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Dear Kevin

Grant Thornton Australia Limited (Grant Thornton) is pleased to provide the Australian Accounting Standards Board with its comments on Exposure Draft ED 181 Fair Value Measurement which is a re-badged copy of the International Accounting Standards Board's ED/2009/5 (the ED). We have considered the ED and set out our comments below.

Grant Thornton's response reflects our position as auditors and business advisers both to listed companies and privately held companies and businesses, and this submission has benefited with some initial input from our clients, Grant Thornton International which is working on a global submission to the IASB, and discussions with key constituents.

The views expressed here are preliminary in nature, and a more detailed Grant Thornton's global submission will be finalised by the IASB's due date of 28 September 2009.

Appendix 1 contains our more detailed preliminary responses to both the IASB's and the AASB's questions.

Support for the project

We support the Board's objectives for this project to:

- establish a single source of guidance for fair value measurements in IFRSs;
- clarify the definition and related guidance
- enhance disclosures about fair value.

We agree with the proposed definition of fair value and with much of the supporting guidance. However, we do have certain concerns with the application of the proposed definition and with some aspects of the detailed guidance. Our main concerns are summarised in the following paragraphs.

Application of proposed definition

Non-financial items

The proposed model is of course intended to apply to all fair value measurements, including both financial and non-financial assets and liabilities. For financial assets we find the guidance mostly clear, appropriate and consistent with existing practice.

For non-financial assets we find the guidance more complex, confusing and potentially onerous. We comment on some of the specific areas that create complexity in the following paragraphs and in our responses to the Invitation to Comment. We believe the problems mainly stem from attempting to apply a market-based, transfer valuation model for assets that:

- may rarely, if ever in some cases, be bought and sold in stand-alone transactions
- derive their value from being used in conjunction with other assets and liabilities
- may have more than one commercial use.

We recognise that the Board has attempted to address these matters, for example by including an 'in-use valuation premise'. Unfortunately, we believe that it is these same efforts that have served to add complexity and reduce clarity.

We also appreciate that this project is intended to clarify and unify the concept of fair value rather than determine when fair value should be used. However, we believe that the ED serves to illustrate the difficulties of seeking to a single model to such a diverse range of assets (and, to a lesser extent, liabilities).

Accordingly, we believe that the Board should in due course revisit the question of whether 'fair value' is the most appropriate measurement basis for most non-financial assets.

Liabilities

As explained in our response to the Board's Discussion Paper *Credit Risk in Liability Measurement,* we have significant doubts as to the usefulness of measuring most liabilities in a way that leads to gains or losses as a result of changes in the obligor's own credit standing. We are also not persuaded that the fair value of most liabilities is affected by non-performance risk. This is because, in the absence of evidence to the contrary, we doubt that the price an obligor would have to pay to transfer a liability to a third party is increased or decreased by the obligor's ability to meet the obligation.

Guidance

We have several detailed comments on the proposed guidance in our responses to the Invitation to Comment questions. The majority of these comments relate to guidance applicable to non-financial assets, and therefore expand on the general concerns expressed above. Our concerns relate mainly to the proposals on highest and best use, the in-use valuation premise and to the evident need to consider the value of combinations of assets to determine the fair value of individual assets.

Despite our detailed comments and concerns, we support the broad thrust of the proposals. These seem to be driving at:

- estimating fair value using a 'best price' concept

- avoiding use of a scrap value by making assumptions about the availability of complementary assets where applicable.

We believe that these are sensible and relatively simple concepts. However, we also believe the ED over-complicates and over-emphasises these concepts. Taken together, the draft guidance seems to require entities not only to identify the most advantageous market but also to consider:

- whether that market is a market for the asset itself, of for an asset group or business that includes the asset in concern
- alternative uses by participants in that market (which could in turn affect the identity of the most advantageous market)
- alternative combinations of assets to identify the best price on a combined basis (which could again affect the identity of the most advantageous market).

We suggest that the Board needs to rationalize and simplify this guidance. Broadly, we suggest that this can be achieved by including the main concepts within the overall 'most advantageous market' material in the main body of the (draft) IFRS. Additional material should be relegated to the Application Guidance section.

In doing this, we believe that the various matters to be considered to identify the 'best price' (alternative uses, combinations of assets) should be required only if it is evident that these factors will affect the best price.

If you require any further information or comment, please contact me.

Yours sincerely
GRANT THORNTON AUSTRALIA LIMITED

Keith Reilly
National Head of Professional Standards

Appendix 1:
Responses to ITC 21 Questions

Invitation to comment questions

Definition of fair value and related guidance

Question 1

The exposure draft proposes defining 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) (see paragraph 1 of the draft IFRS and paragraphs BC15–BC18 of the Basis for Conclusions). This definition is relevant only when fair value is used in IFRSs.

