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Mr Kevin Stevenson
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Dear ~~Mr Stevenson~~ Kevin

ED 199 MEASUREMENT UNCERTAINTY ANALYSIS DISCLOSURE FOR FAIR VALUE MEASUREMENTS

The Heads of Treasuries Accounting and Reporting Advisory Committee welcomes the opportunity to provide comments to the Australian Accounting Standards Board on Exposure Draft 199 *Measurement Uncertainty Analysis Disclosure for Fair Value Measurements*.

Comments by HoTARAC on questions from the Exposure Draft are in Attachment 1.

HoTARAC considers the meaning of "the effect of correlation between unobservable inputs" is unclear. Therefore, HoTARAC is uncertain of the added benefits such an assessment would provide to a sensitivity analysis disclosed in general purpose financial statements.

HoTARAC considers the proposed disclosures would highlight the volatility and subjectivity of recognised fair values categorised within Level 3 of the fair value hierarchy. Therefore, without information about the likelihood of the alternative fair values being more representative, HoTARAC suggests that disclosing ranges of alternative values may reduce confidence in the recognised figures.

HoTARAC believes it is difficult to fully assess the consequences of this proposal in isolation from the latest IASB thinking on other related aspects of the previous Fair Value Measurement Exposure Draft, such as the fair value hierarchy and valuation techniques. Specifically, HoTARAC is concerned that the IASB has not adequately addressed the circumstances of non-financial assets, particularly where there is no active market, and the relationship between the fair value hierarchy and valuation techniques. As a result, HoTARAC is unclear how the disclosure proposal applies to valuation techniques that predominantly use Level 3 inputs, which HoTARAC suspects may often be the case with the depreciated replacement cost technique.

Public sector entities are likely to be impacted by these proposals to a greater extent than other reporting entities, as they would have relatively more Property, plant and equipment, such as major infrastructure, and Heritage and cultural assets that would use Level 3 fair value inputs. Therefore, the concerns expressed in Attachment 2 are regarded to be more significant for public sector entities.

If you have any queries regarding HoTARAC's comments, please contact Ms Sue Highland from Queensland Treasury on (07) 3405 6064.

Yours sincerely

D W Challen
CHAIR
HEADS OF TREASURIES ACCOUNTING AND REPORTING ADVISORY COMMITTEE

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Encl

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COMMMENTS FROM HEADS OF TREASURIES ACCOUNTING AND REPORTING ADVISORY COMMITTEE HoTARAC RE AASB SPECIFIC QUESTIONS IN AASB ED 199 *MEASUREMENT UNCERTAINTY ANALYSIS DISCLOSURE FOR FAIR VALUE MEASUREMENTS*

Question (a) Are there any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:

(i) not-for-profit entities; and

(ii) public sector entities?

HoTARAC is not aware of any regulatory or other issues that may affect the implementation of these proposals by public sector entities in Australia.

However, public sector entities are likely to be impacted by these proposals to a greater extent than other reporting entities, as they have relatively more Property, plant and equipment, such as major infrastructure, and Heritage and cultural assets that would use Level 3 fair value inputs. Therefore, the concerns expressed in Attachment 2 would be more significant for public sector entities.

HoTARAC is not in a position to comment on the existence of issues for not-for-profit entities outside the public sector.

Question (b) Should the proposed disclosure be included in Australian Accounting Standards – Reduced Disclosure Requirements?

HoTARAC believes this proposed disclosure should be excluded from the Australian Accounting Standards – Reduced Disclosure Requirements. This view is consistent with the exclusion of a corresponding disclosure in respect of financial instruments in AASB 7 via AASB 2010-2 *Amendments to Australian Accounting Standards arising from Reduced Disclosure Requirements*.

Question (c) Overall, will the proposals result in financial statements that would be useful to users?

