BUSINESSEUROPE

22.7/1/1

Jon Nelson
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
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9 May 2007

Dear Sir,

RE: <u>DISCUSSION PAPER: FAIR VALUE MEASUREMENTS</u>

BUSINESSEUROPE welcomes the opportunity to comment on the Discussion Paper issued by the IASB on Fair Value Measurements.

We support the work for clarification in the form of principle-based guidance to measure fair value. However, we believe there is a need for practical guidance, at the level of the standards rather than in the specific proposed standard.

We also support work intended at developing guidance on how to measure the different elements contained in the notion of fair value. But we advocate the use of precise and descriptive wordings that would be applicable to the different situations where fair value is the measurement base. We therefore recommend that the term "fair value" be replaced by the term "current value", as it is more descriptive of revaluation. Current value can be combined to other words in order to identify precisely the measurement: current exit price and current entry price, current market based and current entity-specific values.

Nevertheless we would like to stress again our opposition to an extension of the use of fair values outside the area of financial markets traded on active markets, where fair value measurement may be appropriate but only in certain specific circumstances. We believe that even if analysts may show interest in "up to date" values, they are not necessarily interested in giving priority to mark to modelled values over entity-specific values or have market related fair values be systematically recognised in the primary financial statements.

The Discussion Paper discloses the preliminary views on the principal issues contained in SFAS 157 but doesn't explain the reason why a study originally designed for financial instruments, has been extended to all assets and liabilities that, in existing or future standards, are or will be measured at fair value. This absence of justification is a

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weakness which consequences are detailed in our answers below and which might not allow the desirable objective of consistency throughout the standards to be fulfilled.

In our view, measurement of fair value based on exit price is seldom relevant. Relevance of an exit price may verify for some financial instruments traded in deep and liquid markets only and only when the unit of account does not vary. But other financial instruments and non-financial assets and liabilities are generally not acquired and exchanged on the same markets, in the same state and in deep and liquid markets. We therefore strongly believe that exit price is not the relevant measurement of current value in most instances.

Overall, BUSINESSEUROPE is very concerned that the IASB would at this stage of the measurement debate decide how to measure fair value, once and for all, on a single measurement basis. In our view, performance measurement and what financial statements are deemed to portray need to be fully debated with extensive participation of all stakeholders. Many respondents to the discussion paper on the objectives of financial reporting have stressed the need to define what should be the overriding objective of financial reporting and hence of recognition and measurement decisions.

As a result, BUSINESSEUROPE recommends that the IASB:

- work on a principle based guidance on current value, identifying all forms of them, market based and entity-specific, exit and entry price,
- leave practical guidance under development in individual standards,
- commit not to alter existing practice before appropriate performance measurement objectives have been fully debated and set,
- fully justify future choices made in discussion papers in terms of performance measurement objectives, until the full debate is over.

We enclose detailed comments in answer to the questions raised in the invitation to comment in the appendix attached to this letter.

Should you wish to comment on the above further, please do not hesitate to contact us.

Yours sincerely,

J. Chau

Jérôme P. Chauvin
Director, Legal Affairs Department

BUSINESSEUROPE

Appendix to BUSINESSEUROPE comment letter on the IASB discussion paper on Fair value measurements

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

Question 1: 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?

BUSINESSEUROPE supports the goal of clarifying what is fair value on a consistent basis. The term fair value is used throughout the IFRSs with different outcomes in the measurement and we believe that rationalization of the concept and guidance for its application would be beneficial to the quality of financial statements and their comparability in particular.

Nevertheless, we do not support the path taken to reach this goal. We believe that fair value should be dealt with in the following order:

1. Define precisely the characteristics of information that should be presented in financial reporting, the objective of financial reporting;
2. Include and define fair value, if needed, in the conceptual framework as a measurement base (see §100 of the framework);
3. Develop in the fair value standard the circumstances under which fair value should be the applicable measurement basis and adequate principle-based guidance in order to prevent any misinterpretation;
4. Add in the different IFRSs where fair value is referred to, practical guidance related to the measurement of the specific items dealt with in the standard.

We believe that point 2 can only be achieved once the question of the objective of financial reporting has been set. The questions of

- whether (and where) we want the entity's performance be measured in terms of over- or under-performing the market and/ or whether we want performance measurement help primarily understand the entity's future cash-flows;
- whether (and where) we want market prices to have the priority, even though there would not be any existing active market or the entity's fully disclosed strategy would stand against any disposal scenario;
- when profit ought to be recognised

are central in the definition of fair value.

We also believe that point 3 can only be achieved after a thorough analysis of the attributes of the elements that are under the scope of the different definitions of fair value currently existing in the IFRSs.