Is this definition appropriate? Why or why not? If not, what would be a better definition and why?

Response

We agree with the proposed definition. Compared with the existing definition it clarifies that:

- fair value is exit value based on sale of an asset or transfer of a liability
- the hypothetical exit transaction is an orderly transaction
- the hypothetical exit transaction tales place at the measurement date.

Scope

Question 2

In three contexts, IFRSs use the term 'fair value' in a way that does not reflect the Board's intended measurement objective in those contexts:

a In two of those contexts, the exposure draft proposes to replace the term 'fair value' (the measurement of share-based payment transactions in IFRS 2 *Share-based Payment* and reacquired rights in IFRS 3 *Business Combinations*) (see paragraph BC29 of the Basis for Conclusions).

b The third context is the requirement in paragraph 49 of IAS 39 *Financial Instruments: Recognition and Measurement* that the fair value of a financial liability with a demand feature is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid (see paragraph 2 of the draft IFRS and paragraph BC29 of the Basis for Conclusions). The exposure draft proposes not to replace that use of the term 'fair value', but instead proposes to exclude that requirement from the scope of the IFRS.

Is the proposed approach to these three issues appropriate? Why or why not? Should the Board consider similar approaches in any other contexts? If so, in which context and why?

Response

We agree. In each of the three contexts cited the required measurement might be described as 'fair value' based but not strictly fair value.

The transaction

Question 3

The exposure draft proposes that a fair value measurement assumes that the transaction to sell the asset or transfer the liability takes place in the most advantageous market to which the entity has access (see paragraphs 8–12 of the draft IFRS and paragraphs BC37–BC41 of the Basis for Conclusions).

Is this approach appropriate? Why or why not?

Response

We agree with the concept of considering the most advantageous market. We also welcome the practical expediency of:

- Not requiring entities to perform an exhaustive search of all possible markets to identify the most advantageous market (paragraph 10).
- Assuming that the principal market is the most advantageous in the absence of evidence to the contrary (paragraph 11).

However, we also believe that the concept of most advantageous market needs some further development in the following areas:

- The text in paragraph 8 and elsewhere suggests that there is invariably a real market in the asset or liability in concern. We do not think there is always a market, at least at the level of an individual asset or liability. For example, we believe that there is no market in many liabilities, or in many intangible assets acquired in business combinations. We think this section of the ED needs to acknowledge this.
- Other material in the ED (paragraph 23 footnote and Example 1 of the Implementation Examples) introduces guidance suggesting that the relevant market can be a market for an asset group or business rather than a market in the individual asset in concern. If so this idea needs to be incorporated into, and aligned with, the requirements concept of most advantageous market.
- To the extent that the absence of a market for individual assets or liabilities is not addressed by the preceding bullet point, we believe this section needs to acknowledge that in some cases the most advantageous market is in fact a hypothetical market (with hypothetical participants). (Although we dislike the idea of introducing ever more levels of hypothesis into accounting measurements, this seems to be an unavoidable consequence of using a market-based transfer measurement model for assets and liabilities that are not regularly transferred. The underlying problem is therefore the use of fair value in such circumstances rather than its definition).
- The most advantageous market concept is really a 'best price' concept. As such we believe that much of the draft guidance on 'highest and best use' and 'valuation premise' should be subsumed into the guidance on transaction and market participants currently

included in paragraphs 7 to 14. We expand on this suggestion in our responses to Questions 5 and 6.

Question 4

The exposure draft proposes that an entity should determine fair value using the assumptions that market participants would use in pricing the asset or liability (see paragraphs 13 and 14 of the draft IFRS and paragraphs BC42–BC45 of the Basis for Conclusions).

Is the description of market participants adequately described in the context of the definition? Why or why not?

Response

We agree with the description of market participants subject to clarification on the points raised in our response to Question 3 (concerning the absence of a market for certain individual assets or liabilities).

Application to assets: highest and best use and valuation premise

Question 5

The exposure draft proposes that:

a the fair value of an asset should consider a market participant's ability to generate economic benefit by using the asset or by selling it to another market participant who will use the asset in its highest and best use (see paragraphs 17–19 of the draft IFRS and paragraph BC60 of the Basis for Conclusions).

b the highest and best use of an asset establishes the valuation premise, which may be either 'in use' or 'in exchange' (see paragraphs 22 and 23 of the draft IFRS and paragraphs BC56 and BC57 of the Basis for Conclusions).

c the notions of highest and best use and valuation premise are not used for financial assets and are not relevant for liabilities (see paragraph 24 of the draft IFRS and paragraphs BC51 and BC52 of the Basis for Conclusions).

