THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

12 September 2008

Our ref: ICAEW Rep 97/08

Your ref:

Mr Carlo Comporti
Secretary General
CESR
11-13 avenue de Friedland
75008 Paris
France

By web submission

Dear Mr Comporti

FAIR VALUE MEASUREMENT AND RELATED DISCLOSURES OF FINANCIAL INSTRUMENTS IN ILLIQUID MARKETS

The Institute of Chartered Accountants in England and Wales (the Institute) is pleased to respond to your request for comments on the Draft Statement *Fair Value Measurement and Related Disclosures of Financial Instruments in Illiquid Markets.*

Please contact me if you would like to discuss any of the points raised in the attached response.

Yours sincerely

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THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

ICAEW Representation

ICAEW REP 97/08

FAIR VALUE MEASUREMENT AND RELATED DISCLOSURES OF FINANCIAL INSTRUMENTS IN ILLIQUID MARKETS

Memorandum of comment submitted in September 2008 by The Institute of Chartered Accountants in England and Wales, in response to CESR's Draft Statement *Fair Value Measurement and Related Disclosures of Financial Instruments in Illiquid Markets*, published in July 2008.

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INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales (the Institute) welcomes the opportunity to comment on the Draft Statement *Fair Value Measurement And Related Disclosures Of Financial Instruments In Illiquid Markets* published by The Committee of European Securities Regulators (CESR) in July 2008.

WHO WE ARE

2. The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 130,000 members in more than 140 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 700,000 members worldwide.

3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The Institute ensures these skills are constantly developed, recognised and valued.

4. Our members occupy a wide range of roles throughout the economy. This response was developed by the Financial Reporting Committee of the Institute, which includes preparers, analysts, standard-setters and academics as well as senior members of accounting firms.

MAJOR POINTS

5. We welcome CESR's acknowledgement that the 'competence of setting, formally interpreting standards and issuing general interpretation of existing standards lies with the IASB/IFRIC'. We accept that CESR may seek to influence the debate and has a role in operation of EU markets, particularly in stressed times. But while it may be appropriate for CESR 'to stress the importance of appropriate application of measurement and disclosure requirements', we do not believe it is appropriate for CESR to seek to offer putative guidance on the application of IFRS.

6. Most of the draft comprises guidance that is in existing IFRS. Moreover, the draft statement duplicates and/or parallels the work that the IASB is doing through its Expert Advisory Panel (EAP) on the valuation of financial instruments in inactive markets. We suggest that it would be much better for CESR to provide these ideas as input to the EAP than to produce separate best practice guidance itself. Regardless, given that the IASB has both fair value and financial instrument disclosure issues on its September 2008 agenda it would be better to await the outcome of the Board's deliberations before taking any further action. In any case, we recommend that CESR does not issue its own guidance since its status would be unclear within the framework of IFRS.

SPECIFIC QUESTIONS

Question 1. Do you agree with CESR's views above regarding the distinction between active and nonactive markets for fair value measurement?

7. We agree that the analysis in the paper is generally consistent with accepted interpretation and practice up until December 2007 year ends. However, this is being discussed by the EAP and could be subject to change.

8. Paragraph 29 addresses the identification of forced sales. It mentions the tracking of a market price against a reliable internal valuation technique in order to determine whether a sale is forced. It is unclear as to why an internal valuation technique would be used in the first place if there are current market transactions or is it saying that market transaction could be forced sales and a reliable internal valuation technique needs to be used as a gauge to compare values. It also begs the question of whether, if there is a proliferation of sales at what is perceived to be a series of forced sales in a particular instrument, these prices should be used to determine fair value for that instrument.

Question 2. Do you agree with CESR's views above regarding inputs to valuation techniques for financial instruments in illiquid markets?

9. This area is also under review by the IASB expert panel. We agree that appropriate risk factors should be taken into accounting in determining fair values.

10. The draft statement's material on inputs to valuation techniques largely repeats the relevant paragraphs of IAS 39. Subject to our overall reservations about the appropriateness of CESR issuing it own guidance, we have the following comments on paragraphs 31 to 38.

    (a) Paragraph 35 focuses on liquidity risk and correlation risk between the senior and junior tranches of Collateralised Debt Obligations (CDOs). We agree that this guidance is useful.

    (b) Paragraph 38 cautions against the use of indices in fair valuing financial instruments that are not the same as those whose values have been used in compiling the index and cites as an example the shortcomings of the Asset Backed Securities Index – Home Equity (ABX.HE index). IAS39.AG77 already contains this guidance in more general terms when it states that 'the corresponding change in the fair value of the financial instrument being valued is determined by reference to current prices or rates for similar financial instruments, adjusted as appropriate for any differences from the instrument being valued'. It is useful to point out the limitations of such an index in this context. It would be helpful if more specific examples like this could be developed.

Question 3. Do you agree with CESR's views above regarding disclosures of financial instruments in illiquid markets?

11. The draft statement sets out extracts from IFRS 7 with the current guidance on determining classes of financial instruments. We have already written to

the IASB with suggested improvements to IFRS 7 following implementation experience but without specific reference to current market conditions. A suggested improvement was to provide clearer implementation guidance on determining classes. In our view, consistent with the overall approach in IFRS 7, classes are likely to reflect how risks are managed as the defining characteristics amongst the many different characteristics of financial instruments. In keeping with financial reporting generally, classes, once determined, are likely to remain consistent over time and within the financial statement disclosures as a whole.

12. We have the following comments on paragraphs 40-61.

    (a) Paragraph 56 comments on sensitivity analysis. We are not convinced that sensitivity analysis is always as meaningful as it is sometimes assumed. Where there are large volumes of instruments and where they are subject to many different assumptions where no assumption is dominant, it can be extremely difficult to summarise them into any meaningful sensitivity analysis that a reader of accounts could be expected to understand.

    (b) Paragraph 61 states that disclosures are part of financial statements. Once the requirements of accounting standards are met, issuers are free to provide additional information outside the financial statements, for example, in management commentary.

Question 4. Do you agree that the benefits of the presentation of disclosures regarding financial instruments in illiquid markets in the example in Box 2 outweigh the costs of preparing this information?

13. While example disclosures can be helpful, particularly in informing developing practice, prescribed standard requirements are likely to be less informative and relevant than disclosures designed by companies to meet their individual and changing circumstances. Therefore we do not agree that there are sufficient benefits in mandating a specific format of disclosure.

14. Box 1 appears to be an odd mix of IFRS 7 and IAS 39 references. There are no disclosure requirements in IAS 39 and the references made to IFRS 7 do not appear to support the disclosures suggested by the box. We assume that the reference to an individual financial instrument in point 4 in box 1 is not intended to suggest that disclosure should be done at such a level of granularity, which would be impractical.

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