Asian-Oceanian Standard-Setters Group (AOSSG)

Preliminary Views

Working Group

Fair Value Measurement

29 September 2010

I. Introduction

Objective of WG

The objective of WG is to assist the AOSSG in preparing improved proposals to the IASB regarding the fair value measurement project.

WG Members

1. China Accounting Standards Committee (CASC): Lead Country
2. Hong Kong Institute of Certified Public Accountants, Hong Kong SAR (HKICPA)
3. Accounting Standards Board of Japan (ASBJ)
4. Korea Accounting Standards Board (KASB)
5. Malaysian Accounting Standards Board (MASB)

The progress of WG activity

1. The IASB published further enhancements to a disclosure proposal on level 3 fair value measurement in June 2010.
2. The IASB posted a staff draft of a forthcoming IFRS on fair value measurement that reflects the tentative decisions made to date by the IASB and the US Financial Accounting Standards Board (FASB) in August 2010.
3. The CASC circulated Questionnaire on the fair value measurement project to AOSSG WG on 22nd August 2010.
4. All AOSSG members sent comments on questionnaire to CASC on 12th September 2010.
5. 2nd AOSSG meeting on 29th and 30th September 2010.

Next Steps

1. CASC will circulate near-final draft of AOSSG WG preliminary views to AOSSG members on 15th October 2010.
2. All AOSSG members are expected to send comments on near-final draft of AOSSG WG preliminary views to CASC on 31st October 2010.
3. CASC will finalize AOSSG views and send to AOSSG secretariat by 8th November 2010.
4. AOSSG secretariat will send AOSSG views to IASB on 9th November 2010.

II. Preliminary Views on Questionnaire on Fair Value Measurement

Question 1

The IASB made several revisions to the *ED/2009/5 Fair Value Measurement* after redeliberation, eg. market reference, disclosure for an asset when its highest and best use differs from its current use. Do you agree with the current proposals in the staff draft issued on August 19, 2010? If not, which proposal(s) do you disagree with, and why?

CASC

We propose that the Board redeliberates the following issues concerning fair value measurement:

a) Unit of account

The current proposal relies heavily on the other IFRS to determine the unit of account, and we believe that the Board need to further clarify the unit of account since it will have potential influence on the fair value measurement, either when applying the highest and best use notion or the valuation premise.

b) Blockage factors and other premiums and discounts

We believe the proposal on blockage factors is not clear and will lead to diversity in practice. We believe that the Board need to clarify the difference between the blockage factors and other premiums and discounts (eg. a discount for lack of marketability, and discounts that may be associated with the size of an individual financial instrument). The consideration of premiums and discounts also has relationship with the unit of account, and should be applied based on valuation premises that these assets can be most efficiently sold to market participants. The current proposal requires that the unit of account is individual instrument. For Level 2 and Level 3 fair value measurement of financial instrument, it's not clear whether and when premiums and discounts other than blockage factors may be applicable, and how entities can distinguish the liquidity adjustment that is specific to inactivity of the market for the instrument from adjustment related to the aggregate size of the holding.

c) Operational challenges

We have great concerns over the operational challenges for fair value measurement. We believe that converging on high-level principles related to defining fair value does not go far enough. Having different applications of fair value in different jurisdictions will impair the quality of fair value information. The hierarchy of the fair value reflects the activity of the markets. The lower the level is, the harder it is to measure the fair value, and the less relevance the information is. Without clear and stringent principles, fair value measurement can be utilized as a means to manipulate earnings, which makes the information neither reliable nor relevant. Although the problems encountered by different jurisdictions may be similar, the frequency and extent of occurrence of these problems in the emerging markets and transitional economies are a lot greater, which pose great

difficulties for these jurisdictions to comply with the standard consistently. Therefore we propose that the Board take full account of the practical circumstances of emerging markets, and clarify a couple of issues in the forthcoming IFRS (please refer to the answer to Q3 and Q4).

HKICPA[*]

We generally agree with the proposed changes related to the highest and best use concepts and the valuation premise concepts.

On the change related to measuring the fair value of financial instruments managed within a portfolio, the ability to measure the portfolio on a net basis fits with what is done in practice and therefore the proposal seems OK. However, there is an issue in that para 55 requires the portfolio to be grossed up into its constituent assets and liabilities in the balance sheet. However, the staff draft is not clear as to what acceptable methods might be used to do this. The staff paper on this subject presented at the joint boards meeting on 11 March 2010 gives some insight but even that shies away from discussing how the grossing up should be done. It seems that in grossing up the net portfolio position to show the assets and liabilities separately, it is necessary to allocate the bid-ask spread and any counterparty credit valuation adjustments to the unit of account to be recognised in the B/S. That is, it is not as simple as applying the "net price" arrived at in the measurement process to individual assets and liabilities to give you the net number. Some application guidance on this should be added to Appendix B, without being too prescriptive as to the method of allocation of the adjustments.

