

Florence E. Harmon
Acting Secretary of the Securities and Exchange
Commission
100 F Street, NE
Washington
DC 20549-1090.
USA

By E-mail: rule-comments@sec.gov

August 14, 2008

Dear Sirs,

**Re: File No. 4-560
Roundtable on Fair Value Accounting Standards, held on July 9,
2008, and
File No. 4-564
Roundtable to analyze the Performance of International Financial
Reporting Standards and U.S. Generally Accepted Accounting Prin-
ciples During the Subprime Crisis, held on August 4, 2008**

The Institut der Wirtschaftsprüfer in Deutschland [Institute of Public Auditors in Germany] (IDW) appreciates the opportunity to contribute to the ongoing debate on the issue of fair value accounting and to comment on IFRS in the light of the recent period of market turmoil.

We continue to support moves by the IASB and the FASB towards convergence in financial reporting, and would like to reiterate our support for the Commission's recent and ongoing initiatives in this area, both via the SEC Advisory Committee on Improvements to Financial Reporting and the above-mentioned Roundtable Discussions. In this context, we refer to our letters dated March 26, 2008 and June 16, 2008 to the SEC's Advisory Committee on Improvements to Financial Reporting.

We note that, in a letter to you dated July 2, 2008, the German Accounting Standards Committee submitted a research paper addressing the question of which financial accounting measurement concept provides the most decision-useful information to professional investors. Whilst the findings of this research

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paper broadly corroborate the IDW's views, we also have the following comments:

We share the concerns of members of the Advisory Committee on Improvements to Financial Reporting as to the relevance and reliability of valuation modeling techniques, and in particular the concerns as to the subjectivity in the valuation of thinly-traded assets and liabilities expressed in the Final Report of August 1, 2008. In the context of fair value, we have consistently commented on the need to balance the reliability of accounting measurements, and especially those at fair value, with the relevance of the information they provide to investors, given the objectives of financial reporting, as only reliable information can be relevant. In our view, fair value is not always the most relevant measurement basis; for example, "value in use" may be more relevant for assets intended for ongoing use within a business, as it conveys information about the intended entity-specific use. Furthermore, the advantages and disadvantages associated with individual valuation techniques for calculating fair value also need to be considered in this equation. In this context, we would also like to draw your attention to our letter of response to the Discussion Papers on Fair Value Measurements Part 1 Invitation to Comment and Part 2 SFAS 157 Fair value Measurements dated May 2, 2007. For your convenience, we enclose a copy of our response letter.

As mentioned in our letter concerning File No. 265-24 „Subcommittee Reports of the SEC Advisory Committee on Improvements to Financial Reporting“ of June 16, 2008, given the widespread controversy surrounding the issue of fair value and, in particular, recently, in relation to the role requirements of various financial reporting frameworks around the world to measure certain items at fair value may have played in the downward spiral currently experienced in the "credit crunch" or "liquidity crisis", we welcome the SEC Advisory Committee's call for a cautious approach. In our opinion, there is a distinct need at an international level to reconsider the mechanics of the calculation of fair values, in particular in those situations where market prices either do not exist or, even when they exist, where they become subject to short-term volatility attributable to psychological impacts such as those recently observed within capital markets. Alternative measurement methods to arrive at fair value, such as discounted cash flow methods might be worthy of consideration in these situations.

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We hope that you will find our comments and suggestions useful in further deliberations on these issues and would be very pleased to be of further assistance if you have any questions or comments about the contents of our letter.

Yours truly,



Klaus-Peter Naumann
Chief Executive Director



Norbert Breker
Technical Director
Accounting and Auditing

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Enclosed: Copy of IDW Comment letter Fair Value dated May 2, 2007 to Sir David Tweedie, IASB, London

Sir David Tweedie
Chairman of the
International Accounting Standards Board
30 Cannon Street

London EC4M 6XH
United Kingdom

Düsseldorf, 2 May 2007

542/552

Dear Sir David

Re.: Discussion Paper – Fair Value Measurements – Part 1: Invitation to Comment, Part 2: SFAS 157 Fair Value Measurements

We appreciate the opportunity to comment on the above mentioned Discussion Paper issued by the IASB in November 2006 and would like to submit our comments as follows:

The IASB's Discussion Paper on Fair Value Measurements has been published as a part of the convergence project. In general, we support the aim of IASB and FASB to achieve convergence. However, we are not convinced that the approach taken in this case is appropriate. The Discussion Paper includes a recently published final standard of FASB, SFAS 157. In our view, there is a danger that the SFAS is simply adopted into IFRSs to the extent that fair value is currently used in the IFRSs instead of aiming to achieve the best solution having balanced the pros and cons of differing views.

