

- While an asset may be currently used in a given business, should an entity consider whether it could continue operating the wider asset group using a substitute asset? This could allow different potential highest and best uses to be considered for the substitute asset(s) and the other assets in the asset group. For example, a business may include a factory located in a high-cost location. It may be possible to sell the factory for re-development and transfer operations to a lower cost location. This would allow the development value of the land to be realised while retaining the value of the operations (subject to relocation costs).

b) whether the current uses of many assets are different from their highest and best use, and in which specific circumstances the two uses vary.

Cases in which an asset's current use is not its highest and best use are not common. Examples of circumstances where the highest and best use may be different from the current use include:

- A brand (or technology) acquired in a business combination that is actively used by the acquired company but which would be withdrawn by the buyer in order to strengthen their own pre-existing brand (or technology). This withdrawal is referred to as a defensive use of the intangible asset to contrast with active use of the asset by the acquired company prior to the acquisition. Historically, little or no value was typically assigned to defensive intangible assets, even if market participants might be expected to actively use them. However, IFRS 13 requires that defensive intangible assets be recognized at a value that reflects the asset's highest and best use based on market participant assumptions. Therefore if the in-use is the highest and best use by market participants, the acquirer should recognise and measure the trade name at its acquisition date on that basis.

- Land that is used as part of an entity's operating activities but which has a higher value for other purposes – for example, an inner city factory or land on which biological assets grow where the land value as a site for residential or commercial property development exceeds the business' operating value or if the business could be re-located to a lower-cost location with a limited effect on its operating value, as outlined above.

c) whether, when applying highest and best use to a group of assets and using the residual valuation method, the resulting measurement of individual assets in the group may be counter-intuitive. If so, please explain how this happens, and in which circumstances.

An issue arises as to whether the value of an asset based on its highest and

best use can be zero if the asset provides value based on its current use. For example, a building used as a factory built on a piece of land which could be sold for re-development would have a value of zero if it would be torn down to change the land use. There are several concerns with such an approach, including that if the re-development did not occur and operations continued to use the building, measurement of the building at zero would result in no ongoing depreciation despite its continued use.

The same issue arises for land on which biological assets grow. For example, assume a situation where the fair value of the land would be based on its highest and best use as a site for residential or commercial property development. Applying the residual method to measure the fair value of the biological assets (per IAS 41 *Agriculture*, paragraph 25) might result in a minimal or nil fair value for the biological asset. IFRS 13 does not provide guidance on how to allocate the combined fair value to the different components. If the residual method is used and the fair value of land is equal to the fair value of the combined assets, then the fair value of the biological asset is zero.

The issue was submitted to the IFRS Interpretations Committee in 2012 who noted that guidance on the application of the highest and best use concept in IFRS 13 does not explicitly address the accounting implications if those circumstances arise. The issue was referred to the IASB to provide clarification.

We believe that the issue should be considered by the IASB and guidance should be provided.

d) *whether there is diversity in practice relating to the application of the concept of highest and best use, and when and why this arises.*

We do not have such information.

Question 5 – Applying judgements required for fair value measurement

Please share your experience to help us assess the challenges in applying judgements when measuring fair value:

a) *is it challenging to assess whether a market for an asset or a liability is active? Why, or why not?*

Although there is a clear definition of “active market” in IFRS 13, the assessment of whether a market is active can be challenging in some circumstances, particularly in borderline cases. The current guidance in IFRS 13

is not sufficient in circumstances in which the volume or level of activity is not clearly indicative of an active market. This creates significant challenges in practice. Some stakeholders may be confused as to whether or how the indicators in IFRS 13.B37 can be used to determine that a market is or is not active.

Enforcement decisions of regulators in this area suggest that entities find it difficult to appropriately determine whether an active market exists. Therefore additional guidance in applying the definition would be helpful. This could take the form of examples, education material or others.

b) *is it challenging to assess whether an input is unobservable and significant to the entire measurement? Why, or why not?*

In many cases, it is not challenging to assess whether an input is observable by checking a reputable data source. However, the complexity arises when deciding which adjustments, if any, should be made to the observable input, which would bring the fair value measurement to a Level 3.

For example, in applying the guideline public company method, a technique under the market approach, to value a private company, an entity may use the enterprise value to earnings before interest, taxes, depreciation and amortisation ("EV/EBITDA") multiple at which a comparable company is trading to the EBITDA of the subject company. However, while the historic EBITDA multiple is observable, the significant judgments that should be applied in selecting/adjusting this multiple are less clear. For example:

- Have the correct comparable companies been selected?
- Do companies in the industry trade on multiples of EBITDA?
- Are historic or prospective EBITDA multiples more relevant? (Prospective multiples cannot be observed).
- What adjustments might be made to the comparable multiples – e.g. for differences in growth rates, profitability, risk, leverage, capex, etc.
- What normalisation adjustments to the comparable companies' earnings has the market implicitly applied and what adjustments would a market participant apply to those of the subject company?
- Which in a range of multiples for the comparable companies should the entity pick?

