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September 28, 2009

International Accounting Standards Board
30 Cannon Street,
London EC4M 6XH
United Kingdom

Dear Sirs,

Fair Value Measurement, Exposure Draft, May 2009

This letter is the response of the staff of the Canadian Accounting Standards Board (AcSB staff) to the IASB's Exposure Draft on Fair Value Measurement, dated May 2009.

The AcSB staff discussed this Exposure Draft with the AcSB, the AcSB's Academic Advisory Council, User Advisory Council, Insurance Accounting Task Force, IFRS Advisory Committee and various Canadian auditors, preparers and users. The views expressed in this letter take into account comments and perspectives raised by these stakeholders. However, they do not necessarily represent a common view of the AcSB, its Committees or staff. Views of the AcSB are developed only through due process.

Overall, we think that the proposed standard on how to determine a fair value measurement is a significant improvement compared to existing guidance in IFRSs. We strongly support preparers', advisors' and users' calls for the IASB and the FASB to work together to develop a common fair value measurement standard, using the same words, at the same time.

In comparing the Exposure Draft proposals to US Statement of Financial Accounting Standards No. 157 *Fair Value Measurement*, as amended (Accounting Standards Codification Topic 820-10 *Fair Value Measurements and Disclosures*), we have identified several significant differences that concern us. These differences and other detailed comments on the proposals are explained in the attached Appendix. We think that these differences must be addressed before the proposed IFRS is finalized.

During the transition to the new standard, we strongly recommend that IFRS 1 be amended to allow first-time IFRS adopters to apply the new IFRS prospectively, just like IFRS preparers. Otherwise, retrospective determination of fair values is likely to be required, contrary to the IASB's usual practice. Also, to assist entities preparing to adopt IFRS in 2011, we urge the IASB to provide an early indication of the mandatory effective date; for example, that it will not be effective earlier than January 1, 2012.

We would be pleased to elaborate on any of our comments in more detail if you require. If so, please contact Peter Martin, Director Accounting Standards at +1 416 204-3276 (e-mail peter.martin@cica.ca), Ian Hague, Principal Accounting Standards at +1 416 204-3270 (e-mail ian.hague@cica.ca), or Rebecca Villmann, Principal Accounting Standards at +1 416 204-3464 (e-mail rebecca.villmann@cica.ca).

Yours truly,



Peter Martin, CA
Director
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Appendix

AcSB Staff Comments on the IASB Exposure Draft, *Fair Value Measurement*, May 2009

Question 1 - Definition of fair value and related guidance

1. We agree with the proposal to define 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) because a market price or a market-based estimate of that price can provide an objective and independent value of an item at the reporting date. We can accept an exit price because we think that the present entry price for one party to a transaction should be the same as the present exit price for the other party to that same transaction.

Question 2 – Scope

2. For measuring share-based payment transactions, reacquired rights in a business combination and financial liabilities with a demand feature, we agree with the IASB that the term “fair value” is used in a way in the individual standards that does not reflect the intended measurement objective in the proposed fair value measurement standard. We agree with replacing the term “fair value” in IFRS 2 and IFRS 3. However, we disagree with the proposed approach to IAS 39. We think that the statement in IAS 39 that, “the fair value of a financial liability is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid,” is an exception to fair value as defined in the proposed fair value measurement standard. As such, it should be dealt with in a way that does not contradict the proposed definition. We recommend that the measurement basis for a financial liability with a demand feature be amended to describe it as, “the higher of: (a) fair value; and (b) the amount payable on demand, discounted from the first date that the amount could be required to be paid.” In the absence of adopting such an approach, financial liabilities may be described as being measured at fair value, even though the measurement is not a fair value determined in accordance with the proposed fair value measurement standard.
3. If the IASB decides to require fair value reporting for some investments in which a reporting entity holds a controlling interest, as part of the consolidation project, the IASB may want to evaluate adopting proposals similar to those the FASB proposed in FSP FAS 157-g,

“Estimating the Fair Value of Investments in Investment Companies That Have Calculated Net Asset Value per Share in Accordance with the AICPA Audit and Accounting Guide, Investment Companies.”

Question 3 - The transaction takes places in the most advantageous market

Assuming a hypothetical transaction

4. The proposed standard enables an entity to determine a fair value measurement in any circumstance, either by referring to a price in an actual transaction or by using valuation techniques to estimate a price in an assumed transaction. To try to ensure that an estimate is representative of a real market transaction, the Exposure Draft states that, “it is necessary to consider the characteristics of market participants who would enter into a transaction for the asset or liability” (paragraph 12). The difficulty with this criterion is that recent experiences have demonstrated that, at times, potential market participants choose not to enter the market at all. That is, there may be no orderly transactions, no markets and, therefore, no market participants.
5. We think that the IASB should learn from recent experiences of trying to determine fair values when markets are inactive and consider:
 - (a) providing more detailed guidance on developing reasonable and supportable valuation assumptions when determining level 3 fair values; and
 - (b) whether these experiences have identified circumstances in which fair value should not be required and an alternative measurement basis required.