Are these proposals appropriate? Why or why not?

Response

Highest and best use

We support the basic idea of considering an asset's highest and best use in measuring fair value. We also agree with the practical expedient in paragraph 18 to the effect that an exhaustive search for higher and better uses is not required in the absence of evidence.

However, we also question why this guidance is necessary in view of the requirement to consider the *most advantageous market*. If participants in the most advantageous market can derive additional value from an alternative use then this would presumably be reflected in the price in that market. While we agree that an IFRS should acknowledge that possible alternative uses should be considered in identifying the most advantageous market and its participants, we believe the ED over-emphasises the highest and best use notion. We also believe possible alternative uses will affect fair values only in a small minority of cases.

We therefore suggest that:

- A requirement to consider possible alternative uses in incorporated into the material on the most advantageous market and the price in that market currently in paragraphs 8 to 16.
- The more detailed material on applying this requirement should be relegated to the Application Guidance.

Valuation premise

We agree with the inclusion of the guidance in paragraph 22(a) under the heading 'valuation premise'. We also agree that this should apply only to non-financial assets. Without this guidance the proposed definition of fair value and other unit of account guidance would presumably result in the use of scrap value for assets such as specialist plant and work-in-progress. Scrap value would not in our view be an appropriate measure. We believe that the in-use valuation premise is essentially a pragmatic means of avoiding this outcome.

However, we also believe the terminology introduces unnecessary confusion and that the material in the ED makes a simple point in an unduly cumbersome manner. The terminology is confusing because the hypothetical transaction is always an exchange transaction regardless of the valuation premise. What differs depending on circumstances are the assumptions made about the transaction.

The substance of this guidance is primarily that assets whose value is dependent on the availability of complementary assets should be valued on the presumption that those complementary assets are available to market participants. (It is worth noting that this will not always reflect reality). We would prefer to see this stated concisely in the main body of the Standard without using the proposed valuation premise terminology.

The guidance also includes a requirement to assess highest and best use 'on the basis of the use of the asset together with other assets and liabilities as a group' (footnote to paragraph 23 and also IE Example 1). This is not quite the same as assuming that market participants have access to complementary assets and liabilities. Rather, it is introducing a requirement to consider how alternative groupings of assets and liabilities will affect the combined value. We do not necessarily disagree with the thrust of this but:

- We are unsure as to whether this is intended to be the same thing as assuming that market participants have access to complementary assets and liabilities (noting that it seems to be an additional consideration).
- We think the guidance raises questions as to what the unit of valuation really is. Although the ED purports to require an assumption of individual sale (see paragraph 23), the reality of applying this guidance is that a combined value is determined. Presumably an allocation of the combined value to individual assets is then required (which is also implied in paragraph B2(e) of the Application Guidance).
- We are concerned at the practicality of a requirement to consider alternative combinations of assets (and liabilities) to determine highest and best use. We suggest that some expedience is required if this guidance is to be retained, along the lines that combinations of assets are considered only when it is evident that total value would be increased by a sale of the asset group.

We suggest that the complexity and potential confusion in this area stems from the Board's efforts to accommodate current valuation practice within a market-based, hypothetical transfer fair value model. This is turn raises a question as to whether this fair value model is appropriate for non-financial assets, especially those: (i) whose value is dependent on the availability of complementary assets and liabilities; (ii) for which there is no market on an individual basis); (iii) which are held for use rather than sale.

Application of highest and best use guidance to financial assets and to liabilities

We agree with the ED's proposals to the effect that this guidance is not applicable to financial assets or to liabilities.

Question 6

When an entity uses an asset together with other assets in a way that differs from the highest and best use of the asset, the exposure draft proposes that the entity should separate the fair value of the asset group into two components: (a) the value of the assets assuming their current use and (b) the amount by which that value differs from the fair value of the assets (ie their incremental value). The entity should recognise the incremental value together with the asset to which it relates (see paragraphs 20 and 21 of the draft IFRS and paragraphs BC54 and BC55 of the Basis for Conclusions).

Is the proposed guidance sufficient and appropriate? If not, why?

Response

We agree with paragraphs 17 to 19. We are concerned that paragraphs 20 and 21 lead to a curious mixture of measurements of (in this case) the land and factory building - see our comments below on Example 2 of the Implementation Examples.