We understand that it is not the intention of this Discussion Paper to expand the use of fair value in financial reporting (Discussion Paper, Part I, paragraph 7), but in addition to our concern regarding the current scope of fair value measurements it is foreseeable that other projects will incorporate additional fair value measurements for which SFAS 157 would apply. If convergence is taken seriously, in our view, SFAS 157 should be amended to the extent that the IASB concludes that some requirements of SFAS 157 are not appropriate following evaluation of the comments made during its global due process.

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An appropriate concept on fair value measurements can only be defined on the basis of a clear and comprehensive concept of what financial reports should portray. This concept should be derived from the objectives of financial reporting. For example, the question as to when the switch from the entry price, at which goods have been acquired by a wholesaler, to the exit price needs to take place is a fundamental issue affecting the understanding of financial performance. This question is at the heart of the discussions concerning the question how an entity's performance should be portrayed in financial reporting. Until the outcome of these discussions demonstrates convincing arguments, we do not accept an exit price measurement on initial recognition.

Another major concern is that the application of the proposed definition of fair value together with the respective guidance to the measurement of liabilities would lead to the well known accounting anomaly in the case of a change in the entity's own credit risk, as we have previously explained in our comment letter on Financial Instruments – Proposed Amendments to IAS 32 and IAS 39 dated 11 October 2002.

Furthermore, we would like to reiterate our view set out in more detail in our comment letter on the Discussion Paper – Measurement Bases for Financial Accounting – Measurement on Initial Recognition, dated 22 May 2006 – that market measurement is not an objective of financial statements. As outlined in the Board's Framework, the objectives of accounting are "decision usefulness" as well as "stewardship". The use of measurement concepts and accounting policies is not an end in itself, but only a means to fulfil the objectives of financial statements. The arguments put forward in the Discussion Paper in support of the market measurement objective, primarily referring to the Framework's definition of assets and liabilities, are in our view not convincing.

We do not support the assumption underlying the Discussion Paper that fair value is the most relevant measurement basis, irrespective of the circumstances. In contrast, in our opinion, the value in use is often more relevant, because it conveys information about the intended entity-specific use. This is especially true when the asset is not intended for sale but for ongoing use in the entity's value generating process. Also, a (hypothetical) market price does not reflect the expectations and risk preferences of all market participants, condensed to a single price that can be expected to earn the current rate of return available in the marketplace for commensurate risk at the measurement date. Instead, prices stemming from imperfect markets, which in practice will mostly be the case, merely reflect the expectations of the individuals carrying out the particular transaction. It is not clear to us why information about the expecta-

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tions of a (often virtual) market participant should be more relevant than information about the management's expectations, which does take account of the entity-specific synergies realizable.

One important argument against an extended use of the proposed fair value measurements is that fair value can be a superior measurement basis only when perfect and complete markets (or at least very active and liquid markets with low transaction costs) exist; in reality, however, for many assets and liabilities this is not the case. The existence of market imperfections is an inevitable precondition for the existence of lucrative investments: entities are continuously searching for innovations and competitive advantages in order to remain profitable. Furthermore, in the case of perfect and complete markets, there would be no need for financial statements anyway because there would be no information asymmetry.