Guidance for developing reasonable and supportable assumptions

6. The proposed standard requires an entity to make the assumption that knowledgeable market participants are able and willing to enter into transactions for the asset or liability. An entity is expected to develop a supportable rationale for making adjustments to future cash flows to reflect market participants’ expectations at the measurement date. When there are no orderly transactions and no markets, there are no observable inputs from which to judge how market participants’ expectations about market, credit and liquidity risk are changing. Such uncertainties demonstrate that common benchmark inputs and acceptable norms are no

longer applicable. There may be little evidence available to support the assumptions and adjustments made to estimate a fair value in a hypothetical transaction. As a result, the extent of variation in the resulting fair value estimates could be significant.

7. For example, beginning in 2007, the Canadian market for non-bank-sponsored asset-backed commercial paper (ABCP) collapsed due to liquidity issues. Throughout that collapse, the resulting standstill arrangements and the subsequent restructurings, Canadian entities determined and reported the fair value of their holdings in ABCP in order to comply with Canadian GAAP. We understand that, throughout that time, entities used a wide variety of valuation approaches and that there was a wide range of estimates.
8. The proposed standard includes guidance developed by the IASB Expert Advisory Panel on how to identify when a market is not active and a transaction is not orderly and how to evaluate market information. In addition to the requirement for an entity to consider all circumstances and risks in valuations when markets are inactive, and an acknowledgment of how difficult those valuations can be, many stakeholders think that more detailed guidance should be provided. They think that application guidance, including illustrative examples, should be developed to explain how an entity should develop reasonable and supportable valuation assumptions when determining a level 3 fair value. If entities can be required to prepare such valuations, then the development of such guidance should be feasible. Providing more detailed guidance would help to reduce the wide variety of valuation approaches used and narrow the resulting range of estimates determined.

Are there circumstances in which fair value should not be required?

9. The difficulties and challenges of developing reasonable and supportable estimates of fair values may identify circumstances in which fair value should not be required. A variety of stakeholders commented that even larger entities that have the sophistication and the resources to develop quality valuations have found estimating fair values challenging when markets are inactive. We think that stakeholders are questioning the informational value of the resulting hypothetical fair value estimates of an asset or a liability when markets are inactive for a significant period of time. These price estimates lack information value because, if the entity tried to sell its asset or settle its liability in an actual market, no market

participant would enter into a transaction for that asset or liability at that date. In other words, no one can know whether these price estimates faithfully represent real economic markets for the asset or the liability and as a result, the estimates could possibly mislead users. We think that, as part of the current project on Financial Instruments: Classification and Measurement, and other projects in which fair value measurement is contemplated, the IASB should consider whether these circumstances may exist and specify a measurement basis other than fair value.

Most advantageous market versus principal market

10. With the objective of developing principle-based standards in mind, we agree *conceptually* with the IASB’s decision that a fair value measurement assumes that the transaction to sell an asset or transfer a liability takes place in the most advantageous market to which the entity has access. However, the Exposure Draft proposes that, as a practical expedient, an entity may assume, in the absence of evidence to the contrary, that the principal market for the asset or liability is the most advantageous market. This differs from the approach in SFAS 157, which assumes that the transaction to sell the asset or transfer the liability takes place in the principal market, or in absence of a principal market, the most advantageous market.
11. From a convergence perspective, many stakeholders questioned whether assuming that the transaction occurs in the most advantageous market, rather than the principal market, created a substantive difference between SFAS 157 and the IASB proposals. Some stakeholders attributed the difference to style of drafting, whereas other stakeholders think that in some circumstances a different market could be selected depending on whether an entity applied the IASB proposals or SFAS 157. This latter view is reinforced by the IASB identifying in the Basis for Conclusions that the reference market concept is not “largely consistent” with SFAS 157 and by the statement in SFAS 157, paragraph 8 that:
- “If there is a principal market for the asset or the liability, the fair value measurement shall represent the price in the market (whether that price is directly observable or otherwise determined using a valuation technique), *even if the price in a different market is potentially more advantageous at the measurement date.*” (emphasis added)
12. From an operational perspective, the proposed standard places an onus upon an entity to consider if there is any evidence that would rebut the assumption that the principal market is

the most advantageous market. Especially for financial assets and financial liabilities, several stakeholders we spoke with considered that a substantial effort would be required at each reporting date to substantiate that the principal market is the most advantageous market. They saw this requirement as being an even harder task for non-financial assets and non-financial liabilities.

13. Ideally, we would recommend that the IASB should work jointly with the FASB to develop a high-quality approach that is operational. However, given that the FASB has assessed the expected effort and cost of continuously evaluating if evidence exists that would contradict the principal market assumption, or proving that a market is the most advantageous market, we recommend that the approach used in SFAS 157 on this issue be adopted; that is, an entity should use the principal market and only in the absence of a principal market, identify the most advantageous market. A rational market participant would be expected to transact in the most advantageous market whenever possible.
14. If the IASB affirms its decision that a fair value measurement should assume that the transaction to sell an asset or transfer a liability takes place in the most advantageous market to which the entity has access, we think that the difference between that approach and the approach used in SFAS 157 should be clearly identified in the standard.