While an entity may conclude that a single market-derived multiple is appropriate, there are a number of significant judgments on which that conclusion is based. Therefore, the Board should consider whether measurements that involve significant judgment should be classified in Level 3 even where an observable market data point is used as a starting point.

Question 6 – Education

Question 6A—Education on measuring biological assets at fair value

Please describe your experience of measuring the fair value of biological assets:

a) *are any aspects of the measurement challenging? Why, or why not? Please provide examples to illustrate your response.*

We are aware of cases in which measuring the fair value of biological assets is challenging, such as the fair value measurement of fruit bunches growing on oil palm trees as well as other produce growing on bearer plants. This difficulty reflects in part the fact that such assets are typically not sold prior to harvest separate from the related bearer plants, so the value conclusions derived using other valuation techniques often cannot be compared to market prices. This difficulty increases the further from harvest is the valuation date.

Regarding oil palm trees, most planters agree that the formation of a fruit is between 3 to 4 months before its harvest (the stage commonly referred to as the formation of the 'black bunches'). Therefore, there may be less than 4 months of black bunches still hanging on the trees at every period end. Using the income approach, the fair value of the black bunches is calculated by discounting the forecast revenue derived from harvesting after period end, less the cost of harvesting and maintenance of the trees, less a profit margin. However, diversity exists with respect to the length of the forecast period. There are at least two approaches in practice:

– Approach A – the forecast period is limited to two to four weeks of revenue after period end: The proponents of this approach believe that a market participant would value certain bunches based on the oil content of the fruits as at the period end. The oil content in the black bunches is very low during the initial period. It will only spike up between two to four weeks before harvest. Hence, the forecast period should be limited to only two to four weeks of revenue after the period end. This will result in a lower fair value for the black bunches. An issue in applying this approach is ensuring that it values all the biological assets that a market participant would consider in pricing the assets, rather than a subset – e.g. mature fruit.

– Approach B – the forecast period incorporates three to four months of harvest after period end: The proponents of this approach believe that the fair value should incorporate the future yield of the black bunches and not just the content of oil of the fruits as at period end – i.e. incorporating its "capability to yield" in the model. Therefore, the forecast period should include three to four months of harvests subsequent to the period end. The proponents of this approach believe that it is more consistent with the requirements of IFRS 13 because it measures all the assets, not just the most mature bunches.

With regards to the reliability of measurement, based on our experience, the oil palm plantation industry is a very mature industry and sufficient data exists to support the forecasts described above. This data is also used for internal (operational) purposes.

Another area in which diversity exists in practice is the factoring of maintenance costs (primarily fertilizer costs) in the forecast. Unlike perennial crops, an oil palm tree continues to bear fruit throughout the year. It is therefore difficult to differentiate whether the maintenance costs directly contribute to the biological transformation of the fruit as at year end or to the trees. Diversity exists in practice. Some entities consider that these maintenance costs are not material and need not be factored into the valuation (based on the view that fertilizers applied currently will only benefit future fruit) while others factor the full maintenance costs into the valuation model.

Furthermore, we have encountered a number of issues on the application of IAS 41.30 related to the presumption that fair value can be measured reliably. A number of entities argue that the presumption can be rebutted on initial recognition, on the basis that quoted prices are not available and alternative fair value measurement is clearly unreliable. The IFRIC received a request on the subject and issued an agenda decision concluding that the use of different supportable assumptions is not evidence of significant practical difficulties, and therefore concluded that it would not result in and of itself in a conclusion that fair value measurements are clearly unreliable. We believe that the wording in IAS 41.BC4C which refers to “significant practical difficulties” should be clarified. This paragraph does not clearly describe what constitutes significant practical difficulties.

b) what, if any, additional help would be useful in applying IFRS 13? In which areas?

We believe that education guidance on the following would be useful and reduce diversity in practice:

– Fair value measurement of fruit growing on bearer plants. We understand that detailed guidance cannot be provided because the fair value measurement is

based on facts and circumstances. However, illustrations of the application of suitable techniques would be helpful.

- Examples of when fair value is clearly unreliable and the biological asset can be measured at cost. This would include clarification of the meaning of "significant practical difficulties".

Question 6B—Education on measuring unquoted equity instruments at fair value

Please describe your experience of measuring the fair value of unquoted equity instruments:

a) in 2012, the IFRS Foundation Education Initiative published Unquoted equity instruments within the scope of IFRS 9 Financial Instruments. Have you used this education material? If so, how did this material help you to measure the fair value of unquoted equity instruments?

