10 September 2010

Our ref: ICAEW Rep 87/10

Your ref: ED/2010/7

Ms Hilary Eastman
Senior Technical Manager
International Accounting Standards Board
30 Cannon Street
London
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Dear Hilary

MEASUREMENT UNCERTAINTY ANALYSIS DISCLOSURE FOR FAIR VALUE MEASUREMENTS

The ICAEW is pleased to respond to your request for comments on *Measurement Uncertainty Analysis Disclosure for Fair Value Measurements.*

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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ICAEW REP 87/10

MEASUREMENT UNCERTAINTY ANALYSIS DISCLOSURE FOR FAIR VALUE
MEASUREMENTS

Memorandum of comment submitted in September 2010 by the ICAEW, in response to the International Accounting Standards Board exposure draft *Measurement Uncertainty Analysis Disclosure for Fair Value Measurements*, published in June 2010

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INTRODUCTION

1. The ICAEW welcomes the opportunity to comment on the exposure draft *Measurement Uncertainty Analysis Disclosure for Fair Value Measurements* published by the International Accounting Standards Board.

WHO WE ARE

2. The ICAEW 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, we provide leadership and practical support to over 134,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. We are a founding member of the Global Accounting Alliance with over 775,000 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. We ensure these skills are constantly developed, recognised and valued.

MAJOR POINTS

4. The main proposal in the ED is that when preparing a measurement uncertainty analysis for Level 3 fair value measurements 'an entity shall take into account the effect of correlation between unobservable inputs if such correlation is relevant'. We agree with this proposal.

5. It would be helpful for the guidance that will accompany the eventual standard to give more examples of correlation between unobservable inputs. The one example given in the ED is in any case not ideal (see paragraph 9 below).

6. It is unclear whether the IASB regards correlations as in themselves unobservable inputs, which would require disclosure in their own right, and the effects of changes in which would be disclosed as part of the uncertainty analysis. Certain passages in the exposure draft can be read in this sense (eg, BC20). On the other hand, this is not an explicit requirement and it could be argued that a correlation between inputs is not itself an input. In support of the latter approach, it could further be argued that the effect of changing assumptions about correlations between inputs would be that one or more of the inputs would be changed. Eg, to use the example in the ED, in assessing the value of residential mortgage-backed securities, if the correlation between prepayment rates and probability of default changes, then one or both of these inputs will also change. As the changes in the inputs would be disclosed, it may be regarded as superfluous to disclose the changes in the correlations as well, as these are implicit in the changes to the inputs. It would be helpful to clarify this point either in the eventual standard's requirements or in supporting guidance.

7. It would also be helpful for the guidance that will accompany the eventual standard to make clear whether correlations should be taken into account at the portfolio level or at the product level. It seems possible to us that correlations may exist (or may appear to exist) at the portfolio level that do not appear to exist at the product level.

RESPONSES TO SPECIFIC QUESTIONS

Are there circumstances in which taking into account the effect of the correlation between unobservable inputs (a) would not be operational (eg for cost-benefit reasons) or (b) would not be appropriate? If so, please describe those circumstances.

8. It is useful to distinguish between correlations of which the entity is aware and those that may exist, but of which it is unaware. Where an entity is aware of correlations between unobservable inputs, a requirement that they should be taken into account should be both operational and appropriate. There may be correlations between unobservable inputs of which the entity is unaware. BC21 implies that entities will have to 'determine which unobservable inputs are correlated with each other'. We do not think that it would be cost-effective to require entities to search for potential correlations of which they are currently unaware.

9. In this connection, we note that potential correlations of which the entity is unaware are more likely for Level 3 inputs than for Level 2 inputs, as relationships between inputs at this level will probably be less well understood. The only example of correlation in the ED, given in the table at Example 1, is between 'prepayment rates' and 'probability of default', which in the May 2009 exposure draft *Fair Value Measurement* (paragraph 51), though in slightly different wording ('prepayment speeds' and 'default rates') are given as examples of Level 2 inputs. It may be helpful in Example 1 to mention a correlation that is more clearly between Level 3 inputs.

Q2

If the effect of correlation between unobservable inputs were not required, would the measurement uncertainty analysis provide meaningful information? Why or why not?

10. We believe that, very broadly, a requirement to take correlations between inputs into account can be seen as equivalent to a requirement not to make inconsistent assumptions about the ways in which inputs might have been different. This reading of the proposals is supported by BC20, which explains that the effect of the proposed requirement to take correlations into account is that:

> '[A]n entity would need to determine whether using a different combination of unobservable inputs … would have a consequential effect on any of the other unobservable inputs used'.

11. On this basis, we would expect many entities to attempt to take correlations into account even without an explicit requirement to do so. We would, therefore, often expect a measurement uncertainty analysis to provide meaningful information even in the absence of the proposed explicit requirement. But we believe that an explicit requirement to consider correlations will provide clarity.

Q3

Are there alternative disclosures that you believe might provide users of financial statements with information about the measurement uncertainty inherent in fair value measurements categorised within Level 3 of the fair value hierarchy that the Board should consider instead? If so, please provide a description of those disclosures and the reasons why you think that information would be more useful and more cost-beneficial.

12. We believe that the proposed disclosures are broadly satisfactory and so we do not see any need to find more useful and more cost-beneficial alternatives to them.

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