ASBJ

(a) We agree with the current proposals in the Staff Drafts on August 19, 2010. The IASB have taken into account responses from its constituents to the *ED/2009/5* and conducted a joint redeliberation session with the FASB, to come up with the Staff Draft.

(b) For example, there was a divergence in the concept of a market in which a fair value measurement assumes a transaction takes place. The IASB's *ED/2009/5* assumed that a transaction takes place in the most advantageous market, while the FASB (Topic 820) assumes that it takes place in the principal market. Respondents to the *ED/2009/5* raised their concerns about the difficulties with identifying and selecting the most advantageous market when an asset or liability is exchanged in multiple markets throughout the world. The Staff Draft now proposes the assumption of a principal market, to take into account the concerns raised from the respondents, and to converge with the FASB. The Staff Draft also addresses various practical or implementation issues, such as blockage factors, control premiums and measuring the fair value of liabilities. We believe that the Staff Draft is appropriate.

[*]HKICPA preliminary view on the questionnaire represents the preliminary comments from HKICPA Standard Setting Department only and not the official view of HKICPA which is representative view of the accounting profession based on the comments they received.

KASB

We agree with the IASB's amendments related to applying valuation adjustments in a fair value measurement. In addition, we suggest that the IASB define the relationships between the standard of the fair value measurement and the Report of Expert Advisory Panel and the educational material (expected to be published on 2nd quarter of 2011) so that these can be used effectively.

On the other hand, the Staff Paper notes that measuring the fair value of financial instruments that are managed within a portfolio does not affect the presentation on the F/S. However, when these kind of financial instruments are presented, we think that there needs to be detailed explanations on fair values allocation and recognition of financial assets and liabilities in the statement of financial position.

MASB

(a) Blockage factor

The paper proposes to disallow the use of a blockage factor even if a market's daily trading volume is not sufficient to absorb the quantity held. We disagree with this as in our view the fair value measurement should include a blockage factor as the entity need to pay a premium to obtain control and hence, block holding should have a higher value that that of quoted market price.

(b) Highest and best use

We have significant concerns in applying the highest and best use notion in the fair value of certain non-financial assets. Although we agree with the proposed definition of fair value, we do not believe it is appropriate to broadly apply the concept to all types of non-financial assets. We believe the nature of the non-financial asset should be given due consideration in applying the notion of highest and best use. For example, whilst it may be apt to apply the concept to investment property, we believe it is not appropriate to fair value property, plant and equipment such as plantation / factory land assuming its highest and best use by market participant that is different from its current use. Land used for agriculture, residential or commercial purposes would have different best use values. We are doubtful of the wisdom of imputing a value to the plantation / factory land that is different from its current use because, in our view, current use values provide the most useful information to users about the entity's future cash flows. Therefore, to use a value based on other than current use would be confusing to users.

In addition, we are concerned about any potential manipulation in earnings management that may arise from the notion of highest and best use which will most likely require the use of judgment by management. In this regard, we strongly urge the Board to reconsider the applicability of highest and best use notion to all non-financial assets. However, should the Board decide to proceed with the proposals despite the concerns raised, more prescriptive guidance may be required in applying the notion of highest and best use to mitigate the potential manipulation that may arise.

Question 2

2.1 The IASB has tentatively decided to require an entity to disclose a measurement uncertainty analysis that takes into account the effect of correlation between unobservable inputs for fair value measurements categorized within Level 3 of the fair value hierarchy unless another IFRS specifies that such a disclosure is not required for a particular asset or liability. Do you think that proposal is appropriate? If not, why not?

2.2 If you find the proposal appropriate, do you believe that all assets or liabilities concerned should disclose such information? If not, please specify the assets or liabilities for which such a disclosure should not be required, and explain why.

2.3 Are there alternative disclosures to the proposed measurement uncertainty analysis that you believe might provide users of financial statements with information about the measurement uncertainty inherent in fair value measurements categorized within Level 3 of the fair value hierarchy that the IASB 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.

CASC

[2.1]
In our view, the measurement uncertainty analysis disclosure for fair value measurement proposed by the ED will not enhance the transparency of the fair value measurement, but lead to misunderstanding for users of financial statements because of the information redundancy.

Firstly, unobservable inputs are developed using the best information available in the circumstances. The disclosure of increase/decrease in fair value proposed by the ED is not consistent with the fair value measurement categorized within Level 3 of the fair value hierarchy. Simply disclosing the range of those fair values might cause users to improperly conclude that all amounts within the range are equally representative of fair value, which would no doubt confuse the users of financial statements.

Secondly, it's hard enough to measure fair value categorized within Level 3 of the fair value hierarchy using valuation techniques and significant unobservable inputs. Measuring fair value when changing one or more of the unobservable inputs to a different amount, and take into account the effect of correlation between unobservable inputs could only be harder, let alone that the correlation between unobservable inputs is itself unobservable.

Thirdly, different categories of items measured at fair value may involve different unobservable inputs. Sometimes changes for unobservable inputs used for certain products of the same category may also differ due to their specific features. According to the ED, an entity shall analyze and build valuation techniques individually, and measure the effects of the correlations between unobservable inputs, which are too difficult and costly. For entities with a large quantity of fair value measurements categorized within Level 3 of the fair value hierarchy, uncertainty analysis for fair value measurements is not operational.