We find the education material useful as it contains examples of situations where available guidance is limited.

b) do you have questions not covered in unquoted equity instruments within the scope of IFRS 9 Financial Instruments? Do you think that additional help would be useful in applying the requirements? Why, or why not? Please provide examples to illustrate your response.

We believe that it would be useful to add more guidance in the section 'Transaction price paid for a similar instrument of an investee' on valuation of equity securities in complex capital structures where multiple classes of securities exist. In particular, useful guidance in this area includes the methods of allocating the equity value to the multiple classes of securities and the considerations affecting the selection of the appropriate method; example 4 refers to an adjustment to reflect differences between preferred and ordinary shares (e.g. adjustment to reflect the priority of the preferred shares upon liquidation). This is an important difference between different classes of ordinary and preferred shares and the methods used to quantify the value effect of such differences are not well developed.

Question 7 –Effects and convergence

a) Please share your experience of the overall effect of IFRS 13:

(i) what effect did IFRS 13 have on users' ability to assess future cash flows? If you are a user of financial statements, please provide us with examples of how you use information provided by entities about their fair value measurements and any

adjustments you make to the measurements.

(ii) what effect did IFRS 13 have on comparability of fair value measurements between different reporting periods for an individual entity and between different entities in the same reporting period?

(iii) what effect did IFRS 13 have on compliance costs; specifically, has the application of any area of IFRS 13 caused considerable costs to stakeholders and why?

Users and preparers of financial statements are best positioned to respond to these questions.

b) Please comment on how you are affected by the fact that the requirements for fair value measurement in IFRS 13 are converged with US GAAP; and please comment on how important it is to maintain that convergence.

We believe that it is very important to maintain convergence with US GAAP regarding fair value measurement. In our view, maintaining convergence aids comparability and avoids potential confusion and unnecessary costs that would otherwise be incurred by preparers and users in identifying and assessing GAAP differences. In addition, practical guidance on applying fair value measurement principles has developed more quickly in the US for many items. The ability to apply these principles has facilitated fair value measurement for IFRS.

Although maintaining convergence is important, this should not prevent the IASB from making some amendments to clarify the standard or from providing some guidance to increase the quality of the disclosure requirements.

Question 8 – Other matters

Should the Board be aware of any other matters as it performs the PIR of IFRS 13? If so, please explain why and provide examples to illustrate your response.

Education on measuring fair value of insurance contracts

IFRS 17 *Insurance Contracts* requires or permits the determination of the fair value of groups of insurance contracts applying IFRS 13 in certain instances (e.g. when applying the fair value approach on transition to IFRS 17). While some insurers may already have experience determining the fair value of insurance contracts under IFRS 13 (e.g. when applying business combination accounting), measuring the fair value of insurance contracts under IFRS 17 is expected to be more common and may result in practical issues arising during the implementation period of IFRS 17. Some concerns

around determining the fair value of insurance contracts have already been raised during the IFRS 17 drafting process.

Given the complexity inherent in such a process and the new areas where a fair value measurement is required or permissible, this area would benefit from the support of education materials that address the concerns raised when applying a fair value measurement under IFRS 13 for insurance contracts measured applying IFRS 17.

Tax considerations in determining fair value

Fair value is defined in IFRS 13 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*. Accordingly, fair value takes into account future income taxes that a market participant purchasing the asset (or assuming the liability) would be expected to pay (or to receive), without regard to an entity's specific tax situation. This is specifically mentioned in IAS 41.BC6.

IFRS 13 does not address how taxation affects the fair value measurement. In practice, it is not clear how a market perspective should factor the tax considerations in determining the fair value (for example, in determining FVLCD under IAS 36). This gives rise to a number of questions, - e.g. what valuation hypothesis should be used, what assumptions should be made about market participants and their tax basis. We believe that additional guidance on tax considerations in determining fair value should be provided considering the prevalence of the issue.

Application issues that could warrant additional guidance or minor amendments

We believe that IFRS 13 provides appropriate principles-based guidance related to the measurement of fair value. We understand that the application of IFRS 13 requires significant use of judgment and different interpretations may arise. We would not be in favour of a standard prescribing a set of rules. However, we highlight a few practical issues in this section. We believe these can be addressed through education material, additional examples or the Annual Improvements Process, depending on the issues. If the Board decides to go ahead with such modifications, we would be pleased to provide additional details.

Day one gain/loss recognition: misunderstanding of the guidance on day one differences (IAS 39.AG64 vs IAS 39.AG76 / IFRS 9.B5.1.1 vs. IFRS 9.B5.1.2A)

We want to repeat a comment we included in our comment letter on the ED in September 2009, as we believe there remains some confusion in practice on how to apply IAS 39 AG64 vs IAS 39 AG76 (reproduced as IFRS 9.B5.1.1 vs IFRS 9.B5.1.2A), as amended by IFRS 13.