Due to the concerns outlined in Attachment 2, HoTARAC is uncertain whether these proposals would provide benefits to mainstream users of financial statements. Those users who may benefit from this information are likely to be specialist users with particular information needs. For those users who do not need this extra information, the relevance of what is disclosed is likely to be outweighed by the complexity of the disclosures.

Question (d) Are the proposals in the best interests of the Australian and New Zealand economies?

Due to the concerns outlined, HoTARAC does not consider that these proposals are in the best interests of the Australian economy. The proposed disclosures would highlight the volatility and subjectivity of recognised fair values categorised within Level 3 of the fair value hierarchy. Therefore, without information about the alternative values being more representative, disclosing ranges of alternative values may, in fact, reduce confidence in the recognised figures.

HoTARAC offers no comment in respect of the New Zealand economy.

Implications for GAAP-GFS Harmonisation

There are no known implications for GAAP-GFS harmonisation, as GFS does not deal with financial statement note disclosures.

COMMMENTS FROM HEADS OF TREASURIES ACCOUNTING AND REPORTING ADVISORY COMMITTEE HoTARAC RE IASB ED/2010/7 *MEASUREMENT UNCERTAINTY ANALYSIS DISCLOSURE FOR FAIR VALUE MEASUREMENTS*

Question 1 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.

(a) HoTARAC has a number of concerns with the ED's proposals, as set out below.

Effect of correlation

HoTARAC considers there is a lack of clarity about the "effect of correlation between unobservable inputs", and how this is intended to impact on the disclosure required by the rest of Paragraph 2(a) of the ED.

HoTARAC notes that, in Paragraph BC21, the IASB acknowledges the practical considerations, and judgement required, in determining whether unobservable inputs are correlated, and what effect any such correlation has on the fair value measurement. HoTARAC questions whether the IASB's objectives for the proposed disclosure will be met consistently when such judgement is required in assessing and dealing with correlation between inputs.

Illustrative Example 1 does not assist preparers in understanding this matter. In respect of information for users, it is difficult to see what use can be made of the figures in the two columns headed "Difference in fair value from using different unobservable inputs that could have reasonably been used". To be of use, information on the likelihood of the "true" fair value varying from what was actually recognised would be required. Also, there is no indication of the relative influence each of the factors under "Significant unobservable inputs" has in determining the disclosed fair value. Paragraph IE5 refers to disclosing the "relative subjectivity and limitations of the unobservable inputs", but this would best be demonstrated in Illustrative Example 1 itself.

A further issue with Illustrative Example 1 is that it includes line items relating to investment properties, for which adjustments have been made to comparable property values. Since this Example deals only with Level 3 fair value measurements, HoTARAC questions the appropriateness of including assets for which the measurement inputs may be closer to Level 2 inputs, assuming the "comparable property values" are observable in a market, and along the lines of Paragraph 51(d) of IASB ED/2009/5. Therefore, HoTARAC has a strong preference that the investment property line items be replaced with a highly specialised piece of plant and equipment that can only be manufactured by the entity itself and therefore, would require substantial use of Level 3 inputs, and that a non-financial liability also be included in the example.

The only reference to "correlation" in Illustrative Example 1 is the wording in brackets towards the top of the table under the heading "Significant unobservable inputs", but this does not give any indication of how the correlation influenced the disclosed figures. Contrary to what is inferred in the last sentence of Paragraph BC28, HoTARAC has not been able to identify any requirement within IAS 36 *Impairment of Assets* regarding disclosure of the effect of correlation between inputs in respect of recognised fair values.

Paragraph BC21 refers to the Board not providing guidance on making assessments about the effect of correlation. However, HoTARAC believes that if, such assessments are expected to influence the financial statement disclosure, a certain amount of guidance is necessary. In particular, the disclosure requirement needs to be supplemented by an Illustrative Example that demonstrates how to determine the existence of relevant correlation between inputs. Also, the IASB needs to demonstrate how this ED's proposal fits with the entire package of proposals arising from the *Fair Value Measurement* ED, that is inputs, valuation techniques, fair value hierarchy and disclosures.

