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Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London
United Kingdom
EC4M 6XH

Dear Mr Hoogervorst

Request for Information: Post-implementation Review – IFRS 13 *Fair Value Measurement*

Deloitte Touche Tohmatsu Limited is pleased to respond to the International Accounting Standards Board's ('the IASB's') Request for Information *Post-implementation Review – IFRS 13 Fair Value Measurement* ('the request for information).

Overall, we believe that the implementation of IFRS 13 has had a very positive effect on financial reporting as it has enhanced the understanding of the concept of fair value and, as a result, the comparability of its application across a range of entities and of items valued. We also applaud the success of both the IASB and FASB in achieving convergence between IFRS 13 and its US GAAP equivalent as we believe convergence between the two frameworks is particularly important given that fair value measurement is intended to reflect an economic phenomenon (the exit price for the item in question).

In terms of areas in which further guidance would be beneficial, we highlight:

- Application of the concept of highest and best use of non-financial assets, particularly in assessing what level of evidence is required to suggest that current use may not be highest and best use.
- A number of unresolved conceptual issues on the measurement of fair value of growing produce on bearer plants.
- The unit of account for measurement of equity investments in the scope of IFRS 9 *Financial Instruments* versus that for investments in subsidiaries measured at fair value. More generally, a lack of clarity on the unit of account in other IFRSs has been a source of tension in the application of IFRS 13 (which depends on the consistent application of that concept) to, for example, property, plant and equipment, biological assets and investment property.

We also note that the use of fair value as defined in IFRS 13 can highlight issues relating to other standards. For example, the measurement in consolidated financial statements of the fair value of an asset within a 'wrapper company' based on a hypothetical sale of the asset itself can give a lower value than would be achieved through sale of the shares in the wrapper company in circumstances when a logical market participant would purchase the shares. This can give rise to a 'day 1' loss on purchase of such a company that does not reflect a genuine economic loss.

In respect of a number of areas, including the valuation of unquoted equity investments, we also note that bodies other than the IFRS Foundation have issued guidance on the application of IFRS 13 in particular circumstances. We believe that this indicates a perception that guidance beyond that provided in IFRS 13 itself or in the educational material issued by the IFRS Foundation is necessary and would encourage the IFRS Foundation to work with those interested parties (including, but not limited to, the International Valuation Standards Council) to ensure that guidance provided is consistent with IFRS 13 and that divergent practices do not develop between items to which such guidance has been applied.

Our detailed responses to the questions in the request for information are included in the Appendix to this letter.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0) 20 7007 0884.

Yours sincerely

Veronica Poole
Global IFRS Leader

Appendix

Question 1 – Your background and experience

Please tell us:

(a) your principal role in relation to fair value measurement. For example, are you a preparer of financial statements, an auditor, a valuation specialist, a user of financial statements, a regulator, a standard-setter, an academic, or a professional accounting body? If you are a user of financial statements, what kind of user are you (for example, buy-side analyst, sell-side analyst, credit rating analyst, creditor/lender, asset or portfolio manager)?

(b) your principal jurisdiction and industry. If you are a user of financial statements, which geographical regions and industries do you follow or invest in?

How extensive is your experience in relation to the measurement of the following items at fair value (including the measurement of their recoverable amount on the basis of fair value less costs of disposal)?

This response is submitted on behalf of member firms of the Deloitte Touche Tohmatsu network. This network includes member firms operating in more than 150 countries and territories and across a wide variety of industries.

The network includes valuation specialists who are engaged in the preparation of valuations for, amongst other things, financial reporting purposes and auditors of financial statements required to assess valuations prepared by other parties (which may include assessing the work of an expert as required by auditing standards). In both of these capacities, the valuation of a wide variety of items can be relevant.

For the purposes of responding to the post-implementation review questions, we are commenting in our capacity as auditors of financial statements. In this capacity, we have been involved in the measurement of fair value of a wide variety of items across many industries and jurisdictions.

Question 2 – Fair value measurement disclosures

(a) How useful do you find the information provided about Level 3 fair value measurements? Please comment on what specific information is useful, and why.

(b) In your experience of Level 3 fair value measurements:

- *(i) how do aggregation and generic disclosure affect the usefulness of the resulting information? Please provide examples to illustrate your response.*
- *(ii) are you aware of any other factors (either within or outside IFRS requirements) affecting the usefulness of the information? Please provide examples to illustrate your response.*
- *(iii) do you have suggestions on how to prevent such factors from reducing the usefulness of the information provided?*

(c) Which Level 3 fair value measurement disclosures are the most costly to prepare? Please explain.

(d) Is there information about fair value measurements that you think would be useful and that IFRS 13 does not require entities to disclose? If yes, please explain what that information is and why you think it would be useful. Please provide any examples of disclosure of such information.