Fourthly, the uncertainty of fair value measurement is caused by various factors, and the correlation between unobservable inputs is only one of the many. The correlation between

observable inputs and the correlation between observable inputs and unobservable inputs may also cause uncertainty of fair value measurement. The disclosure requirement proposed by the ED is obviously not comprehensive.

Considering the effects of correlations between unobservable inputs is not operational under most circumstances for the reasons described above. Especially when measuring the net asset of an entity or the total investment in a fund, there can be many inputs affecting the fair value. The entity usually completes the valuation depending on the assets' assessment report or financial statement of the investment fund, and it's difficult to list and analyze all unobservable inputs. Sometimes, entities (especially small ones) develop their fair value measurement based on bid-ask prices by one or more intermediaries, and have no access to the valuation techniques used making the required analysis and disclosure impossible.

To sum up, the cost that entities will bear to meet the disclosure requirements would significantly outweigh the benefit that users of financial reports would gain from the information disclosed. Therefore, we suggest the Board to reconsider the proposal in the ED and exempt the related disclosure.

[2.2]
We believe that only financial instruments should be required to disclose such information if have to.

[2.3]
In our view, it can be useful to disclose the different amount of the unobservable inputs that could have reasonably been used in the circumstances, and the reasons for the management to have chosen the amount to develop the fair value.

HKICPA

We generally support the Board's effort to improve the fair value disclosure requirements for Level 3 measurements. However, we have concerns about whether the proposed measurement uncertainty disclosure in the ED is operational. We believe the requirement as articulated in the ED is not clear and that the level of analysis the IASB had intended in the ED and the objective of the proposed correlation assessment will not be well understood.

In particular, while we note that BC20 states that the IASB has concluded that an entity should not be required to disclose quantitative information about the degree of correlation between unobservable inputs, it is unclear to us whether the IASB expects an entity in practice to compute some statistical analysis in order to identify the correlations that should be "taken into account" as required in paragraph 2(b). In particular, we find that the absence of specific examples of identified "correlations" between level 3 unobservable inputs in the illustrative example accompanying the ED and the discussion in paragraphs BC18 to BC21 leaves us unsure of what the IASB has in mind when it refers to "correlations", especially as we are sceptical as to whether a meaningful calculation of statistical correlation between unobservable inputs is even possible.

We are also concerned about the proposed format for this disclosure, as illustrated in the illustrative example attached to the ED. Based on this illustrative example, it appears that the

IASB expects the disclosure to provide the upper and lower limits of a range of possible outcomes at an aggregated level for each class of assets or liabilities. In our view it is questionable whether such a table, as illustrated in the example, would provide meaningful information to users. Specifically, we note that the determination of other unobservable inputs that could have been reasonably used in the Level 3 measurement is very subjective and difficult to apply when there are ranges of inputs. Diversity in practice is likely to result as it is not clear how to determine the boundaries of a reasonable estimate and the method of alternative input selection. Therefore, such a table may inappropriately indicate a degree of measurement certainty associated with the outer limits of a range, which in practice may not be achievable in a level 3 valuation, rather than providing useful information concerning measurement uncertainty associated with the way in which the recognised fair value has been computed.

We recognise that significant inputs for fair value measurements made under Level 3 of the hierarchy are based on assumptions and are inherently subjective. We believe that a clear description of the valuation methodology used in arriving at the fair value and disclosure of identified relationships between key variables, together with information concerning key assumptions/inputs used and how these assumptions/inputs were arrived at, would provide useful information for the user to understand how the fair value was determined and would enable the user to obtain an appreciation of the uncertainty associated with that valuation.

We further recommend that the IASB works closely with the International Valuation Standards Council to consider qualitative disclosure alternatives such as describing the nature or extent of the uncertainty and the justification for preferring the inputs that were actually used in the adopted fair value estimate.

ASBJ

[2.1]

(a) We think the proposal is appropriate. We have analyzed additional benefits and costs of taking into account the effect of correlation between unobservable inputs, provided that the measurement uncertainty analysis is to be conducted. We have concluded that taking into account the correlation would bring about sufficient additional benefits, which the costs for the compliance would not outweigh.

(b) We would like to add that our constituents, especially prepares, have raised their concerns about the difficulties in the actual implementation, while they did not disagree with our theoretical analysis.

(Our theoretical analysis)

(a) We have analyzed additional benefits and costs of taking into account the effect of correlation between unobservable inputs, provided that the measurement uncertainty analysis is to be conducted. What we would like to high light is that we are not evaluating whether the uncertainty analysis is necessary or not. That is given. We are just analyzing additional benefits and costs of taking into account the effect of correlation in

the uncertainty analysis.