Variability

While the proposed disclosure requirements in Paragraph 2(a) of the ED appear to relate only to variability in amounts used for the measurement inputs actually used, other references in the ED appear to contradict this interpretation, and require classification. For example:

- the relevant heading in Illustrative Example 1 refers to using "different unobservable inputs that could have reasonably been used", which implies that different inputs, not just different amounts, have been used;
- the final sentence of Paragraph BC18 refers to users needing to know the effect of correlation to assess the extent to which the use of a different unobservable input would effect the recognised fair value. This implies that the disclosure needs to take into account inputs that weren't used for the recognised fair value; and
- the second sentence of Paragraph BC20 refers to an entity determining whether the use of different combinations of unobservable inputs would result in a significantly higher or lower fair value. Does this imply that the disclosure needs to take account of inputs that weren't used for the recognised fair value, or does it refer to differences in amounts used in respect of the same group of inputs?

HoTARAC notes that Paragraph 2(a) refers to a "significantly higher or lower fair value measurement", rather than a "materially higher or lower fair value measurement", which implies that "significance" and "materiality" have different meanings. As the concept of "significance" is central to the proposed disclosure requirement, more clarity is needed about how to gauge "significance", as distinct from "materiality". Otherwise, HoTARAC recommends that Paragraph 2(a) refers to "materially" rather than "significantly".

Subject to clarification of the intent of Paragraph 2(a) of the ED, HoTARAC recommends that disclosures only be required to deal with the effects of amounts at the limits, highest and lowest, of a range of reasonably possible amounts, similar to Paragraph B18(b) of IFRS 7 *Financial Instruments: Disclosures*. Further, HoTARAC recommends that the Paragraph 2(a) requirements take account of the economic environment in which the entity operates, as well as the timeframe that the assessments relate to, similar to Paragraph B19 of IFRS 7.

Practicalities

HoTARAC has reservations about the practicalities of undertaking a sensitivity analysis in accordance with Paragraph 2(a) of the ED in respect of all types of valuation techniques, particularly those involving a current replacement cost approach, which are likely to involve substantial use of Level 3 inputs. Given the nature of Level 3 inputs, HoTARAC considers that correlation between such unobservable inputs would generally not be reliably determinable and/or may not have any effect on the fair value. In such circumstances, HoTARAC questions the benefit of the proposed disclosure.

HoTARAC believes that the recognised fair value should reflect the most reasonable inputs available, as well as the most reasonable amounts, and relevant correlation between the inputs used. On this basis, HoTARAC considers that assessments of the correlation between inputs, and the use of alternative amounts for those inputs and possibly, alternative inputs, would be more effectively incorporated into the actual measurement requirements and guidance of the eventual *Fair Value Measurement* Standard. HoTARAC questions the benefits of supplementing a recognised fair value with disclosures about less reasonable inputs/amounts.

HoTARAC considers the proposed disclosures would highlight the volatility and subjectivity of recognised fair values categorised within Level 3 of the fair value hierarchy. Therefore, without information about the likelihood of alternative values being more representative, HoTARAC suggests that disclosing ranges of possible values may reduce confidence in the recognised figures.

Overall views

Due to the uncertainties outlined above, HoTARAC is unable to estimate the likely costs that would be incurred by preparers and operational implications in analysing information for this disclosure. Subject to addressing the issues described above, increased use of inputs in a fair value calculation makes it more impractical and costly for an entity to re-calculate that fair value in light of numerous alternative combinations of amounts and, possibly, inputs, and to assess the significance of the difference in fair value resulting from each possible combination.

HoTARAC strongly recommends that the IASB consult with a representative of the valuation profession, such as the International Valuation Standards Council, about the practical aspects of this proposal. In many cases, professional valuers will be responsible for providing the information required for this disclosure.

