THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

23 October 2008

Our ref: ICAEW Rep 125/08

Your ref:

Ms Hilary Eastman
Project Manager
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By email heastman@iasb.org.uk

Dear Ms Eastman

DRAFT DOCUMENT IASB EXPERT ADVISORY PANEL: MEASURING AND DISCLOSING THE FAIR VALUE OF FINANCIAL INSTRUMENTS IN MARKETS THAT ARE NO LONGER ACTIVE

The Institute of Chartered Accountants in England and Wales (the ICAEW) is pleased to respond to your request for comments on the Draft Document *IASB Expert Advisory Panel: Measuring and disclosing the fair value of financial instruments in markets that are no longer active*.

Whilst we have made efforts to consult with our committees over a number of the areas in the Draft Document, given the timeframe, the level of consultation has necessarily been limited. Our comments must be construed in that light.

Please contact me should you wish 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 125/08

DRAFT DOCUMENT IASB EXPERT ADVISORY PANEL: MEASURING AND DISCLOSING THE FAIR VALUE OF FINANCIAL INSTRUMENTS IN MARKETS THAT ARE NO LONGER ACTIVE

Memorandum of comment submitted in October 2008 by The Institute of Chartered Accountants in England and Wales, in response to the Draft Document *IASB Expert Advisory Panel: Measuring and disclosing the fair value of financial instruments in markets that are no longer active*, published in September 2008.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 Document *IASB Expert Advisory Panel: Measuring and disclosing the fair value of financial instruments in markets that are no longer active,* published in September 2008.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.

MAJOR POINTS

4. We welcome the publication of the Draft Document that summarises the discussions of the International Accounting Standards Board's (IASB's) Expert Advisory Panel set up to examine the application of the fair value measurement guidance in International Financial Reporting Standards (IFRSs) when markets are no longer active. The current economic situation is so serious and urgent that we agree the IASB should act quickly in giving help and educational guidance of this nature, even if it means that a fuller due process is not possible. In the introduction it is stated that the document *'provides useful information and educational guidance for measuring and disclosing fair values and does not establish new requirements for entities applying IFRS or any other GAAP'*. We believe that this statement is important since the IASB needs to strike the right balance between providing useful educational material for all the constituency in the current market situation and recognising the IASB's usual due process.

5. We are, of course, aware that there have been calls from various quarters to suspend fair value accounting on a temporary basis during the current economic crisis. We wish to take this opportunity to state that, in our view, this would be a retrograde move. Not only would it not solve the 'pro-cyclical' problems that people appear to believe should be blamed on mark to market accounting (erroneously in our view), but in fact it could make matters worse by storing up bad news and thus causing the markets to freeze up pending receipt of that news. We also believe it will have little effect in practice. In a European context, we can easily see

situations where issuers would nevertheless have to release the relevant information as to do otherwise would run the risk of market abuse. In any case, we would suggest that, even if suspended in the primary financial statements, the information would have to be disclosed in the notes to the financial statements and users will tend to focus on that information and adjust for it. It is vital that the market continues to receive transparent information for investors to regain confidence and to restore a willingness to invest.

Measurement

6. We appreciate that the panel has of necessity explored in considerable detail how fair values are derived when markets are thin. However, one of the aims of IFRSs is to be principles rather than rules-based. The detail in the discussions is not conducive to that end unless it is part of a process in determining whether the existing guidance in IAS 39 *Financial Instruments: Recognition and Measurement* is fit for purpose for situations in which markets for certain types of financial instrument are no longer active. The document states that the fair value measurement requirements in IAS39 are generally clear and well understood. We agree and, that being the case, we see no compelling reason to enhance the existing guidance on valuation when markets are not active. Nevertheless, in the current environment, a description – as contained in the document – of what entities are in fact already doing to apply the fair value standards may be reassuring to other parties, including some users, who may not have the relevant in-depth knowledge either of the financial reporting standards or the financial instruments themselves.