(b) First we have analyzed the benefits. Let us assume that an entity uses two unobservable inputs to measure fair value of a certain financial instrument. The entity would select a combination of the two unobservable inputs which it assumes reasonable in the fair value measurement. This selection would be dependent on the entity's judgment and if the judgment changed, so would the selection. This is the measurement uncertainty inherent in the measurement using unobservable inputs. Therefore, it is important to disclose how fair value measurement would change, if an entity selected another reasonable combination of the unobservable inputs.

(c) We think it is reasonable to say that when an entity chose a different value for one input, it would also choose another different value for the other input, if there were a correlation between the two inputs. In other words, it would be irrational to assume that the entity would continue to use the same value for one input, even though it changed the value for the other. The uncertain analysis without taking into account the correlation would be meaningless and misleading. In this sense, we believe that taking into account the correlation would bring about sufficient additional benefits.

(d) As for costs, we fully understand that prepares would incur burdens when they were required to conduct uncertainty analysis. But it is quite a different issue whether prepares would incur additional costs if they were required to take into account the correlation, provide that the uncertainty analysis is to be conducted.

(e) We think that it is reasonable to assume that an entity is already aware of correlation between unobservable inputs, when it chooses a reasonable combination in the fair value measurement. Therefore, we believe that the cost would not change so much, if an entity were required to take into account the correlation in the uncertainty analysis.

(f) Following the above theoretical analysis, we have concluded that taking into account the correlation would bring about sufficient additional benefits, which the costs for the compliance would not outweigh.

[2.2, 2.3]
Nothing particular

KASB

[2.1]

(a) We disagree with the IASB's proposal to require considering the effect of correlation between inputs in estimating the different effect on the fair value measurement of a change in more than one unobservable input when unobservable inputs are used on the level 3's fair value measurement.

(b) There were F/S preparers' opinions that disclosing the information about the level of fair values of assets or liabilities not recognized at fair value in the statement of financial position are difficult. Considering this matter, also disclosing the effect of the correlation between unobservable inputs will heavily increase F/S preparers' burden. In addition, from the cost and benefit perspective, when compared with cost of companies who must produce the subjective information for themselves, the benefit that users of financial statements will gain might be insignificant.

(c) Among the KASB's collected opinions, some opinion holders agree with IASB's suggestion that the additional information regarding the interdependence or the correlation of unobservable inputs should be provided since it is essential to users of financial statements. However, these opinion holders also believe that considering correlation or interdependence of inputs will increase the burden on the F/S preparers. As a result we suggest that the IASB provide the practical example or guidance on this matter.

MASB

[2.1]

In any valuation technique, there may be more than one unobservable input in use giving rise to many correlations, with each correlation having its own impact on the fair value measurement of the asset/liability. In such situations an assessment of the effect of correlation between these unobservable inputs would be practically difficult to establish and measure. In addition the measurement basis of the correlation between such unobservable inputs may differ amongst entities even for those operating in the same industry, hence impacting the comparability of the financial statements.

From an operational perspective, as it is now, obtaining data for unobservable input is already very challenging given the maturity and sophistication of the market. Having to take into account the effect of correlation between unobservable inputs would pose even greater operational challenges.

[2.2]

Please refer to Q 2.1.

[2.3]

No further comment.

Question 3

Do you think that more guidance is needed to ensure consistent application of the fair value measurement? If so, please specify what principles or issues need more guidance.

CASC

We believe that more guidance should be provided to ensure consistent application of the fair value measurement, especially for emerging markets and transitional economies.

a) When using quoted price provided by a third party, what measures should be taken to determine that the quoted price is development in accordance with the IFRS.
b) What are disorderly transactions and how to identify them?
c) Can a weighted average of the quoted price for a period (say last hour before the market closes) be regarded as fair value? If so, which level does it belong to?
d) How to measure the fair value using the price within the bid-ask spread that is most representative of fair value? How to justify that the price is most representative of fair value, especially when the spread is wide?
e) How to measure the fair value of certain items (eg. the ones listed in the answer to Q4) , especially when there's no active market and a valuation technique is required?

HKICPA

No particular comment on this aspect.

ASBJ

In Japan, it is common for a company to own shares of other companies that it has business relationship with (strategic investment or cross holding). Majority of those shares are unlisted. Under the IFRS 9, which has taken out "cost exemptions", those shares are required to be presented at fair value on the balance sheet. Many of Japanese constituents have raised their concerns about how to measure the fair value of those unlisted shares.

KASB

We support the IASB's decision on publishing educational material for the emerging and transition countries and we expect this educational material will be effective guidance on fair value measurement. Moreover, we expect this to include detailed examples such as how companies can produce unobservable inputs related to unlisted stocks for assessment purpose.

Question 4

4.1 In the practice in your jurisdiction, do you encounter any difficulties measuring certain assets, liabilities or equity instruments at fair value? Please specify the difficulties encountered, and assets, liabilities or equity instruments concerned. How do you deal with these difficulties currently?

4.2 More specifically, what method(s) are used, in your country, to determine the fair value of an asset with a restriction on its sale in practice, eg. equity investment with a lock-up period? How do you decide the scale of adjustment made to reflect the effect of that restriction?