As demonstrated by the purpose of the project, there are different ways in the current IFRSs for valuing fair value. This matter of fact is of the highest interest to try to determine the characteristics of the different elements qualifying for fair value. It is also our clear understanding that the IFRS standard on how to measure fair value will command whatever extensions of fair value measurement the two Boards – IASB and FASB – may decide in the future. It is therefore of the utmost importance that a measurement objective not be decided once and for all before the appropriate debate has taken place; it is also of the utmost importance that every form of fair value measurement be subject for adequate guidance so that the consistency objective – which fully justifies this project – has a chance of being fulfilled in all circumstances.

Question 2: Is there fair value measurement guidance in IFRSs that you believe is preferable to the provisions of SFAS 157? If so, please explain.

IFRS existing guidance is provided in different standards, a choice that we support. Indeed as already mentioned we believe that practical guidance ought to be provided in each standard permitting or requiring fair value measurement. However we acknowledge that greater consistency among standards and with well defined measurement objectives calls for a set of principles with which each of the detailed pieces of guidance would comply.

For example, we believe that guidance provided in IFRS 3 is rather practical and we recommend that such level of guidance be provided in each standard.

Issue 2: Differences between the definitions of fair value in SFAS 157 and in IFRSs

Question 3: 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?

BUSINESSEUROPE does not support the idea that an exit price would be relevant to all the assets and liabilities that qualify for fair value measurement.

Such an assertion would distort the representation of the transaction from the real world economy in some situations. We disagree with the assumption made in SFAS 157 that most often an exit price equals an entry price, for the following reasons:

- exit and entry price will equal only on quite deep and liquid markets, in which an equilibrium price can be met, or in transactions in which buyer and seller can deal with each other directly, without any intermediary,

- more importantly, most non financial assets are bought and sold on different markets, and sold in a different state from which they were first acquired. Most liabilities, both financial and non-financial, are settled and for most of them there is no market in which they could be transferred to some third party. Finally, financial assets arising from a manufacturing or servicing company or from banks banking books are not subject for any exchange transaction, except for some punctual portfolio disposal transactions. The reference to an exit price will therefore very rarely be consistent with the entity's business model, i.e. with its economic source of profit. In those circumstances, if and when revaluation would provide more relevant financial information, an entry price would in our view be the relevant measurement attribute. Therefore defining fair value as being a market based exit price in all circumstances would trigger profit recognition in contradiction, most frequently, with the entity's economic drivers of profit, at times, in our view, when performance has not been generated yet in any way.

However there are situations when an exit price may be relevant to meet certain measurement objectives. For example, in an impairment test where the recoverable amount of the asset is to be compared to its carrying value, an exit notion should prevail. Also the performance of bank trading activities is best measured on the basis of an exit price.

As we see there is room for more than a current value measurement basis. All the more so that the items to which fair value can apply and how it should apply is not yet known. The invitation to comment notes in §7 that "amendments will need to be made to existing guidance.... amendments might change how fair value is measured in some standards and how the requirements are interpreted and applied". This highlights the fact that fair value might not be a single measurement base but might be made of different values such as current entry price, current exit price, and current entity-specific value.

In addition to the above, we do not believe that measurement should be made from the perspective of a market participant. We believe financial reporting should be provided from the entity's perspective, consistently with the entity's fully disclosed operations and strategy, the entity being in interaction with the market.

Finally, we believe the entity should be regarded as being itself a regular, ordinary market participant, unless there is objective evidence that it is not so.

Question 4: 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.

We believe that an entry price is relevant to reflect current market based expectations for assets or liabilities that, according to the entity's business model, are not expected to be exchanged or transferred but that are going to be incorporated in the production process of the entity or that are to be settled in conformity with the contract from which they arise. The revenues of the entity will be derived from the utilisation of the assets or liabilities in conjunction with the process in which they are integrated to and not from a hypothetical transaction reflecting the market assessment of their value. In that case, the financial position of the entity is better shown with an entry price than with an exit price.

Question 5: 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.

Yes. We believe that fair value is a concept that embodies different values that would be better described with appropriate terminology such as "current exit price", "current entry price", "current entity-specific exit price", "current entity-specific entry price". Current value indeed is in our view more descriptive of revaluation.

Question 6: 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 IFRS 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.

As the DP correctly states (#16, 17), there are a number of entry price notions in current practice. Especially on initial recognition, if fair value is required it should in our view always be the entry price (see also FASB Concept Statement 7 par 7 and 27; as opposed to SFAS 157 par. 16 and SFAS 157 par C 51).