7. The paragraph on page 4 of the Draft Document that addresses the issue of forced transactions states that in practice forced transactions are rare and that evidence that a transaction falls within this description is required before it can be ignored in arriving at the fair value of a financial instrument. The recently issued SEC paper 2008-234, when considering transactions that are determined to be disorderly, states that the results of disorderly transactions are not determinative when measuring fair value and then goes on to state that the fact that a transaction is distressed or forced should be considered when weighing the available evidence. This is not the same message as that in the Draft Document which states that, once the status of a transaction is established as forced having been supported by evidence, it can be ignored as a factor in determining fair value. There may also be other differences in nuance between the two documents. In general, it would be helpful if there could be consistency between guidance issued by the SEC or FASB and the IASB in fair value measurement.

Disclosure

8. Good disclosure around fair value is important at any time, but even more vital in current market conditions. Although the Draft Document discusses disclosure in some detail, including aggregation and granularity, it would be helpful to emphasise up front how important it is for entities to structure disclosure in the most helpful way possible for users. In this context,

positioning of disclosure so it is adequately highlighted in financial statements (i.e. where necessary in a prominent position) and the use of OFR/MD&A disclosures to augment financial statement disclosures, should also be emphasised. In fact, most of the disclosures quoted as good practice are extracts from the OFR/MD&A and are not part of audited financial statements. The IASB should make it clear where these are taken from and address the issue of structuring of disclosures and how the OFR/MD&A can be used to help emphasise key messages, supported by the detailed disclosure requirements for the audited financial statements.

9. The Draft Document acknowledges that an entity must decide, on the basis of its particular circumstances, how much detail it should disclose. We agree with this since it recognises that there is no standard template for disclosure. Some reporters are already making efforts to give enhanced disclosure on specific risk areas, so the exhortation here should be for all entities to think about disclosures carefully and consider best practice, not minimum requirements. That said, it should be made as clear as possible that these are just suggested disclosures, set out for entities to consider. It is important that they should only be adopted where they are relevant to a significant risk concentration held by that entity. Otherwise there is a risk that calling for additional detailed disclosure across the board will only expand the volume of the financial statements rather than enhance the quality of disclosure.

10. In addition, some care needs to be exercised in not overloading preparers (many of whom are under a great deal of pressure) with changes or additional disclosures that would require unduly costly or time-consuming systems changes. From a practical perspective, given many financial institutions work to a calendar year, there may be little time to implement major changes for this year when they should be focusing on running their business in a difficult economic environment. There are plenty of other, more cost-effective improvements that entities can make to their disclosures. We note that an exposure draft of a revised version of IFRS 7 *Financial Instruments: Disclosure* is due to be published shortly and we look forward to commenting on that exposure draft in the context of the suggestions about disclosure provided in the Draft Document.

RESPONSES TO SPECIFIC SECTIONS OF THE DRAFT DOCUMENT

Information from brokers and pricing services / Broker quotes/ Pricing services

11. We agree that there should be a clear reason for switching pricing services but the merit of consistency of method used in arriving at a fair value for an investment in an inactive market can be questionable. There is a need to revisit methods constantly to ensure that validations and model prices are within an acceptable range when compared with information on the same instruments coming out of other sources. A similar degree of rigour needs to surround the use of broker quotes and this is adequately addressed in the paper.

Changes in own credit

12. IFRS7 Appendix B4 contains guidance on how to measure the amount of the change in fair value that is attributable to change in the liability's credit risk. We would expect the paper to refer to that guidance in this section. In addition, the first sentence of the 'Changes in own credit' section on page 13 states that there is inconsistency in practice about inclusion of own credit adjustment when fair valuing derivatives. It then goes on to state that in the current environment it is necessary to reconsider whether or not the effect of own credit risk on a valuation is material because the effect of own credit on valuations changes over time as market conditions change. We believe that this seems to be giving an interpretation of IAS39 and is outside the status of the educational guidance provided elsewhere in the Draft Document.

Measuring the underlying components of an instrument

13. It has been observed that fair values of investments in structured notes have been influenced by credit ratings that are not driven by the value of the underlying financial assets. This practice can result in subsequent material losses that would have been recognised earlier as impairment had the value of the underlying assets driven the fair value estimation. It would be helpful if the role of credit ratings in the valuation exercise were to be addressed in this section.