4.3 More specifically, what method(s) are used, in your country, to determine the fair value of an investment in unquoted equity instruments, eg. an investment in private equity? What are the specific difficulties and how do you deal with them?

CASC

[4.1]

The unique business environment in an emerging economy like China would cause the following difficulties in fair value measurement.

a) **Long term stock suspension**. There is a significant amount of stock suspension in Chinese stock exchange markets, some as long as 2 years. Having no active market transactions cause difficulty in developing the fair value measurement. The current treatment in practice to determine fair value is to utilize the index return approach, using Stock Valuation Index developed by Securities Association of China.

b) **Unquoted equity investment**. It's been difficult to locate the right comparable company or appropriate inputs in China. The current treatment in practice is to measure the fair values by using market approach, but with significant adjustment on values of a comparable company. A second approach (usually income approach) will be used to confirm the value.

c) **Non-performing assets held by asset management companies**. There is no reliable date for non-performing assets to be used in a valuation technique.

d) **Restricted equity instrument.** It's unique in the Chinese capital market that some state-owned public company is not fully traded on the market. For stocks of the same company, there are both tradable and non-tradable stocks. It's hard to determine the discount rate to reflect the effect of the restriction on its sale. Empirical study was conducted to analyze the discount rate for companies of different industries. The result is used as reference for a company to determine the discount rate.

e) **Derivatives**. When adjusting the credit risk of a certain derivative instrument, Credit Default Swap (CDS) spread usually serves as the determining input. However, since there is no CDS market in mainland China, it's impossible to quote CDS spread for fair value measurement. Currently financial ratios and ratings from credit rating agencies are used to determine the adjustment.

[4.2]

Market approach or income approach is commonly used to measure the fair values of equity instruments with restriction on sale. Significant inputs include market multiples for market approach or discount rate for income approach. In the practice, empirical study was conducted to analyze the discount rate for companies of different industries. The result is used as reference for a company to determine the discount rate.

[4.3]

Market approach, income approach or cost approach can be used to measure the fair value of unquoted equity instrument.

When using market approach, the key is to find the right comparable company and comparable indicator. In China, there are very few appropriate comparable public companies available. Determining the discount rate of comparable company is subjective. It's hard to find information of similar equity transaction due to lack of public information. It's impossible to estimate future cash flow especially when there's questionable or even no data (especially for earnings) for the entity to be evaluated.

When using income approach, the key is to predict the future cash flow and to determine the discount rate, which can be very subjective. In practice, market approach is commonly used and the fair value is rechecked by using income approach. Cost approach is only the alternative option when neither market approach nor income approach is feasible.

HKICPA

[4.1]

The answers for questions 4 are consulted with some leading accounting firms.

One of the practical difficulties we encounter is to value the conversion features (options) embedded in a private company's convertible preference share ("CPS") for IAS 39 purpose. The conversion features may typically entitle the CPS holder to convert to common share(s) (CS) at any time (optional conversion) or upon IPO (mandatory conversion). We note that there is a diversity in practice as to how to value these features properly.

We have observed that some practitioners treat the conversion features of CPS as the same as those of the convertible bonds ("CB") and use the binomial model to value them accordingly. However this valuation method may not be appropriate in our view because:

1. The binomial model requires an input of the maturity date that CB has, however CPS has a perpetual life, i.e. CPS holder can always remain as a CPS holder, unless it triggers the mandatory conversion in the case of an IPO.

2. The economic substance of the conversion features in CB could be different from the conversion features embedded in CPS. CB's conversion features entitle the holder to convert to CS in order to participate/share the upside potential of the company. In comparison, a participating CPS holder can achieve the same goal even without any conversion right, because he can always receive the equity return (e.g. dividend) that a common share holder would normally enjoy. Therefore, a participating CPS holder has no incentive to convert and downgrade himself from a CPS holder to a CS holder, i.e. the value associated with the optional conversion features is minimal. On the mandatory conversion features side, the private CPS is required to convert to public common share in the case of an IPO. In other words, mandatory conversion features entitle the CPS holder to get access to the liquidity at the cost of losing the CPS privileges. We consider the value of the mandatory conversion features as the difference between the liquidity gained and the privileges lost.

[4.2]

We use put option to assess the lack of marketability discount associated with an equity investment with a restriction on the sale, considering that the value of a put option can be viewed as the proxy of the compensation to the holders of losing the rights to dispose the underlying shares during the lock-up period. The following factors are to be considered to reflect the effect of the restriction on sale:

(a) the length of the lock-up period should be carefully scrutinized. Only the lock-up period “travelling with shares" can be considered in the valuation.

(b) We generally use the historical volatility (the company itself and/or comparable companies) as proxy of expected volatility to be adopted in put option estimation. The selection of the comparable companies and the historical time period used for volatility estimation may have significant impact on the put option value and should be carefully considered.