Question 4 – Market participant assumptions

Knowledgeable characteristic excludes information asymmetry

15. We agree that an entity should determine fair value measurements using the assumptions that market participants would use in pricing the asset or liability. We disagree with the description of “market participants” because the proposed characteristic that market participants are “knowledgeable” does not adequately take account of information asymmetry.
16. Empirical evidence has proven that prices in active and orderly markets, even for common items (e.g., used cars), can reflect discounts for information asymmetry. Therefore, observable prices in level 1 of the fair value hierarchy include any discounts for information asymmetry. Based on the presumption that market participants “are presumed to be as knowledgeable as the reporting entity about the asset or liability” (paragraph 13(b)),

valuations using level 3 inputs would result in fair value measurements that do not factor in information asymmetry. The Basis for Conclusions, paragraph BC45, states that the IASB had proposed to address this inconsistency by suggesting that market participants could be expected to do sufficient “due diligence” to remove this risk, so that:

“The market participant and the reporting entity are presumed to be equally knowledgeable about the asset or liability, although neither party is perfectly knowledgeable. In other words, a fair value measurement does not reflect information asymmetry, although it does reflect information uncertainty (ie uncertainty an entity faces because it does not have perfect knowledge about the timing and amount of future cash flows).”

17. We think that assuming away information asymmetry contradicts the reality of market pricing for many assets and liabilities and reduces the representational faithfulness of level 3 fair value measurements. We think that the effect of information asymmetry could be significant, in particular for many non-financial assets and non-financial liabilities.
18. In comparing the IASB proposal to SFAS 157, we think that the proposed IFRS would result in an unacknowledged difference. The description of “knowledgeable” in SFAS 157, paragraph 10, does not state that market participants are presumed to be as knowledgeable as the reporting entity about the asset or liability. The Basis for Conclusions to SFAS 157, paragraph C34, notes that “some respondents questioned the extent to which market participants would be expected to be knowledgeable, referring to markets that are characterized by information asymmetry, where some market participants have information about an asset or liability that is not available to other market participants.” To address information asymmetry:

“The Board agreed that it would be reasonable to presume that a market participant that is both able and willing to transact for the asset or liability would undertake efforts necessary to become sufficiently knowledgeable about the asset or liability based on available information, including *information obtained through usual and customary due diligence efforts, and would factor any related risk into the fair value measurement.*” (emphasis added)

Following SFAS 157, valuations using level 3 inputs would factor in risks due to information asymmetry as well as information uncertainty.

19. We think that this is a fundamental difference between the draft IFRS and SFAS 157. To faithfully represent the information asymmetry that exists in active and orderly markets, we

recommend that the approach used in SFAS 157 on this issue be adopted in the IASB standard. We think the IASB should revise the knowledgeable characteristic of a market participant as follows:

“i.e., they are sufficiently informed to make an investment decision and would factor any related risk into the fair value measurement ~~are presumed to be as knowledgeable as the reporting entity about the asset or liability;...~~”

Question 5 - Application to assets: highest and best use and valuation premise

Should not be based on a single highest and best use

20. Some valuers expressed concern that, although the valuation premises in the IASB’s proposals appear to be the same as those in Canadian and international valuation standards, they seem to be applied differently. The proposed standard requires the application of either an ‘in-use’ or an ‘in-exchange’ premise, instead of requiring evaluation of both. Using accepted valuation concepts for real estate, a valuator would take into account whether a property could be used for commercial, industrial or residential purposes, but the resulting fair value is always considered to be a value that would be received in a market exchange. From their experience, there is rarely one highest and best use that all market participants would assume. To select one use over other possible uses, a valuator would need to focus on the long-term versus the short-term feasibility of the alternative uses. However, valuers are required by their own professional standards to reflect the probability of whether various assumptions in a valuation will occur. Thus, the resulting fair value would factor in the possibility that different uses may turn out to be the highest and best use.
21. We think that clarity is necessary as to whether the way in which the proposed standard uses the term “highest and best use” is the same as that use by valuers. If not, it should be clearly explained why it is different and, ideally, different terminology should be used. We recommend that, in applying the highest and best use concept, the IASB clarify that a valuation should reflect the likelihood of different possible uses turning out to be the highest and best use of an asset. The proposed standard should explain that the application of the highest and best use concept does not result in selecting a single highest and best use and resulting value. We think that this is consistent with the way that market participants would determine the price at which they would transact.