If the exit price is used as fair value on initial recognition, entities will frequently have to record a day one gain or loss. In the situations we have described in our answer to question 3, such profit recognition may contradict the entity's economic drivers of profit. For example, the purchase of a product to be transformed or transferred from the wholesale to the retail markets does not trigger profit to be gained from resale, at a time when the identification of a potential customer is still to come. This is counterintuitive as one would assume that the entity pays or receives the value it considers the “fair value” of the good, not incorporating yet the value its business is expected to add to the asset. In those circumstances, external users of the financial statements would be mislead by the performance presented by entities.

In current practice for example when an entity issues a bond it uses the entry price including transaction cost upon initial recognition (according to IAS 39.43).

Furthermore, the values used in financial reporting should reflect the purpose for which the entity uses the measured good. If for example the entity cannot be expected to sell an item but to use it in its operating cycle, the entity-specific value of the item would be replacement cost - or in other words entry value. On the other hand, if the entity is expected, in conformity with its business model, to sell an item, exit price would be appropriate.

Question 7: Do you agree with how the market participant view is articulated in SFAS 157? Why or why not?

Where a market does exist, the market participant notion is welcome as real market participants exist. Assumptions to be use in measurement would hence be more relevant.
But most of the time only highly hypothetical transactions are at stake, market participants being also hypothetical. Referring to such highly hypothetical transactions would put the entity at risk of not giving a true and fair view of the situation. Indeed assumptions in those cases are likely to be very subjective and be far less verifiable and relevant than the entity’s specific data.

As a consequence, we do not fully agree with how the view is articulated.

- The entity shall be considered as a valid market participant unless objective evidence proves against it. In other words, the entity’s assumptions should not be adjusted unless it is proven that it is not a valid participant.
- The expected usage of the asset or liability in conformity with the entity’s business model should be taken into account; otherwise the valuation would encompass transactions that will never meet the market.

We agree that hypothetical transaction be the basis for estimates when the transaction would be feasible (i.e. the market exists and the disposal/transfer transaction is consistent with the entity’s business model).

Question 8: Do you agree that 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?

Yes we do agree.

Question 9: 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?

Most financial and non financial liabilities are very rarely, if ever, traded. There is therefore no transfer market to refer to. Consistently with our comments above, we disagree that the reference in current measurement should be a transfer transaction. For this reason we believe the definition of current value for liabilities should be based on settlement. This also applies to quoted bonds. Indeed the choice an entity may make of repaying a quoted debt is in itself also a settlement scenario.

Question 10: 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?

BUSINESSEUROPE notes that in practice the valuation is made on the basis of the settlement, because IFRS do not call for valuations on the basis of a transfer scenario solely, except for “contingent liabilities” in IFRS 3.

Issue 3: Transaction price and fair value at initial recognition

Question 11: 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.

No. We believe it is not appropriate to use estimates when actual prices exist. Indeed the entity’s transaction price is likely to be the most reliable valuation of the asset or the liability, unless it can be demonstrated that the transaction has not taken place under normal market terms.

The only circumstances in which we believe transaction prices should not be used are those rare circumstances when performance measurement is best based on an exit price.

Question 12: 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.

No, we do not think that the provisions of FAS 157 would lead to a portfolio based valuation in an IAS 39 environment. IAS 39 always refers to a single financial instrument and we therefore think that the conclusion drawn in the DP – although theoretically possible – is unlikely.

Issue 4: Principal (or most advantageous) market

Question 13: 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?

Yes because at last this is the way the entity is most probably going to react in its economical environment.

We agree with the view of « rational economic behaviour » developed in paragraph C27 of Appendix C, Part 2, being consistent with normal profit motivations. Yes, indeed, entities' economic purpose is to optimise profit. Thus, referring to those markets on which the entity usually transacts, will be relevant, and even in our view increase the meaningfulness of the measurement and ensure greater reliability in predicting future cash-flows

Issue 5: Attributes specific to the asset or liability

Question 14: 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?

Yes, as long as the attributes embody all the consequences of the transaction for the entity.

Question 15: 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?

We believe the future standard needs to be more precise than SFAS 157 on this account. Transaction costs include both unavoidable costs (those costs that any market participant would incur to have access to the asset or the liability) and costs that arise because the entity wishes, for example, to be assisted by advisors in the transaction. If the IASB wishes to have the current value definition exempt from any form of transaction costs, then we believe any measurement should be made on the basis of the current value plus unavoidable transaction costs. However we note that those unavoidable transaction costs are very similar to the transportation costs which are given as an example of costs to be taken as part of fair value (costs incurred to access to a market).

Issue 6: Valuation of liabilities

Question 16: 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 strict answer to that question would, in our view, be yes, the fair value of a liability should include all the risks specific to that instrument which would include credit risk to the extent that it exists in the instrument (ie instrument specific not just general credit risk of the entity).