Application to liabilities: general principles

Question 7

The exposure draft proposes that:

a	a fair value measurement assumes that the liability is transferred to a market participant at the measurement date (see paragraph 25 of the draft IFRS and paragraphs BC67 and BC68 of the Basis for Conclusions).

b	if there is an active market for transactions between parties who hold a financial instrument as an asset, the observed price in that market represents the fair value of the issuer's liability. An entity adjusts the observed price for the asset for features that are present in the asset but not present in the liability or vice versa (see paragraph 27 of the draft IFRS and paragraph BC72 of the Basis for Conclusions).

c	if there is no corresponding asset for a liability (eg for a decommissioning liability assumed in a business combination), an entity estimates the price that market participants would demand to assume the liability using present value techniques or other valuation techniques. One of the main inputs to those techniques is an estimate of the cash flows that the entity would incur in fulfilling the obligation, adjusted for any differences between those cash flows and the cash flows that other market participants would incur (see paragraph 28 of the draft IFRS).

Are these proposals appropriate? Why or why not? Are you aware of any circumstances in which the fair value of a liability held by one party is not represented by the fair value of the financial instrument held as an asset by another party?

Response

We believe these requirements are appropriate.

Application to liabilities: non-performance risk and restrictions

Question 8

The exposure draft proposes that:

a the fair value of a liability reflects non-performance risk, ie the risk that an entity will not fulfil the obligation (see paragraphs 29 and 30 of the draft IFRS and paragraphs BC73 and BC74 of the Basis for Conclusions).

b the fair value of a liability is not affected by a restriction on an entity's ability to transfer the liability (see paragraph 31 of the draft IFRS and paragraph BC75 of the Basis for Conclusions).o

Are these proposals appropriate? Why or why not?

Response

Non-performance risk

We agree that non-performance risk *may* affect a liability's fair value, but only to the extent that this affects the estimated price that would need to be paid to transfer the liability to market participants at the measurement date.

We do not agree with the requirement in paragraph 29 to the effect that non-performance risk is assumed to be the same both before and after the hypothetical transfer. We think this assumption is an inappropriate rule that does not serve to maximise the usefulness of the reported information and may be inconsistent with the general model.

Instead, we believe that the fair value of a liability should focus on the obligation rather than the specific obligor's ability to meet the obligation. In relatively rare situations we accept that liabilities are extinguished by purchasing the corresponding asset from the counter-party. We believe the price agreed in such transactions is evidence of fair value and also that the price will be affected by the non-performance risk associated with the liability (including the obligor's credit standing).

In the absence of observed transactions, we believe the entity should consider the price it would have to pay to be relieved of the liability on the assumption (notional) market participants would expect to meet the obligation.

We have commented in more detail in this area in our response to the Board's Discussion Paper *Credit Risk in Liability Measurement*.

Restrictions

We agree that the fair value of a liability should not be adjusted for restrictions.

Fair value at initial recognition

Question 9

The exposure draft lists four cases in which the fair value of an asset or liability at initial recognition might differ from the transaction price. An entity would recognise any resulting gain or loss unless the relevant IFRS for the asset or liability requires otherwise. For example, as already required by IAS 39, on initial recognition of a financial instrument, an entity would recognise the difference between the transaction price and the fair value as a gain or loss only if that fair value is evidenced by observable market prices or, when using a valuation technique, solely by observable market data (see paragraphs 36 and 37 of the draft IFRS, paragraphs D27 and D32 of Appendix D and paragraphs BC76–BC79 of the Basis for Conclusions).

Is this proposal appropriate? In which situation(s) would it not be appropriate and why?

Response

We agree that the transaction price is usually persuasive evidence of fair value at initial recognition. We also agree that the four situations listed in paragraph 36(a)-(d) are all valid examples of when the transaction price may not be indicative of fair value.

However, the second sentence of paragraph 36 says that the price transaction price *is the best evidence* of fair value other than in the four specified circumstances [emphasis added]. This seems to contradict the preceding sentence in paragraph 36, and the Board's comments in BC77. We suggest that the second sentence of this paragraph should be amended along the lines:

> 'The transaction price is likely to be persuasive evidence of fair value of an asset or liability at initial recognition unless:'

We agree with the approach to day 1 gains and losses, subject to clarification of one point. This concerns the proposed amendments to paragraph AG 76 of IAS 39. As drafted, the revised AG76 would preclude recognition of a day 1 gain or loss even if the transaction price is not considered to provide relevant evidence of fair value (for example the price in a related party transaction or forced transaction). The effect if this is that the initial carrying value would be the transaction price even though it is not a 'fair value relevant' price. We are unsure as to whether this reflects the Board's intention. We believe that existing paragraph AG76 has been written in the context of a transaction price in a transaction that is itself relevant to a fair value measurement. We suggest that the proposed amendment might usefully clarify this point.