Assess whether current use continues to be highest and best use

22. The highest and best use concept is described as the use of an asset by a market participant that would maximise the value of the asset or group of net assets, after considering the uses that are physically possible, legally permissible and financially feasible. In paragraph 18, the proposed standard indicates the importance of identifying the highest and best “current” use. However, it states that “an entity need not perform an extensive search for other potential uses if there is no evidence to suggest that the *current* use of an asset is not its highest and best use” (emphasis added). Either over time or given the changing economic environment in which market participants are making purchasing and investing decisions, market participants’ views can change as to what is the highest and best use of the asset or group of assets. Though we agree that an entity need not perform an exhaustive search, we think that an entity should be required to consider a range of factors, both related to the asset and the economic environment, to confirm whether the use of the asset continues to be the highest and best use of the asset or a group of assets at the measurement date.

Clarifying the ‘in use’ valuation premise

23. In reading the proposed standard and discussing its application with stakeholders, we find that the ‘in use’ valuation premise is interpreted as using the asset in a market participant’s operations and the ‘in exchange’ valuation premise relates to assets that are not used directly in the operations. These views do not reflect the explanation of the ‘in exchange’ valuation premise in paragraph 23(b) that “the fair value of the asset is the price that would be received in a current transaction to sell the asset to market participants who would *use the asset on a stand-alone basis*” (emphasis added).

24. Though the description of the ‘in use’ premise in SFAS 157 does not specify that the assets and liabilities would be used as part of the market participant’s operations, we understand that the premise has been interpreted that way in practice. To promote consistent application, we recommend that the IASB clarify the ‘in use’ premise by focusing on how the assets or liabilities would be used in the market participant’s operations.

Distinguishing the unit of valuation

25. With the release of SFAS 157, the FASB and other educators emphasized the need to distinguish the unit of *valuation* separately from the unit of *account*. When estimating a fair value using a valuation technique, an entity may use a unit of valuation, different to the unit of account, in order to maximise the value of the asset or the group of assets and liabilities. Depending on the unit of account prescribed by the IFRS applicable to the asset or liability or group of assets or liabilities, an entity may need to allocate that fair value determined using the unit of valuation to identify the fair value of a unit of account.
26. Though the unit of valuation is not a specified concept in SFAS 157, we understand that, in practice, experience has demonstrated that identifying and using a different unit of valuation from the unit of account has been helpful in applying the US standard. To codify practise, we think that the IASB should work jointly with the FASB to include guidance in their fair value measurement standards to distinguish the role of the unit of valuation from the unit of account. If a joint proposal cannot be developed to address this fundamental concern, we think the IASB should do so to promote consistent application of the proposed standard across jurisdictions.

Highest and best use and ‘in use’ valuation premise for financial assets

27. The proposed standard clarifies that financial assets should be measured using an ‘in exchange’ valuation premise, because the ‘in use’ premise is not relevant for financial assets. We agree with the IASB’s decision.
28. Given the economic circumstances over the last two years, some stakeholders think this proposal would have resulted in recognising an ‘in exchange’ value for some assets that the holders perceived to be lower than their ‘in use’ value. These stakeholders describe an ‘in exchange’ value as based on realising the cash flows from holding a financial asset for the long-term (for example, based on a lender’s expectation that it would hold a loan to maturity and collect the contractual cash flows as part of their business). We think that some stakeholders may be interpreting the ‘in exchange’ premise as the price that can be realized today regardless of circumstances. Stakeholders may not be focusing on the presumption that an orderly transaction requires marketing activities that are usual for the item in order for

potential market participants to be knowledgeable about the long-term feasibility of the item. Accordingly, we recommend that the long-term, as well as the short-term, feasibility of the in-exchange premise be emphasised in the explanation of this concept (also see paragraph 20 of this Appendix).

Considering the benefits of a diversified portfolio

29. Paragraph 24 of the proposed standard states that the ‘in use’ valuation premise is not relevant for financial assets because “the fair value of a financial asset determined using an in-exchange valuation premise reflects any benefits that market participants would derive from holding that asset in a diversified portfolio.” For a reader not familiar with finance literature, this statement can create confusion as to whether the holder of a stand-alone financial asset should value the financial asset as a part of a diversified portfolio or on a stand-alone basis.
30. We think that the IASB is trying to explain that active markets for financial assets only price non-diversifiable risk, as each market participant is capable of holding a diversified portfolio of financial assets. This view is supported by extensive evidence in finance and capital markets literature. Diversifiable risk is excluded because it can be reduced or eliminated by holding a diversified portfolio. Therefore, the presumption in active markets is that each market participant holds a diversified portfolio of financial assets. As some may dispute this view, we recommend that the IASB explain their rationale in the Basis for Conclusions, by reference to the pertinent literature.