While users of financial statements are better placed to comment on the usefulness of disclosures, we observe that disclosure of the unobservable inputs into a fair value measurement can give a valuable insight into the valuations process and facilitate an assessment of the quality of an entity's earnings as 'Level 3' valuations often give rise to unrealised gains and losses and information on those inputs is, by definition, not otherwise available to users.

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Aggregation and generic disclosure can be a challenging issue, albeit one that is common to a number of areas of financial reporting rather than being restricted to disclosures on fair value measurements. Both aggregation and generic disclosure can be necessary in the explanation of some fair value measurements as it would be impractical to provide individual disclosure on each item in, for example, a large portfolio of investment properties or a financial institution's trading book. Similarly, we do not believe that a user of general purpose financial statements should be expected to be familiar with valuations techniques even if they are commonly used within a particular industry. Conversely, a more educated investor may want to see confirmation that a valuation has been performed in the manner that they would expect. As such, we believe that explanation of those techniques has value, even if it is to some extent 'generic' to entities using that technique.

We believe that the disclosure requirements of IFRS 13 provide a useful structure within which to provide disclosures, but appropriate aggregation and restriction of 'generic' disclosure to only that which is useful still requires the exercise of judgement. However, as noted above this is by no means an issue particular to fair value disclosures. As such, we believe that application of such judgements would be best addressed holistically through initiatives such as the IASB's Materiality Practice Statement and its wider Disclosure Initiative.

The cost of producing disclosures on fair value measurement varies, but is often higher in industries such as agriculture where fair value measurement is not used for internal management information purposes. More generally, disclosures on the sensitivity of fair value measurement to changes in unobservable inputs can add cost as they, by definition, require calculations beyond those used to determine amounts recognised in the financial statements. This information can be valuable when there is a single, well understood, input (for example, a forecast commodity price) influencing a fair value measurement but providing a meaningful sensitivity analysis becomes more difficult in circumstances (such as, for example, some equity valuations) where there are multiple unobservable inputs which interact which each other. In these circumstances, information on sensitivity to a single input can be of limited value or even misleading. We believe that additional guidance on sensitivity disclosures in such circumstances, particularly in respect of the quantitative disclosures on financial assets and financial liabilities required by IFRS 13.93(h)(ii), would be helpful as it is currently unclear how inter-related inputs should be factored into such a quantification and at what, if any, point such a quantification ceases to be meaningful due to the interactions of multiple inputs.

Separately, we question whether it remains appropriate for IAS 34 *Interim Financial Reporting* to require all entities to provide detailed disclosure on the fair value of financial instruments (but not of other items measured at fair value) in interim financial statements as this implies that information on the fair value of financial instruments is always more useful than information on the fair value of other items measured at fair value. In some industries, the reverse might often be true. As such, we believe that the Board should undertake a broader consideration of the value of fair value disclosures in interim financial statements and how that might vary depending on the entity's facts and circumstances.

Question 3 – Prioritising Level 1 inputs or the unit of account

(a) *Please share your experience to help us assess:*

(i) *how common it is for quoted investments in subsidiaries, joint ventures and associates, and quoted cash generating units to be measured at fair value (please support your comments with examples).*

(ii) *whether there are material differences between fair value amounts measured on the basis of P×Q alone (when P is the quoted price for an individual instrument and Q is the quantity of financial instruments held) and fair value amounts measured using other valuation techniques. Please provide any examples, including quantitative information about the differences and reasons for the differences.*

(iii) *if there are material differences between different measurements, which techniques are used in practice and why.*

Please note whether your experience is specific to a jurisdiction, a region or a type of investment.

(b) *The Board has undertaken work in this area in the past (see Appendix 3). Is there anything else relating to this area that you think the Board should consider?*

As stated in our response to ED/2014/4 *Measuring Quoted Investments in Subsidiaries, Joint Ventures and Associates at Fair Value*, we believe that the principle that fair value measurement should be consistent with the unit of account of the asset or liability to be measured is fundamental to IFRS 13 and that it is not appropriate to depart from this principle solely due to the availability of a Level 1 input for individual assets (such as an individual quoted share) within a larger unit of account (such as an investment in a quoted subsidiary). When the unit of account is, for example, a subsidiary as a whole then fair value should be measured on this basis regardless of whether the subsidiary's shares are quoted.

We also observe that when a transaction occurs in such an asset (for example, the sale of a quoted subsidiary) they are rarely priced on an unadjusted PxQ basis, providing further basis that the fair value of that larger unit of account (as defined in IFRS 13) is not PxQ. In various jurisdictions, there are well established bases for estimating the effect of, for example, a control premium and again as stated in our response to ED/2014/4 we believe that proper application of the disclosure requirements of IFRS 13 and, when relevant, IAS 36 *Impairment of Assets* provides users with sufficient information to assess the valuation method applied. As such, we believe that the post-implementation review of IFRS 13 would be an appropriate time to reconfirm that the general approach of IFRS 13 that fair value measurement be based on the unit of account for that investment applies to both quoted and unquoted equity investments.

