Hong Kong Institute of
Certified Public Accountants
香港會計師公會

12 June 2009

To: Members of the Hong Kong Institute of CPAs
All other interested parties

INVITATION TO COMMENT ON IASB EXPOSURE DRAFT ON *FAIR VALUE MEASUREMENT*

Comments to be received by 7 September 2009

The Hong Kong Institute of Certified Public Accountants' (Institute) Financial Reporting Standards Committee (FRSC) is seeking comments on the IASB Exposure Draft which has been posted on the Institute's website at: www.hkicpa.org.hk/professionaltechnical/accounting/exposuredraft/content.php.

The proposed IFRS defines fair value, establishes a framework for measuring fair value and requires disclosures about fair value measurements.

IFRSs require some assets, liabilities and equity instruments to be measured at fair value. However, guidance on measuring fair value has been added to IFRSs piecemeal over many years as the IASB or its predecessor decided that fair value was an appropriate measurement or disclosure basis in a particular situation.

As a result, guidance on measuring fair value is dispersed across many IFRSs and it is not always consistent. Furthermore, the current guidance is incomplete, in that it provides neither a clear measurement objective nor a robust measurement framework. The IASB believes that this adds unnecessary complexity to IFRSs and contributes to diversity in practice.

The IASB's objectives for publishing the proposed IFRS are:

(a) to establish a single source of guidance for all fair value measurements required or permitted by IFRSs to reduce complexity and improve consistency in their application;

(b) to clarify the definition of fair value and related guidance in order to communicate the measurement objective more clearly; and

(c) to enhance disclosures about fair value to enable users of financial statements to assess the extent to which fair value is used and to inform them about the inputs used to derive those fair values.

The proposed IFRS does not require additional fair value measurements.

To ensure consistency between IFRSs and US generally accepted accounting principles, the proposals incorporate recent guidance on fair value measurement published by the US Financial Accounting Standards Board and are consistent with a report of the IASB's Expert Advisory Panel published in October 2008 on fair value measurement in illiquid markets.

--- A summary of the main proposals in the Exposure Draft is set out in the Appendix.

In accordance with the Institute's Convergence Due Process, comments are invited from any interested party. The FRSC would like to hear from both those who do agree and those who do not agree with the proposals contained in the IASB Exposure Draft.

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Comments should be supported by specific reasoning and should be submitted in written form.

To allow your comments on the IASB Exposure Draft to be considered, they are requested to be received by the Institute on or before **7 September 2009**.

Comments may be sent by mail, fax or e-mail to:

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Comments may be made available for public review unless otherwise requested by the contributor.

Appendix

Summary of the main proposals in the Exposure Draft (ED)

(1) Definition of fair value

The ED proposes to define 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)".

Key aspects of the definition proposed in the ED are:

- **Characteristics of the asset/liability** – A fair value measure is performed for a particular asset or liability and, therefore, considers only the characteristic of the asset or liability that market participants would consider when determining a price at the measurement date.

- **Orderly transactions** – Assume exposure to the market for a period before the measurement date to allow for usual marketing activities. It is not a forced transaction.

- **Most advantageous market** – A fair value measure reflects a transaction taking place in the most advantageous market to which the entity has access. This is one that maximizes the amount that would be received to sell the asset or minimizes the amount that would be paid to transfer a liability after considering transaction and transport costs. This assessment is made from the perspective of the reporting entity, and is presumed to be the market that the entity would normally enter into such a transaction.

- **Highest and best use and valuation premise** – A fair value measure reflects a market participant's ability to use the asset to its highest and best use. This is the use that maximizes the value of the asset, considering uses that are physically possible, legally permissible and financially feasible, and does not consider the intended use of the asset by the acquirer/holder. The highest and best use of an asset establishes the valuation premise, which may be either "in use" or "in exchange".

- **Transfer of a liability** - A fair value measure reflects the continuation of the liability – that is, another market participant would fulfil the obligation, rather than it being settled with the counterparty or otherwise extinguished. If there is no observable market price for the transfer of the liability, fair value is determined by using the same methodology that the counterparty would use to measure the fair value of the corresponding asset. The fair value of a liability also reflects the effect of non-performance risk, which is the risk that an entity will not fulfil an obligation.

- **Equity instruments** – Fair value is measured from the perspective of a market participant who holds the instrument as an asset.

(2) Valuation techniques

Where fair value is determined using a valuation technique, the ED proposes that the technique should be either a market approach, income approach or cost approach, as appropriate. An entity would choose the valuation technique most appropriate in the circumstances and for which sufficient data are available to measure fair value. Specific guidance on markets which are no longer active are also provided in the Application Guidance (Appendix B) and the Illustrative Examples of the ED.

(3) Fair value at initial recognition

The ED notes that, in many cases, the transaction price to acquire an asset or to assume a liability (entry price) will equal the exit price. In determining whether fair value at initial recognition equals the transaction price, an entity shall consider factors specific to the transaction and the asset or liability. The transaction price is the best evidence of fair value at initial recognition unless:

- The transaction is between related parties.
- The transaction takes place under duress or is a forced transaction.
- The unit of account of the transaction differs from the asset for which fair value is being determined.
- The market in which the transaction takes place differs from the market in which the entity would normally sell the asset.

If the transaction price differs from its exit price, the ED proposes that the difference is recognised in the profit or loss unless an IFRS requires some other treatment.

(4) Fair value hierarchy

The ED proposes a fair value hierarchy that prioritises into three levels the inputs to valuation techniques used to measure fair value:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.

- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (ie as prices) or indirectly (ie derived from prices).

- Level 3 inputs are inputs for the asset or liability that are not based on observable market data (unobservable inputs).

(5) Disclosures

The ED proposes to extend the fair value disclosures adopted in the recent revisions to IFRS 7 *Financial Instruments: Disclosures* issued in March 2009 beyond financial instruments – to all assets, liabilities or equity that are measured at fair value. Such disclosure includes information that enables users of its financial statements to assess the methods and inputs used to develop those measurements and, for fair value measurement using significant unobservable inputs (level 3), the effect of the measurements on profit or loss or other comprehensive income for the period. The ED also extends this, by requiring disclosure of the fair value hierarchy for assets or liabilities where fair value information is only disclosed, even though the items are not measured at fair value.