[4.3]

Investments in private equity are usually valued by using valuation techniques that referenced from the "International private Equity and venture capital Valuation Guidelines ", last updated in September 2009. Those valuation techniques are in a broad sense consistent with the valuation principles and practices observed in business valuation practice. We also recognize that the valuer would need to exercise professional judgement in the selection of the appropriate valuation method(s), taking into account the nature and fact of the investment, the availability of the information and its materiality in the context of the total portfolio.

ASBJ

See response above to Question 3.

MASB

A. Bond Market

Guidance on Using the Prices Quoted by Pricing Agency

One of the main challenges in the implementation of the ED in emerging or developing economies, such as Malaysia, is the insufficient market depth for certain classes of securities which are commonly held at fair value. This is especially true for the bond market. Generally, entities holding bonds would usually value the securities using last quoted price based on the last trade date.

However, in many emerging economies, the volume of trade for the bond market is significantly lower as compared to the equity market. There could be instances where the last trade date could be more than six months prior to the reporting date and in some cases, over one year. For example in Malaysia, only 34 daily trades were reported out of 2,541 bonds outstanding as compared to 928 daily trades out of 1,303 counters for the equities market.

As a result, bonds would fall into either Level 2 or 3 category depending on whether the inputs that are significant to the measurement are observable or unobservable, and hence, requiring valuation techniques to be applied. In such cases valuations of bonds would normally make reference to prices provided by an independent bond-pricing agency. To better understand on how the pricing agency works, we are pleased to enclose in Appendix 1 a brief write-up of the methodology used by the pricing agency in Malaysia to generate a bond value.

Given the statistics and the "illiquid" nature of the bond market, there are concerns whether prices quoted by a pricing agency meet the fair value measurement criteria.

In this regard, we request for additional guidance designed for emerging markets to assist us to:

i) assess whether the price provided by a pricing agency is acceptable as the fair value under IAS 39 requirements;

ii) factors to consider at the financial reporting date when trading activity for the particular bond is low during the reporting period; and

iii) how the quoted price should be adjusted accordingly.

B. IAS 41 *Agriculture*

The Board has announced its plan to converge with IFRS in 2012 as we are persuaded by IASB mission, that is, to develop a single set of high quality understandable, enforceable and globally accepted financial reporting standards. In pursuit of the convergence plan, the Board has adopted most IFRSs, except one major standard, IAS 41 *Agriculture*.

As you may be aware, Malaysia is one of the top exporters of palm oil and natural rubber. We are also active exporters for other agricultural produce, including sawn logs and sawn timber, cocoa, pepper, sago. Therefore, agriculture activity plays a significant role in our economy and the companies in Malaysia have vast experience in this industry.

However, we received strong rejections (which we have communicated to the IASB previously) from the industry on the accounting standard for agriculture, IAS 41, particularly on the measurement of plantation bearer biological assets at fair value. There is no market for the plantation bearer biological assets except for prices of some of the products produced by the bearer biological assets, for example, there is no market for the oil palm or rubber trees but there is commodity price for crude palm oil, CPO, and rubber.

In our view bearer biological assets are essentially the basis which allows an entity to produce profits, in the same way as a factory with its associated plant and equipment allows a manufacturing operation to produce profits. Hence, we believe bearer biological asset should be treated similarly as other capital assets used in the production or generation of income. Under the IFRS literature, factories, plant and equipment are allowed to be carried at cost less depreciation less impairment. It is hard to see why a different principle should be applied to bearer biological assets whose objective is similar to other capital assets used in the production of income.

Notwithstanding our objection of IAS 41 and on the premise that IAS 41 will not be reviewed by the IASB in the very near future, we would like to provide our views about the guidance required in the Fair Value Measurement Standard on the application of fair valuation of bearer biological assets.

Guidance for Fair Valuing Bearer Biological Asset

We note that the objective of the Fair Value Measurement project is to establish a single source of guidance for all fair value measurements and to specify how entities should measure fair value. We also note that it would not introduce new fair value measurements, nor would they eliminate practicability exceptions to fair value measurements.

By this given objective, paragraphs 9, 17–21 and 23 of IAS 41 will be deleted when the Fair Value Measurement standard is finalised. However in our view, the deletion would render the Fair Value Measurement Standard 'incomplete' as eventually there will be no specific guidance for assets within the scope of IAS 41 albeit the measurement basis is strictly based on fair value (unless an entity rebuts the presumption that fair value can be measured reliably on initial recognition of the biological asset).

In this regard, we believe it is critical for the Fair Value Measurement Standard to include guidance for biological assets because:

a) the measurement basis of IAS 41 is fair value and if no guidance is provided, the standard would inadvertently cause injustice to entities applying IAS 41.

b) fair values of biological assets in many cases are determined based on valuation t echniques.

   In reality, unlike consumable biological assets, there is no active market for beare r biological assets. In fact market only exists for the bearer plantation as a whole (ie land, buildings, vehicles, equipments, trees and produce attached) or the agric ultural produce of the bearer biological asset. In the absence of a market, extensi ve judgement is required to establish the price to be used to determine the fair va lue of the asset.

c) valuation technique is a complex process bearing in mind different market partici pants would have different assumptions. It is even more complex for valuation of biological assets when compared to the valuation of financial instruments.