Question 4 – Application of the concept of highest and best use for non-financial assets

Please share your experience to help us assess:

(a) *whether the assessment of an asset's highest and best use is challenging, and why. Please provide examples to illustrate your response.*

(b) *whether the current uses of many assets are different from their highest and best use, and in which specific circumstances the two uses vary.*

(c) *whether, when applying highest and best use to a group of assets and using the residual valuation method, the resulting measurement of individual assets in the group may be counter-intuitive. If so, please explain how this happens, and in which circumstances.*

(d) *whether there is diversity in practice relating to the application of the concept of highest and best use, and when and why this arises.*

Please note whether your experience is specific to a jurisdiction, a region or a type of asset.

Highest and best use (HABU) can be a challenging concept to apply as when it is determined that HABU differs from current use the resulting valuation is then, almost by definition, not reflective of the entity's business model. Whilst we agree that this is consistent with the definition of fair value at the level of the individual asset, it does lead to results that some would see as counter-intuitive (particularly in circumstances such as the factory and land discussed in IFRS 13.BC72 when the unit of valuation might cover two non-financial assets).

One issue with the application of HABU is that the statement in IFRS 13.29 that "an entity's current use of a non-financial asset is presumed to be its highest and best use unless market or other factors suggest that a different use by market participants would maximise the value of the asset" is not sufficient to determine the weight of evidence that is required to conclude that an asset's current use is not its HABU as the term "suggest" could be read as anything between an indication that an alternative use exists and clear evidence that an alternative use would generate higher returns. The discussion in IFRS 13.BC71 provides some clarity that an exhaustive search for alternative uses is not required, but again adds the qualifier of "if there is no evidence to suggest that the current use of an asset is not its highest and best use" with no explanation of what such evidence might be.

Further complications in determining whether an alternative use would maximise the value of an asset come in identifying the market participants for that alternative use and in estimating the costs of converting the asset (for example, demolition of a factory) as the entity might not have any other reason to make those assessments (if an entity does not intend to convert the asset to an alternative use, it is unlikely to have budgeted a cost of that conversion).

As such, we believe that an appropriate output from this post-implementation review would be the development of additional guidance (possibly including evidence that might indicate an alternative use and how compelling that evidence needs to be) on when it should be concluded that HABU differs from current use. In addition, circumstances where HABU differs from current use often raise questions of whether fair value is truly the most appropriate measurement basis for an asset or whether the unit of account for a fair value measurement is appropriate. We suggest that the Board consider whether any such issues highlight a need for amendments to standards other than IFRS 13.

Question 5 – Applying judgements required for fair value measurements
Please share your experience to help us assess the challenges in applying judgements when measuring fair value:

- *(a) is it challenging to assess whether a market for an asset or a liability is active? Why, or why not?*
- *(b) is it challenging to assess whether an input is unobservable and significant to the entire measurement? Why, or why not?*

Please provide specific examples to illustrate your response and note whether your experience is specific to a jurisdiction or a region or a type of asset or liability.

The assessment of whether a market is 'active' can be challenging as there is little guidance beyond the definition in Appendix A to explain the concept. In particular, it is unclear how a temporary closure of the market (possible at the reporting date) or a low level of transactions in a particular asset or liability affect this assessment. We believe that further indicators of what is and is not deemed an 'active market' would be helpful to preparers of financial statements and that the IASB is best placed to provide such guidance.

Similarly, the lack of guidance on how 'significance' should be assessed can make this assessment challenging as it is unclear whether the assessment is purely quantitative and, if so, what level of impact on a fair value measurement should be considered 'significant'.

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Question 6A – Education on measuring biological assets at fair value

Please describe your experience of measuring the fair value of biological assets:

(a) are any aspects of the measurement challenging? Why, or why not? Please provide examples to illustrate your response.

(b) what, if any, additional help would be useful in applying IFRS 13? In which areas?