Valuation techniques

Question 10

The exposure draft proposes guidance on valuation techniques, including specific guidance on markets that are no longer active (see paragraphs 38–55 of the draft IFRS, paragraphs B5–B18 of Appendix B, paragraphs BC80–BC97 of the Basis for Conclusions and paragraphs IE10–IE21 and IE28–IE38 of the draft illustrative examples).

Is this proposed guidance appropriate and sufficient? Why or why not?

Response
We agree with the proposed guidance on valuation techniques. We believe this is a useful summary of techniques that are commonly applied in practice.

Disclosures

Question 11

The exposure draft proposes disclosure requirements to enable users of financial statements to assess the methods and inputs used to develop fair value measurements and, for fair value measurements using significant unobservable inputs (Level 3), the effect of the measurements on profit or loss or other comprehensive income for the period (see paragraphs 56–61 of the draft IFRS and paragraphs BC98–BC106 of the Basis for Conclusions).

Are these proposals appropriate? Why or why not?

Response
We support the proposed disclosures.

Convergence with US GAAP

Question 12

The exposure draft differs from Statement of Financial Accounting Standards No. 157 *Fair Value Measurements* (SFAS 157) in some respects (see paragraph BC110 of the Basis for Conclusions). The Board believes that these differences result in improvements over SFAS 157.

Do you agree that the approach that the exposure draft proposes for those issues is more appropriate than the approach in SFAS 157? Why or why not? Are there other differences that have not been identified and could result in significant differences in practice?

Response

We agree that the proposed differences are improvements over SFAS 157.

Question 13

Do you have any other comments on the proposals in the exposure draft?

Response

Transport costs and transaction costs

Paragraph 16 of the ED requires that the price in the most advantageous market:

- is not adjusted for transaction costs
- is adjusted for transport costs if 'location is a characteristic of the asset'.

While we do not disagree with the thrust of this requirement we suggest that the way it is expressed is likely to create confusion. In our view if location is a characteristic of an asset, an asset in a different location is not an identical asset. Accordingly, if the appropriate fair value measurement uses a price for an item in a different location as an input, transport costs are another input (similar adjustments for location and condition of inventory in the example of level 2 input in B3(f) of the ED).

Drafting comments

- *ED - paragraph 12*: the intent or meaning of 'considered from the perspective of a market participant that holds the asset or owes the liability' is not clear. The perspective should presumably be that of a market participant that might acquire the asset or liability than an existing holder or obligor.
- *ED - paragraph 36*: we are not clear as to the intent of the words 'for example' at the start of the second sentence.
- *ED - paragraphs 46 and 47*: the first sentence of paragraph 46 seems to contain an internal contradiction. What does having access to the market at the measurement date mean if the entity is unable to sell the asset in that market at that date? We suggest that the key question is when a restriction is regarded as an integral part of the asset (and therefore taken into account in the measurement).

Comments on Illustrative Examples

- *Example 1 (IE2 - IE4):* we have a number of concerns with this Example:
  - It seems to establish a principle to that the most advantageous market might be a market in a business or asset group rather than a market in the individual asset to be valued. This notion does not seem to be supported by the text of the ED itself. Moreover, in this Example the hypothetical transaction considered in measuring items acquired in a business combination is itself a business combination. This seems inconsistent with the requirement to value the assets and liabilities individually as required by paragraph 23 of the ED (although it is perhaps consistent with the footnote to paragraph 23)
  - This Example in turn begs the question as to which of the acquired items should be valued based on a hypothetical business combination, and which based on a transaction in the individual asset or liability.
  - We believe that putting this guidance into practice, which requires the determination of two different sets of values for each asset in an asset group, is burdensome at best and probably impractical.
- *Example 2 (IE5 - IE8)*: the outcome of the guidance in this Example is a curious mix of measurement bases. The factory is valued at an amount that reflects its existing use event though the highest and best use would be to demolish it. The land is valued on an alternative use basis, less the value of the factory based on existing use.

Specific AASB Questions

1 Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:

a not-for-profit entities; and
b public sector entities.

Response

Apart from our earlier comments, we are not aware of any regulatory issues that may effect the implementation of the proposals.

2 whether, overall, the proposals would result in financial statements that would be useful to users; and

Response
Apart from our earlier comments, we are not aware of any regulatory issues that may effect the implementation of the proposals.

3 Whether the proposals are in the best interests of the Australian economy.

Response
Apart from our earlier comments, we are not aware of any regulatory issues that may effect the implementation of the proposals.