However we observe that the fair value of a liability is relevant to an entity's accounts only if the entity may re-purchase its own liability on the market, ie this would happen only when the entity has issued quoted debt. We also note that this fair value is not *a transfer value* and therefore not the amount that the entity would have to pay to transfer its liability to another party.

Moreover for most liabilities an entity has to bear, there is no existing market. For this reason we believe that the relevant current value for liabilities would be a settlement value, not a transfer value.

Issue 7: "In-use valuation premise" versus "value in use"

Question 17: 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?

It is clear that the two terms are different.

Value in use is based on last forecast approved by management and we acknowledge that is it not consistent with fair value as defined in the discussion Paper.

We believe that the entity business model should be the core of fair value and that the in-use valuation premise is not appropriate to all the situations, such as the impairment procedure described in IAS 36; if we were to replace value in use in IAS 36 by in-use valuation, this should follow the process of a revision and not a consequential amendment.

Issue 8: Fair value hierarchy

Question 18: Do you agree with the hierarchy in SFAS 157? If not, why?

We agree with level 1 of the hierarchy where the value of the asset or liability observed on an active and accessible market can be called fair market value.

But we would not reach the same conclusion with the other two levels of the hierarchy: in the absence of a market for an asset or liability, only entity-specific data specific to the asset or liability are observable (beyond general market data as interest rate or foreign currency rates, for example). In most instances (absence of a rather liquid market), we don't believe that level 2 observable similar inputs lead to relevant fair value measurement, unless widely used models are used (in particular the models used in pricing). We therefore believe that level 3 entity-specific inputs should in those cases have priority over level 2 type of valuations. In that respect, a clear wording should be found to help identifying the different situations, such as entity-specific current value and current market value.

The choice between a current entity-specific value and a current market value is to be discussed in another paper.

Question 19: 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?

The different levels in the hierarchy are clear.

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

Question 20: 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.

No. We believe that the impact on market price of the block is an important feature to capture and that is not because we are unable to develop a way to value the block that we should ignore it. Something that can be verified everyday on the market cannot be left aside on the ground that it would be too difficult to estimate. The fact is that a transfer price in real life most often if not always incorporates a blockage adjustment. PxQ is therefore not a faithful representation of the sale of a block of shares..

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

Question 21: 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.

Usually bid-ask spreads are seen as transaction costs on capital markets, as AG 70 of IAS 39 correctly assumes. Therefore we concur with current IFRS regulation to use ask prices (i.e. including transaction costs) on initial recognition (see IAS 39.43). Because this is the amount, the entity actually pays for the asset.

On the other hand bid-ask spreads are also a measure for capital market efficiency and liquidity. The higher the bid-ask spread the less efficient or liquid the market. In a market with high bid-ask spread and therefore low efficiency or low liquidity fair values become less reliable and to use mid-market prices would result in somewhat arbitrary measures. Again, this leads us to the conclusion that current IFRS is preferable over SFAS 157.

As the bid-ask spread as a measure for the efficiency and liquidity of a market is tightly linked to the existence of an active market we do not see how a bid-ask spread can be used for measures other than observable market prices. Or in other words: If no such market exist, the bid-ask spread will move towards infinity. For values other than level 1, we consequently do not see the necessity to use a bid-ask guidance for conceptual reasons. That does not, however, mean that in computed fair values transaction costs should be excluded. To the contrary, we think that transaction costs are even more relevant in such circumstances and should be included in the fair value computation.

Question 22: Should a pricing convention (such as mid-market pricing or bid price for assets and ask price for liabilities) be allowed when another price within the bid-ask spread might be more representative of fair value? Why or why not?

Yes. We believe that the transaction price should be used upon initial recognition. Usually this would be the ask price for assets (including transaction costs). If this is not the ask price for whatever reason, we deem this price more representative of current value.

Question 23: 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?

No. We do not think that bid-ask guidance should be used for unobservable inputs for conceptual reasons (see above).

Issue 11: Disclosures

Question 24: 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.

We think that the current methodology should be kept and improved: for financial instruments, we have disclosure requirements detailed in IFRS 7 and for other assets or liabilities we have the specific standards where the disclosure requirements are detailed. The disclosures grouped altogether in an "umbrella" standard would not be efficient enough because they would either be too detailed to capture all the aspects of the current values used in the standards for all the assets or liabilities or be too broad to capture the specificity of some assets or liabilities.

Issue 12: Application guidance

Question 25: 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?

Question 26: 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).

We recommend that examples are given in the guidance to illustrate the principles in application guidance (as stated in part 1, issue 12 Application guidance) rather than having detailed implementation guidance (as given in part 2, Appendix A) which seems more rules based.