Specifically in respect of produce growing on bearer plants, we re-iterate our comments on the recent IFRS Interpretations Committee tentative agenda decision that there exist a number of conceptual issues (not specific to palm oil [the subject of the submission to the Interpretations Committee] but also relevant to, for example, latex within rubber trees or sap within maple trees from the requirement of IAS 41 *Agriculture* to split a single living organism into two units of account (one of which is measured at cost, the other at fair value), including:

- At what point in the growth cycle (which for some crops can be an extended period including a number of distinct stages of development) a 'fruit' is considered to exist separately from the bearer plant and how an attrition rate for immature fruit should be factored in to that assessment and an assessment of the quantity of produce that will eventually be harvested.
- Whether the capacity for transformation of an immature fruit to a fruit ready for harvest is a feature of the fruit (and, therefore, to be included in the valuation) or of the bearer plant (and, therefore, not to be included). For example, a palm oil blossom has (absent the plant on which it grows) no ability to perform the biological processes for development into a mature fruit.
- If an income approach to valuation is applied, whether or how the costs included in the valuation of a growing fruit should reflect the use of the bearer plant's productive capacity (i.e. should there be a 'contributory asset charge' for use of the plant consistent with a 'rental' cost for use of an item of property, plant and equipment applied in valuing other assets in the course of production and, if so, how would such a cost be calculated) and how general costs such as fertilizer and pest control should be allocated between care of the plant and of the growing produce.

We believe that the post-implementation review of IFRS 13 provides a suitable opportunity to address these wide-ranging and significant (as agriculture continues to form a significant part of the world economy) conceptually issues.

Question 6B – Education on measuring unquoted equity instruments at fair value

Please describe your experience of measuring the fair value of unquoted equity instruments:

(a) in 2012, the IFRS Foundation Education Initiative published Unquoted equity instruments within the scope of IFRS 9 Financial Instruments. Have you used this education material? If so, how did this material help you to measure the fair value of unquoted equity instruments?

(b) Do you have questions not covered in Unquoted equity instruments within the scope of IFRS 9 Financial Instruments? Do you think that additional help would be useful in applying the requirements? Why, or why not? Please provide examples to illustrate your response.

The valuation of unquoted equity instruments can be particularly challenging in, for example, incorporating risks into the valuation and selecting a suitable discount rate for an income approach. Again, this issue is likely to become more prevalent as measurement of financial assets at fair value increases on application of IFRS 9.

The IFRS Foundation's education material is used in some circumstances, but industry groups have also developed their own guidance (for example, the International Private Equity and Venture Capital (IPEV) Valuation Guidelines) on performing equity valuations in accordance with IFRS 13. We believe that such initiatives indicate a demand for guidance beyond that which has been provided by the IFRS Foundation and that the Foundation should work with those practitioners to provide clear, consistent guidance and to mitigate the possibility of divergent practices developing.

Question 7 – Effects and convergence

(a) *Please share your experience of the overall effect of IFRS 13:*

(i) *what effect did IFRS 13 have on users' ability to assess future cash flows? If you are a user of financial statements, please provide us with examples of how you use information provided by entities about their fair value measurements and any adjustments you make to the measurements.*

(ii) *what effect did IFRS 13 have on comparability of fair value measurements between different reporting periods for an individual entity and between different entities in the same reporting period?*

(iii) *what effect did IFRS 13 have on compliance costs; specifically, has the application of any area of IFRS 13 caused considerable costs to stakeholders and why?*

(b) *Please comment on how you are affected by the fact that the requirements for fair value measurement in IFRS 13 are converged with US GAAP; and please comment on how important it is to maintain that convergence.*

Whilst users and preparers of financial statements are better placed to comment on assessment of future cash flows and compliance costs respectively, we believe that the effects of IFRS 13 have been very positive in enhancing the understanding of the concept of fair value and the comparability of valuations across periods and across entities. The introduction of a consistent definition of fair value to be applied across a range of items has also been beneficial in promoting a consistent approach to valuation.

We believe that convergence with US GAAP in this area was particularly important and maintenance of that convergence should be a priority for both boards. Fair value measurement is based on the aim of reflecting an economic phenomenon (the exit price of the item in question), divergence between IFRS and US GAAP in this area would inevitably raise the question of whether one, or both, framework was failing to reflect market reality.

Question 8 – Other matters

Should the Board be aware of any other matters as it performs the PIR of IFRS 13? If so, please explain why and provide examples to illustrate your response.

We would also highlight two other issues relating to fair value (although both have aspects relating to other accounting requirements):

- Circumstances in which the hypothetical transaction envisaged by IFRS 13 is unlikely to occur. This arises commonly when an asset is to be measured at fair value but (due to, for example, income tax or stamp duty considerations) a market participant would logically purchase the shares of a 'wrapper company' holding the asset. Adjustment for a lower price that would be paid for the asset itself can give rise to, for example, a 'day 1' loss on purchase of the wrapper company that does not reflect a genuine loss of value on the part of the reporting entity.
- Accounting for a restriction on sale of an asset (a common feature of, for example, shares used as consideration in a business combination) that is not a feature of the transaction rather than of the asset itself (which might often be shares traded in an active market) but excluding the effect of such a restriction from the cost of a business combination could be seen as leading to an artificially increased value of goodwill.