Highest and best use and valuation premise for liabilities

31. Consistent with our views for financial assets, we agree that the notions of highest and best use and the ‘in use’ valuation premise, in their inverse, do not apply 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

32. We disagree that an entity should separate the fair value of an asset used together with other assets in a way that distinguishes the current value of the asset assuming its current use from the fair value of the asset group assuming its highest and best use, for the following reasons:

- (a) To do so creates a conflict between the requirement that “assumptions about the highest and best use of the asset shall be consistent for all of the assets of the group within which it would be used” (paragraph 22(a)) and the provisions of IFRS standards that require that each of the assets within a group be measured at fair value. The problem is demonstrated in the land and factory example in the proposed standard, in which the factory is to be reported at a value assuming its current use, which differs from its fair value (which is nil or negative) determined on the basis of the highest and best use of the land.
- (b) It introduces a new measurement requirement, “the value of the assets assuming their current use,” that differs from fair value as defined. The new measurement requirement is described as a value that “differs from fair value when the current use of the assets is not their highest and best use” but “reflects all other factors that market participants would consider when determining the price for the assets.” As a result, an asset, such as a factory, in the example, reported at its current use value would not meet the fair value measurement requirement in IAS 16 for the factory.
- (c) Though the users we spoke with thought disclosures about such situations would be useful, several users questioned whether management of an entity would want to indicate that they are not utilizing their assets in their highest and best market use. As a result, disclosures would likely become boilerplate and not be useful.
- (d) The proposals complicate the measurement process, because preparers need to identify, and distinguish between, a current value and a fair value. Users also would need to understand those differences.
- (e) In the land and factory example in the Exposure Draft, several stakeholders questioned whether it would be necessary to recognise a liability for demolishing the factory in order to faithfully represent the incremental value of the asset group. However, such an obligation can be recognised only when the entity is obligated to undertake the demolition. More importantly, as the entity intends to continue in business, the cost of replacing the factory or consolidating its factories should also be taken into account. Thus, we think that a more extensive explanation of how the incremental value is to be determined must be provided.

(f) The proposal creates an unlevel playing field compared to US GAAP, because, unlike US preparers, an IFRS preparer would be required to disclose information about how it uses its assets. That is likely to be viewed as requiring provision of information for which there is a competitive advantage to non-disclosure.

33. We think that the land and factory example set out in the proposed standard, paragraphs 20 and IE5-8, demonstrates a fundamental problem with the application of the “highest and best use” principle. We do not know how this situation would be handled under SFAS 157, as the same example in SFAS 157, paragraph A10-A11, does not explain what value the factory should be reported at if the highest and best use of the land is in exchange. We recommend that the IASB further investigate how to apply the highest and best use concept to valuing groups of assets at fair value when individual assets within the group will not be used on the basis of their individual highest and best use. To ensure the consistent application of a key concept, we think the IASB needs to reconcile their proposals to how similar situations would be addressed under US GAAP.

Question 7 - Application to liabilities: general principles

34. We agree with the general principles the IASB has proposed for measuring the fair value of a liability, because the principles focus on measuring most liabilities based on the inverse of assets, which is reflective of the fact that the characteristics of most liabilities are naturally the inverse of assets. As needed, the principles permit adjusting a value to reflect unique attributes of a liability. Overall, using one consistent measurement approach to measure both assets and liabilities should be easier to understand and result in more consistent application. We note that the principles are consistent with the proposals we made in our response to the IASB Discussion Paper on Fair Value Measurement.

35. Except for circumstances in which there is no corresponding asset for a liability (e.g., for a decommissioning liability assumed in a business combination), we are not 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 corresponding asset held by another party. Consistent with considering the benefits of a diversified portfolio of financial assets, we think that the Basis for Conclusions should explain that active markets for financial liabilities only price non-diversifiable risk.

Question 8 - Application to liabilities: non-performance risk and restrictions***How fair value is determined***

36. A measurement that excludes non-performance risk cannot, by definition, be a fair value measurement. Therefore, we agree that the fair value of a liability should include a *market participant's* best estimate of non-performance risk, including credit risk. This view is consistent with the views expressed in our comment letter to the IASB on Credit Risk in Liability Measurement, dated September 4, 2009.

Clarify purpose of measuring “own” credit risk

37. In considering how an entity would assess its “own” credit risk (more precisely, the credit risk of its own liability), stakeholders have expressed concerns about the challenges of making such estimates, including the release of proprietary information. We think these concerns have been exaggerated by how the proposed standard states the requirement. In paragraph 29, “non-performance risk is assumed to be the same before and after the transfer of the liability” and paragraph in 30 states “non-performance risk includes, but may not be limited to, an entity’s own credit risk.” We think that the requirement should reinforce that non-performance risk of the liability is estimated from the perspective of a market participant. An entity should determine what credit risk a market participant would assign to its liability using observable inputs, not proprietary information, and reflecting information asymmetry from a market participant’s perspective. We recommend that the IASB remove the reference to “own” credit risk and clarify that the objective is to assess the credit risk of the liability from a market participant’s perspective.

38. Also, we think it is important to emphasise that non-performance risk relates to the characteristics of the liability and not the entity. Whether a liability has priority of payment or is secured, the risk of non-performance is lower than for a general unsecured liability of the entity.

Restrictions do not affect performance

39. We agree that the fair value of a liability is not affected by a restriction on an entity’s ability to transfer the liability because the restriction would not affect the requirement for the entity or a market participant transferee to fulfil the obligation.