   This is because other than *price* there are many more inputs that need to be appli ed to the valuation technique of biological assets and it is extremely subjective to do because of the uncertainty of the *output* (ie yield) which are dependent on nu merous factors such as *cost of production* as well as *factors beyond management control* such as weather conditions. In fact none of the inputs to the valuation of biological assets are contractually binding and hence the parameters used to deter mine fair values could be very wide. In other words the margin of error for valua tion of biological assets could be significantly higher than valuations of financial

instruments.

d) for long life bearer biological assets such as perennial tropical tree crops (eg pal m oil and rubber whose estimated economic useful lives are about 25 and 30–33 years respectively), the valuation complexity will be further compounded and hen ce increases the margin of error because of the pro-cyclicality of prices and uncer tainty in the future. This we are certain will raise doubt about the reliability of th e biological asset fair value presented in the financial statements.

Therefore, we strongly believe the IASB should provide guidance for valuations of biological assets to mitigate, at least some if not all, subjectivity inherent in the fair value of biological asset determined based on valuation techniques.

Specifically, we request guidance for *plantation bearer biological assets* in the following areas.

Valuation techniques of plantation bearer biological assets

For IAS 41 purposes, either of the following may be used to arrive at the fair value of biological assets:

a) present value the expected cash flows of the life of the biological assets (as prescribed in IAS 41 paragraph 20); or

b) fair valuation of the entire plantation and deduct the fair value of the raw land from the plantation fair value accordingly (as prescribed in IAS 41 paragraph 25).

However, we find the guidance in IAS 41 to be overly simplistic. We append in Appendix 2 a valuer's perspective of how oil palm plantations valuations are conducted in Malaysia. We request the IASB to consider the principles in Appendix 2 and incorporate a comprehensive guidance for plantation bearer biological assets in the Fair Value Measurement Standard.

Although, it appears the valuation of plantations is similar to valuations of other assets and hence "doable" as in any other valuation process, we wish to highlight that the resources and time required are immense especially for entities that hold large plantations with varying maturity, yield profile, locality, etc. This concern is even more pressing for the purpose of interim reporting as entities may not have the resource and time to update the valuation on a timely basis. For example, Sime Darby Plantation* in Malaysia holds a total landbank of 633,607 hectares of which 530,987 hectares are planted with palm oil and the operations involve the management of 208 plantations.

We believe the Fair Value Measurement Standard should provide further explanation to clarify how an entity could strike a balance in providing meaningful information vis-à-vis limited resources and time.

Selection and application of the appropriate valuation technique

As illustrated in Appendix 2 there are essentially two methods used by valuers in the valuations of plantations ie the comparison method or the discounted cash flow method. We request the IASB to consider:

a) whether there should be a preferred method to determine the fair value of biological assets.

   In addition when fair values are measured using the present value techniques, whether the discount rate adjustment technique or the expected present value technique is the preferred technique for the valuation of biological assets.

   This is to avoid an 'accounting choice' so as to achieve comparability across the in dustry in view of the subjectivity surrounding the valuations of biological assets.

b) providing additional explanation to help preparers select the valuation technique appropriate for the measurement of plantation bearer biological assets if the IASB decides not to prescribe a preferred technique. This is also to sustain comparability of financial statements within the industry.

c) for interim reporting, whether a simplified valuation model can be applied for practical expedient purposes in arriving at the fair value of biological assets. This is to ensure the quality of fair value information reported is not compromised at the expense of resource and time.

We reiterate due to the many subjective inputs to the valuation technique to determine a plantation's fair value, it is extremely hard to conceive the parameters of the valuation inputs accurately which mainly are based management's estimates.

As a result there are significant concerns that the use of fair value may inadvertently adversely affect the quality of financial information due to either manipulation of the inputs to the model or lack of understanding regarding the principles governing the valuation techniques.

For example, we noted that there are differing views whether "current price" or "average market price" should be used in the input to the valuation techniques *(notwithstanding the illustration in Appendix 2 which is based on "projected long term average sales price").*

The different inputs could provide very different results. To illustrate our point, please see Appendix 3 for the assumptions used by different public listed companies in other jurisdictions in deriving the fair value under IAS 41 requirements.

Those who support the use of "current price" believe their interpretation is consistent with the above IAS 41 requirements. On the other hand, those who support the use of "average market price" argue that a valuation based on "current price", although quoted in an active market eg commodity price of CPO or timber, may be too simplistic without taking into account the fair value definition criteria premised on *the amount an asset could be exchanged between knowledgeable willing parties*. For example, in a business combinations exercise involving oil palm plantation during periods when the CPO commodity price is at its highest peak, the

plantation value would not be determined based on that price because realistically there will be no willing buyers. And vice versa, when the commodity price is at its lowest level, a plantation valued at that price would also not be realistic because there will be no willing sellers.