Sometimes, as part of a single contract, an entity acquires or issues a financial instrument and also enters into another transaction, and the contract price paid or received includes consideration for the 'other' transaction. Similarly, a single transaction may have more than one element and the total transaction price relates to all the elements. For example, an interest-free loan from a parent to a subsidiary may include a market-rate loan and an equity contribution from the parent. The issue may also arise in other cases where an entity provides or receives cheap "off market" funding.

We note that there is some tension between the wording in paragraphs AG64 and AG76 of IAS 39 regarding determining the accounting for such transactions. The wording of paragraph AG64 suggests that the fair value of the financial instrument should be determined separately using a valuation technique and this will be different from the total transaction price paid or received. However, paragraph AG76 could be read as prohibiting, in such a case, measuring the financial instrument upon initial recognition at an amount other than the total transaction price, unless the criteria in paragraph AG76 for recognition of a 'day 1' gain or loss are met.

We believe that this reading of paragraph AG76 in the context of paragraph AG64 is not appropriate and the Board's discussion in paragraph BC104 of IAS 39 (IFRS 9.BCZ5.10) supports our view. As explained in paragraph BC104, the principle behind paragraph AG76 is to prohibit recognition of 'day 1' gains or losses unless there is reasonable assurance that fair value is different from the transaction price. We believe that such reasonable assurance normally would exist if the entity knows that the transaction price includes consideration for something 'other' in addition to the financial instrument. We note that IFRS 13.B4(c) mentions that the fair value of an item at initial recognition and the transaction price may differ if the unit of account is different. However, it does not provide any guidance around the application of IAS 39.AG76.

We recommend that the Board should, as part of the PIR project, clarify the interaction between paragraphs AG64 and AG76 and IAS 39 (and *IFRS 9.B5.1.1 vs. IFRS 9.B5.1.2A)* to explain that even in the absence of a fair value determined based on fully observable inputs, paragraph AG76 would not preclude recognising a financial instrument at its fair value, which is different from the transaction price when the transaction price includes consideration for something 'other' in addition to the financial instrument.

Inconsistency in the guidance on bid and ask prices

The guidance in IFRS 13.70 indicates that the price within the bid-ask spread that is most representative of fair value in the circumstances shall be used to measure fair value. IFRS 13.71 provides a practical expedient stating that IFRS does not preclude the use of mid-market pricing or other pricing conventions that are used by market

participants. This guidance creates some ambiguity with regard to the application of the practical expedient – whether the price within the bid-ask spread is subject to the requirement in IFRS 13.70 of being the most representative of fair value.

We believe that the use of mid-market prices is subject to the condition that the mid-market price provides a reasonable approximation of fair value. Therefore, an entity should not ignore available evidence that a mid-market price does not result in a price that is representative of fair value. For example, if the bid-ask spread is particularly wide, or if the applicable bid-ask spread has widened significantly for a specific asset or liability, then a mid-market price may not be representative of fair value.

However, we believe there are different interpretations in practice. Therefore, we believe that the guidance in IFRS 13.70–71 should be clarified in this respect.

Illustrative Example 7 does not represent reality

Example 7 illustrates when the price in a transaction involving a derivative instrument might (or might not) equal the fair value of the instrument at initial recognition. However, a problem with Illustrative Example 7 is that it illustrates a hypothetical transaction that is an exit transaction and which does not occur in practice (and is usually not possible owing to legal constraints). The exit transaction is described as a “transfer [of] its rights and obligations under the swap”. Such instruments cannot simply be sold or transferred as envisaged in Illustrative Example 7 because this would involve changing the credit risk of the instrument, because the credit risk of the original counterparty (‘seller’) would generally be different from the credit risk of the new counterparty (‘buyer’), which affects the position of the other original counterparty and hence would require its consent. Such consent is difficult to obtain. In addition, this would involve additional payments as consideration for the change in credit risk arising from the change in the counterparty. This explains why in practice the exit transaction would usually be cancelling the contract, which is a different kind of exit transaction than IFRS 13 requires to be assumed in measuring fair value. Related to this problem is the fact that the dealer counterparty would be unlikely to agree to a cancellation without forcing the retail counterparty to pay at least the bid/ask spread and maybe even a penalty. Indeed, by stating that the transaction price (an entry price) of zero represents the fair value (an exit price) of the swap to Entity A, Example 7 seems to suggest that it is appropriate to mark to the opposite side of the bid-ask spread (i.e. a long position at ask, a short position at bid) than that explicitly permitted by IFRS 13.70 and to regard the whole of the bid-ask spread as a transaction cost that would be incurred on exiting the position.

We suggest that the Board considers amending example 7 to reflect actual transactions that occur in practice and its analysis of application of the guidance on bid-ask spreads.