Question 9 - Fair value at initial recognition***Improve the language***

40. The fair value proposals are written to specify that “the transaction price is the best evidence of the fair value of an asset or a liability at initial recognition unless” one of the four conditions listed are met. Yet, this proposal conflicts with the description that it is “an example,” which suggests that other cases may exist as well. The parallel requirement in SFAS 157, paragraph 17 does not have this logical problem because it describes the requirement as an example and introduces the factors using an “if” statement. In paragraph C52 of the Basis for Conclusions on SFAS 157, the FASB commits to considering these factors in assessing the appropriate measurement attribute at initial recognition in individual pronouncements on a project-by-project basis. Future assessments may identify other factors that warrant recognition of a gain or loss on initial measurement. A more prescriptive IFRS requirement than US GAAP could result in different outcomes. We think that that door should be left open until more experience is gained. Entities should be permitted to make the case and justify why a transaction price is not representative of fair value on initial measurement. Therefore, we recommend adopting the language from SFAS 157.

Recognise gains and losses on initial recognition

41. We think that when a fair value is a sufficiently robust estimate to be recognized in the balance sheet, it should be sufficiently robust to be recognized in the income statement. Accordingly, we support the view that fair value measurements that include unobservable market inputs can be applied at initial recognition and result in the recognition of day-one gains and losses, when the measurement differs from the transaction price. Accordingly, we think that an entity should recognise any difference between the fair value measurement of an asset or liability at initial recognition and the transaction price.
42. For reasons outlined in the previous paragraph, we disagree with the proposed consequential amendment to paragraph AG76 of IAS 39 to require the deferral of differences between transaction prices and fair values that have been determined on the basis of level 2 and 3 inputs. As deferred gains and losses do not meet the definitions of assets or liabilities and using level 2 and 3 inputs will be appropriate in determining a fair value measurement upon

the adoption of this standard, we recommend that the IASB reconsider and eliminate the proposed observable market data recognition threshold in IAS 39, paragraph AG76, or revise the measurement basis in IAS 39. Otherwise, this proposal will set a precedent for recognizing deferred “what-you-may-call-its,” which the IASB and its predecessor worked hard to eliminate. Accordingly, we recommend that the proposed amendment to IFRS 7, paragraph 28 to require disclosures about deferred gains and losses be deleted.

43. In any event, we do not understand the deferral requirements. Paragraph D32 proposes that “the entity shall recognise that deferred difference as a gain or loss only to the extent that it arises from a change in a factor (including time) that market participants would consider in setting the price.” Fair value by definition reflects all factors market participants would consider. How does an entity determine the amount of the deferral to recognise? Are only changes due to new factors to be recognised? If the IASB decides to require the deferral of such gains and losses on initial measurement, the guidance on deferred gains and losses must be written more clearly.

Assessing and explaining the rationale for recognition of gains and losses on initial measurement in the Basis for Conclusions on other standards

44. Several stakeholders would prefer that the IASB’s fair value measurement standard should exclude any requirements with respect to whether to recognise gains and losses on initial measurement. They are concerned that permitting gain or loss recognition on initial measurement effectively tells an entity to have more faith in its fair value determinations than in transaction prices without considering whether fair value can be faithfully represented. Instead, they recommend that the IASB and stakeholders should debate and decide on a standard-by-standard basis whether the fair value of an item can be faithfully represented before requiring the recognition of gains or losses on initial recognition.
45. We think that as part of selecting fair value as a measurement basis in a standard, the IASB will need to confirm each time that gains or losses on initial measurement should be recognized. We strongly recommend that the IASB explain in the Basis for Conclusions of each new standard its rationale for recognition of any gains and losses that might arise on initial measurement.

Disclose rationale for the recognition of gain or loss on initial measurement

46. Consistent with including a requirement that an entity recognize a gain or loss on initial measurement when the transaction price of an asset or a liability differs from its fair value, we agree with the proposed amendment to IFRS 7, paragraph 28(c) and 28A, to require an entity to disclose separately the gain or loss, and explain why the transaction price was not the best evidence of fair value. Users are keen to understand the circumstances when such a gain or loss arises, in order to evaluate management's performance.

Question 10 - Valuation techniques***Overall***

47. We agree with the proposed guidance on valuation techniques, including specific guidance on markets that are not active and transactions that are not orderly, except with regard to:
- (a) Assuming hypothetical transactions when markets are inactive for a significant period of time. We think that the IASB should learn from these recent experiences of trying to determine fair values when markets are inactive and consider:
 - i) providing application guidance, including illustrative examples, on how an entity can develop reasonable and supportable valuation assumptions when determining a level 3 fair value; and
 - ii) whether these recent experiences have identified circumstances in which fair value should not be required because these price estimates do not faithfully represent a real economic value for the asset or the liability and, accordingly, an alternate measurement basis should be required – see paragraphs 4-9 of this Appendix.
 - (b) Determining whether quoted prices provided by pricing services were determined in accordance with the proposed standard given the proprietary nature of third party pricing methods. Instead, we recommend that preparers be required to evaluate the overall representational faithfulness of the pricing service – see the next paragraph of this Appendix.