In our view, due to the long life nature of bearer biological assets [which could span over two decades] as well as the pro-cyclicality of commodity prices, "current price" may not be the appropriate price to be used in determining fair value. We believe "average market price" would be a more appropriate basis in such circumstances.

Therefore, due to the differing views in the industry, the Fair Value Measurement Standard should include an example to illustrate how the fair value of plantation bearer biological assets should be computed by making reference to the requirements in Appendix C of the IASB Exposure Draft (ED). In particular, the example should explain:

i) how to determine the starting point of the valuation inputs (eg "current price" vis-à-vis "average market price"); and

ii) how the price, yield and cost of production should be adjusted when using the present value technique to measure fair value.

In this regard, we find the explanation in paragraph C17 of the ED a practical step in determining fair values. We request an example to be included in the Fair Value Measurement Standard to educate preparers how to develop a limited number of discrete scenarios and probabilities that capture the array of possible cash flows for bearer plantation valuations based on relevant past period adjusted for changes in circumstances occurring subsequently giving due considerations to market participants assumptions.

Highest and best use of plantation land

We note that land related to agricultural activity is not within the scope of IAS 41 but covered in IAS 16 *Property, Plant and Equipment* and IAS 40 *Investment Property* whose measurement basis is either cost or fair value. For entities that elect the fair value model for plantation land, we are concerned that confusion might arise with respect to the allocation of the fair value between the land and biological assets when the highest and best use of the plantation land is other than agricultural use.

Naturally as a developing country grows, such as Malaysia, the highest and best use of planta tion land will no longer be agricultural use for plantations located close to areas with high co mmercial or residential development potential. In such cases, the market value of the plant ation would be very much higher due to the development potential and there are concern s that confusion might arise as to how the value of the biological assets should be comp uted to give a meaningful / distorted 'fair value' to the biological assets.

For example, when there is an increase in the land value but simultaneously commodity prices decline, there may be little or no effect to the plantation value as a whole because the increase in land value could very well offset the decline in fair value of the biological assets. In this regard, entities might misconstrue that there is no decline in the fair value of the

biological assets by inappropriately allocating part of the increase in land value to the fair value of the biological assets.

Therefore guidance as to how the plantation land incremental value should be derived and allocated will be helpful, not only for preparers of financial statements but also for other interested parties such as valuers involved in plantation valuation exercise, similar to that of paragraphs 20 and 21 and IE5–IE8 of the ED (allocation of incremental value of land).

III. Overview of WG members' view

1. The AOSSG WG members generally agree with the current proposals. We would make the following suggestions for the Board to reconsider:

   a) The IASB should define the relationships between the standard, the Report of Expert Advisory Panel and the educational materials.

   b) The IASB should give application guidance on how to measure the financial instruments portfolio on a net basis while presenting the assets and liabilities separately on the financial statement.

   c) The IASB need to further clarify the unit of account or reassess the unit of account guidance that currently exists in the IFRSs.

   d) The IASB need to clarify the difference between discounts arising from the blockage factors and other premiums and discounts.

   e) The IASB need to revisit the highest and best use notion, since it is not appropriate to broadly apply it to all types of non-financial assets.

2. There's a strong demand among AOSSG WG members for application guidance on a couple of issues. We believe clarification and additional guidance is necessary to ensure that the proposal will be clearly understood and consistently applied.

   a) When using quoted price provided by a third party, what measures should be taken to determine that the quoted price is development in accordance with the IFRS?

   b) What are disorderly transactions and how to identify them?

   c) Can a weighted average of the quoted price for a period (say last hour before the market closes) be regarded as fair value? If so, which level does it belong to?

   d) How to measure the fair value using the price within the bid-ask spread that is most representative of fair value? How to justify that the price is most representative of fair value, especially when the spread is wide?

   e) How to measure the fair value of certain items, especially when there's no active market and a valuation technique is required?

      i. Long term stock suspension
      ii. Unquoted equity investment
      iii. Non-performing assets held by asset management companies

iv. Restricted equity instrument

v. Derivatives (credit risk adjustment)

vi. Bearer biological asset

vii. Plantation land (incremental value)

viii. Conversion features (options) embedded in a private company's convertible preference share

3. Most AOSSG WG members disagree with the measurement uncertainty analysis disclosure (except for ASBJ)

a) Some think that the objective of making such disclosure is not clearly stated, or the proposed disclosure may not met the objective.

b) Almost all WG members think that the proposed measurement uncertainty disclosure is neither operational nor appropriate.

c) Almost all WG members believe that the cost that entities will bear to meet the disclosure requirements would significantly outweigh the benefit that users of financial reports would gain from the information disclosed.

d) Most WG members believe that the proposed disclosure will not provide useful information, or can even be misleading.

4. The alternative disclosure proposed by the WG members includes the following:

a) describing the nature or extent of the uncertainty and the justification for preferring the inputs

b) disclosing the major sources of uncertainty, if any, about the inputs used that would change fair value significantly; and the effect of correlation between inputs whether observable or unobservable, where information about inputs alone would otherwise be misleading