



## **FAIR VALUE MEASUREMENT**

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The exposure draft proposes guidance on valuation techniques, including specific guidance on markets that are no longer active (see paragraphs 38–55 of the draft IFRS, paragraphs B5–B18 of Appendix B, paragraphs BC80–BC97 of the Basis for Conclusions and paragraphs IE10–IE21 and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

It substantially increases the level of guidance on valuation techniques comparing to the actual version of IAS 39. However, it still doesn't propose sufficient guidance in determining the credit spread over the basic interest rate, when using cash flow analysis to establish fair value of a financial instrument for which the market is not active.

There are many ways in determining the credit spread over the basic interest rate of the financial asset's counterpart. Moreover, in some situations this assumption is not considered when using cash flow analysis to establish fair value of some derivative instruments, as in Brazilian market, for instance, where it is not practice to input the credit spread of the counterpart in determining fair value of swap contracts by using valuation techniques (actually, a few number of entities adopt a model that considers credit spread in this situation). For these two reasons – i) the diversity of existing ways in determining the credit spread and ii) when it has to be used or not –, to provide sufficient guidance in this subject could enhance the level of comparability of financial statements and improve their accuracy specially in situations when the economic situation intensifies the effects on accounting balances of credit spread risk.

IAS 39 in its AG 78 assumes that there are situations where an entity may not have information from recent transactions to determine the appropriate credit spread over the basic interest rate to use in determining a discount rate for a present value computation. In its AG 79, IAS 39 provides a very subjective guidance when it says "In applying discounted cash flow analysis, an entity uses one or more discount rates equal to the prevailing rates of return for financial instruments having substantially the same terms and characteristics, including the credit quality of the instrument, the remaining term over which the contractual interest rate is fixed, the remaining term to repayment of the principal and the currency in which payments are to be made."

Today, it substantially represents all guidance provided by IAS 39. As said before, it is not clear explaining when, in the absence of an active market, the credit spread over the basic interest rate could be determined. As there are many ways used by market participants in determining it, we would suggest to be provided a hierarch level of the accepted ways used and sufficient guidance on how to determine that. It also would provide more comparability between



financial statements if IAS 39 considered situations where credit spread should or has to be included in valuation techniques that are based on discounted cash flow analysis (as in Brazilian market example).

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## **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?

Yes. The proposals are appropriate and cover, substantially, all needs of disclosures that are considered essential and necessary to a correct understanding of the subject. As an improvement to the text, it could consider examples to help the reader to understand the context of some paragraphs. For example:

Paragraph 56 – For assets and liabilities measured at fair value... could include an example and be written in this way: For assets and liabilities measured at fair value (for example, trading securities).

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## **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?

As stated on paragraphs BC76 to BC79, of the Basis for Conclusions on the Exposure Draft “Fair Value Measurement” (ED), the Board concluded that recognition of “day 1” gains or losses is



not part of this project's scope and therefore the appropriate treatment to be applied on such situations is to be defined by currently applicable standards.

Also, as stated on paragraph BC110(e), the abovementioned proposal would create a difference between IFRS and US GAAP, since SFAS 157 implicitly requires "day 1" gains or losses to be recognized, even when the fair value measurement uses unobservable (level 3) inputs.

SFAS 157 clarifies on its Basis for Conclusions (paragraph C16) that, in this context, fair value measurement should consider, from the perspective of market participants: a) risks inherent in a particular valuation technique used; and/or b) risks inherent in the inputs to the valuation technique.

The treatment adopted by FASB seems to be conceptually preferable and, perhaps the IASB could consider expanding the requirements of the ED in order to set a single principle for recognition of "day 1" gains or losses (changing the recognition threshold in paragraph AG76 of IAS 39). In this case, an entity could be required to disclose: a) the reasons that caused the transaction price to be different from the exit price; and b) how risks inherent in a particular valuation technique used (or inherent in the inputs to this technique) were considered.

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**Question 13: Do you have any comments on the proposals in the exposure draft?**

Whereas:

(a) paragraph 13 defines the market actors as buyers and sellers that operate in the most advantageous market for the assets (or the liabilities);

(b) paragraph 9 indicates that most advantageous market should be considered from the perspective of the reporting entity;

(c) paragraph 13 (a) mentions the reporting entity is a market actor (even though it indicates that it is not the only one to be considered at the moment of measuring the fair value);

(d) paragraph 14 mentions there is no need to identify a specific market actor, but merely to identify characteristics that distinguish the market actor in terms of: (a) assets (or liabilities); (b) most advantageous market for the assets or liabilities, and (c) market actors with which the reporting entity could carry out a transaction,

It is suggested that the words "market actors" be replaced by "other market actors", whenever the context requires that the view and the assumptions of the reporting entity should not be considered for the purpose of determining the Fair Value Measurement.