Validating price quotes

48. In order to use price quotes provided by a pricing service or broker, the proposed standard requires an entity to determine whether quoted prices were determined in accordance with the proposed standard. Theoretically, we support this requirement but stakeholders claim that this requirement is not practical. The methods used by third party pricing services are proprietary. Preparers have been unable to obtain sufficient and supportable information to validate that the pricing methods used are consistent with methods required by the proposed standard. When the methods of a third party pricing service are proprietary, we recommend that this requirement be revised to require preparers to evaluate the overall representational faithfulness of the pricing service by assessing:

- (a) whether the objective of the pricing service is consistent with the measurement objective in the proposed standard;
- (b) whether past quotes are representative of the prices of transactions completed; and
- (c) the reputation of the provider.

49. Alternatively, the proposed standard could recommend that third parties who provide pricing services might consider engaging an independent auditor to provide assurance that their pricing methodologies and internal controls in order to provide a third party report to all users that their pricing service provided price quotes in accordance with the proposed standard during a specified period of time. Based on receiving such third party reports for the financial reporting period, an entity would then be able to rely on the price quotes provided.

Question 11 - Disclosures

50. We agree with the proposed disclosure requirements, other than the requirement to disclose an asset that is used with other assets and its highest and best use differs from its current use, as proposed in paragraph 60 (see our concerns about the measurement proposal in paragraphs 32-33 of this Appendix). We discussed most of these disclosure proposals with stakeholders as part of the development of the improvements to IFRS 7 and no concerns were raised. In reviewing the proposed new disclosures for liabilities, many agreed they are appropriate. In particular, users supported the requirement that entities disclose the difference between the

fair value of a liability and the amount the entity is contractually required to pay to settle the obligation.

51. Several users reiterated the need for sufficient sensitivity information about an entity's level 3 fair value measurements in order to assess how aggressive or conservative the entity's estimates are. They are concerned about how useful these disclosures may be if information is aggregated at too high a level. As proposed, an entity is to disclose for each class of assets and liabilities the fact that changing one or more inputs to reasonably possible alternative assumptions would significantly change a fair value, and by how much. Other stakeholders are concerned that preparers will not work very hard to identify alternative assumptions and as a result, the disclosures will be incomplete and significantly understate the range of reasonably possible alternative assumptions. Thus, for several reasons, the resulting sensitivity disclosures could be deceptive. To balance the preparers' concerns about providing very detailed information against the users' wish to obtain sufficient information to be useful, some users suggest that the sensitivity disclosure requirement should specify that an entity describe the nature of the change at least by type of risk, for example, whether the change is attributable to credit risk versus liquidity risk and why. To clarify the minimum disclosure expected, an illustrative example of this requirement could be provided.
52. We think that the IASB should heed users' concerns and consider the important insight sensitivity disclosures can provide to users. We note that the overall disclosure objective of the new standard requires an entity to provide sufficient information for users to evaluate the quantitative information. The disclosure objective should influence the quality of information preparers provide. As preparers are just now implementing the current IFRS 7 requirement and starting to provide sensitivity disclosures about fair value measurements of financial assets and financial liabilities, we recommend that the IASB evaluate the usefulness of sensitivity disclosures after initial implementation. If as a result of that analysis, sensitivity disclosures provided are not what the IASB or users wanted, we recommend that the requirement be revised to specify that an entity describe the nature of the change by type of risk that would change a fair value significantly.

Question 12 - Convergence with US GAAP

53. Stakeholders in North America that will prepare both IFRS and US GAAP financial statements support the development of one high-quality global accounting standard. They strongly recommend that the IASB and FASB work together to develop one standard. For them, the effort required to determine and communicate whether the differences in standards may result in measurement differences outweigh the value of any improvements proposed in one standard over the other.
54. Before finalising the proposed standard, we strongly recommend that the IASB resolve the following fundamental differences:
- (a) most advantageous market versus principal market – see paragraphs 10-14 of this Appendix;
 - (b) knowledgeable characteristic of market participant excludes information asymmetry – see paragraphs 15-19 of this Appendix;
 - (c) distinguishing the unit of valuation – see paragraphs 25-26 of this Appendix;
 - (d) when an entity uses an asset together with other assets in a way that differs from the highest and best use of the asset – see paragraphs 32-33 of this Appendix;
 - (e) improve the language that transaction price is best evidence of fair value at initial recognition – see paragraph 40 of this Appendix;
55. If these fundamental differences are not resolved, significant measurement differences in practice will result, including recognition of gains and losses on initial measurement. To avoid one board making further improvements and amendments which are then considered by and improved upon by the other board, et cetera, we support calls by preparers, advisors and users for the IASB and the FASB to work together and develop a common standard, using the same words, at the same time.
56. In addition to the preceding comments about various differences between the proposed standard and SFAS 157, we note that the blockage difference cited in paragraph BC110 relates to existing differences between IFRSs and US GAAP. We agree that the unit of

account in IAS 39 should be applied consistently regardless of the level of the hierarchy within which a fair value is categorised.