(b) Due to the uncertainties described in (a) above, HoTARAC is unable to comment on whether there are any circumstances in which it would not be appropriate to take into account the effect of correlation.

Question 2 If the effect of correlation between unobservable inputs were not required, would the measurement uncertainty analysis provide meaningful information? Why or why not?

HoTARAC is uncertain of any added benefit from requiring correlation between inputs to be taken into account in the measurement uncertainty disclosure, given:

- the uncertainty HoTARAC has about the intention of assessing the "effect of correlation between unobservable inputs"; and
- there is no guidance as to how to assess the existence and extent of correlation between inputs.

Subject to those issues, HoTARAC considers that, if the fourth sentence of Paragraph 2(a) of this ED was excluded, the proposed expansion of the rest of that Paragraph would still constitute an improvement in wording, and would still result in a meaningful disclosure.

It is acknowledged that some users have requested this additional information. However, HoTARAC considers that the users who may benefit from this information are likely to be specialist users with particular information needs, not mainstream users of general purpose financial statements. For those users who do require this extra information, the relevance of what is disclosed is likely to be outweighed by the complexity of the disclosure.

Question 3 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.

To avoid imposing an unwarranted burden on preparers, and to ensure faithful representation of all assets and liabilities recognised at fair value, HoTARAC strongly believes that the disclosure requirements should focus on high-level principles.

HoTARAC believes external auditors play an important role in forming opinions about whether there is faithful representation of material asset values. This audit work involves forming opinions about the valuation methodology, and relevance and reliability of data used to determine recognised figures. In HoTARAC's view, such audit responsibilities are a more cost-effective, and less confusing, approach to convey to users the level of confidence they can have regarding recognised asset values.

As per the views of the IASB's Expert Advisory Panel about better practice disclosures for financial instruments, any fair value disclosures should provide more information about the high-level control and governance arrangements surrounding the determination of fair values. HoTARAC considers such information would be a more cost effective substitute to undertaking, and disclosing details of analyses of values, particularly due to the expected limited number of users who would be able to interpret and use such information.

Another approach for the IASB to consider is to:

- not require the disclosures proposed by Paragraph 2(a) of the ED;
- not require entities to undertake alternative value calculations; and
- instead, require entities to disclose more detail about the range of amounts that could be used for the various data inputs, that is, an expansion of what is set out in Paragraph 2(b) of the ED. Sophisticated users who demand such information can undertake their own alternative fair value calculations, including making their own assessments of the reliability of fair values that predominantly use Level 3 measurement inputs.

Other issues

To assist with the interpretation of these requirements, HoTARAC suggests that the IASB more clearly distinguish between the meaning of "sensitivity analysis" and "measurement uncertainty".

A number of references appear throughout the ED, such as, at the bottom of page 4, and Paragraphs BC12 and BC23, regarding the potential of another IFRS to specify that the proposed requirement in Paragraph 2(a) of this ED may not be required for a particular asset or liability. However, this qualification does not actually appear in either the body of this ED or the previous ED on *Fair Value Measurement*. Therefore, HoTARAC believes, if the IASB's intention is to be effective, that such a qualification should be directly incorporated into the body of the eventual Standard.

HoTARAC notes that certain liabilities, particularly those in respect of employee benefits, have well established disclosure requirements to supplement the recognised fair values. HoTARAC further notes that ED/2009/5 did not exempt entities from compliance with disclosure requirements in other specific Standards. Therefore, HoTARAC believes the IASB needs to review the inter-relationship between the proposed new disclosures and those that already exist under other specific Standards, and ensure there is no overlap in requirements. In this regard, HoTARAC notes that the recent IASB ED/2010/3 *Defined Benefit Plans* includes proposed disclosure requirements about sensitivity analyses.

Editorial matter

A small correction to the spelling of "volatility" towards the bottom of Illustrative Example 1, right hand column, is needed.