57. As well, the FASB has amended or is proposing to amend SFAS 157 to adopt guidance on the measurement of liabilities and disclosures, including requirements to disclose the sensitivity of fair value measurements to changes in assumptions that are similar to the requirements in the proposed standard. We think that the remaining differences relate to style; for example, setting a presumption to recognize gains and losses on initial measurements unless the IASB decides in another standard to not allow its recognition, and other wording differences.

Question 13 – Other comments

Effective date and transition provisions

58. We are concerned that Canadian entities adopting IFRSs (and entities in other jurisdictions with a 2011 adoption date) might be expected to apply the fair value measurement standard as of a date before it is issued by the IASB, or will be discouraged from adopting the standard early, because no amendments to IFRS 1 have been proposed on the restatement of comparatives.
59. Canadian publicly accountable enterprises are required to adopt IFRSs for interim and annual financial statements related to fiscal years beginning on or after January 1, 2011. If the final version of the fair value measurement standard is published after the date of transition to IFRSs of January 1, 2010, i.e. June 30, 2010, Canadian enterprises would be expected to determine fair value measurements of certain items as at the transition date without having the final version of the standard.
60. If the mandatory effective date of a final standard is January 1, 2011, a current IFRS preparer would be required to adopt the standard for its 2011 fiscal year on a prospective basis, whereas first-time IFRS adopters would be required to do so for the 2010 and 2011 fiscal years. For the first year of adoption of this proposed fair value measurement standard, the requirements are inconsistent as to how first-time IFRS adopters and current IFRS preparers are to present their comparative financial information. We note that with the issuance of other significant new or revised standards, such as when the revised version of IAS 39 in

December 2003 for the European adoption of IFRSs, the IASB has in the past not expected first-time IFRS adopters to revise comparative information in the first year of adoption of the standard.

61. If an effective date later than January 1, 2011 is selected, first-time IFRS adopters may be discouraged from early adopting the new standard and determining higher quality fair value information. Given the additional effort of applying the standard at the date of transition to both its comparative and current fiscal years, entities would choose to adopt the standard later.
62. For reasons outlined above, we recommend that IFRS 1 be amended to require first-time IFRS adopters to determine fair values in accordance with the standard on a prospective basis. That is, IFRS 1 should be amended so that a first-time adopter with a transition date before the mandatory effective date of the fair value measurement standard is not required to restate the year of transition comparative financial information but, instead, discloses that those years are not comparable. For example, assuming that the fair value standard is issued in 2010, IFRS 1 should be amended to not require application of the fair value measurement standard for annual periods beginning before January 1, 2011 (ideally, provide the same lead time to first-time IFRS adopters as an existing IFRS preparer).
63. To assist entities adopting IFRS in 2011, we urge the IASB to provide an early indication of the mandatory effective date, for example, that it will not be effective earlier than January 1, 2012. Communicating such an intention would alleviate a significant amount of uncertainty for 2011 adopters and enable them to develop and execute their IFRS adoption plans effectively.

Consequential amendments

64. As many of the consequential amendments are quite significant, we question why the Exposure Draft did not prominently identify the key amendments by asking constituents whether they agreed with the proposals in the invitation to comment.

65. We agree with the consequential amendments proposed, except for the following:

- (a) Paragraph AG76 of IAS 39 would require the deferral of gains and losses on initial recognition that are not evidenced by observable inputs – see paragraphs 41-43 of this Appendix.
- (b) The proposed amendment to paragraph AG2 of IFRIC 13 to take into account “non-performance risk” is unclear. By definition, the “fair value” of an award should reflect both the non-performance risk of the liability and any credit risk of the asset. Therefore, the measurement explanation should clearly differentiate which risk should be considered, that is the fair value of award credits that could be redeemed or the fair value of the awards that are to be offered, or both. We recommend that the requirement in AG2 be revised to articulate the measurement requirement clearly.

Drafting comments

66. In translating the Exposure Draft into French, we identified the following proposed improvements to the text:

- (a) Appendix A – The definition of orderly transactions includes the description that marketing activities are “usual and customary.” These adjectives both refer to something being typically done or occurring. Either use one term or more clearly distinguish the intended difference between the two terms.
- (b) Appendix C, paragraph C2 – We recommend revising the text to avoid introducing what appears to be new and unexplained concept – “value maximising behaviour.” For example:

“Present value (an application of the income approach is a tool used to link uncertain future amounts (cash flows or values) to a present amount using a discount rate that maximises the value that would be received from selling an asset or minimise the value that would be paid to transfer a liability ~~is consistent with value maximising behaviour.~~”

- (c) Appendix D, paragraph D19 – The second sentence in paragraph 120A(ea) of IAS 19 be revised to say “If an entity is adopting the deferred recognition model” or “If an entity adopts the deferred recognition model..” Also, the word “paragraph” at the end of this paragraph should be plural.