The concerns surrounding fair value measurements, especially those pertaining to its reliability, are supposed to be attenuated once a standard on fair value measurements has been finalised (see Discussion Paper, Part II, paragraphs C3-C4). However, in our opinion, this effect should not be overestimated. As already set out in more detail in our comment letter on the Discussion Paper on Measurement Bases – Initial Recognition, fair value has a sufficient degree of reliability only in those rare cases, where a liquid market exists. In all other cases the degree of reliability is inadequate. In the absence of observable market prices fair values derived through valuation techniques will, in the end, reflect an increasing amount of subjective assumptions, even when market prices are available for some of the parameter values necessary.

In our view, the term "fair value" as it is currently used constitutes a family of measurement bases. However, an individual term cannot encompass the different circumstances in which measurement bases depicting current values are used, i.e. entry and exit values. Therefore we suggest replacing the term "fair value" with other terms that more closely reflect the measurement objective applicable to the individual circumstances. Those terms should be defined and explained in the Board's new Framework and afterwards be referred to and used consistently in the different standards as and when appropriate. Therefore, a new standard on fair value measurements might not be necessary at all, as different but more precise terms would replace the term "fair value". We believe that such an approach would also facilitate the forthcoming discussions because it is apparent that different understandings exist of what fair value means.

Please find our detailed comments on the questions raised in the Discussion Paper in the appendix below.

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We would be pleased to answer any questions that you may have or discuss any aspect of this letter. We also confirm that we would be interested in taking part in a round-table meeting on this Discussion Paper.

Yours sincerely

Klaus-Peter Naumann
Chief Executive Officer

Norbert Breker
Technical Director
Accounting and Auditing

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Appendix: Detailed comments on the questions raised in the Discussion Paper

Q1. *In your view, would a single source of guidance for all fair value measurements in IFRSs both reduce complexity and improve consistency in measuring fair value? Why or why not?*

As mentioned above, we believe that the term “fair value” should be replaced by more descriptive terms. This will reduce misunderstandings and improve consistency in measurement. It might make sense to include those parts of the guidance that are not affected by the individual circumstances applying at the point of initial measurement or re-measurement in a single source rather than duplicating such information in several IFRSs. This might primarily comprise guidance on valuation techniques, which could be summarised in an individual standard.

Q2. *Is there fair value measurement guidance in IFRSs that you believe is preferable to the provisions of SFAS 157? If so, please explain.*

Because different concepts underlie SFAS 157, current IFRSs and our response, respectively and guidance has to match the concepts and definitions, it is difficult to make a clear statement as to which guidance in current IFRSs is preferable. IFRSs do not contain a single fair value measurement guidance. Several standards contain specific guidance. As fair value is used in current IFRSs in circumstances in which it is not used in US-GAAP, there is additional guidance in IFRSs that is helpful and appropriate in the respective situations. For example, IAS 16 contains guidance concerning revaluations of property, plant and equipment. As this is based on an entry price notion it would not be appropriate to revert to the guidance in SFAS 157. In this sense, the guidance in IAS 16 is preferable.

Q3. *Do you agree that fair value should be defined as an exit price from the perspective of a market participant that holds the asset or owes the liability? Why or why not?*

We do not agree that fair value should be defined in general as an exit price from the perspective of market participants (see SFAS 157.10). We agree that there are situations where it is appropriate to use a measurement basis defined as an exit price based on the market participant view, for example, in order to

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determine the fair value less costs to sell in IFRS 5 or in the context of the concept of recoverable amount pursuant to IAS 36. But, the use of fair value defined as an exit price based on the market participant view is definitely not adequate in each of the individual circumstances where current market value is used in current IFRSs or where its use may be considered from a conceptual point of view. In our opinion, there are circumstances, where entry prices are more appropriate.

Furthermore, the implementation of a measurement which is solely based on an exit price notion implies that it is necessary for each asset acquired in a market transaction from an independent market participant to determine an exit price based on the market participant view in order to calculate the day-one gains or losses. This would not only cause additional costs in comparison with current accounting by means of using the actual transaction price on initial recognition but it also raises practicability concerns. From a conceptual point of view, we doubt the informational value and therefore relevance of such day-one gains or losses. In addition the severe limitations on the reliability of such exit values should be taken into account since they will mostly be values resulting from level-3 measurements, according to SFAS 157's fair value hierarchy.

We suspect that the notion "from the perspective of market participants that hold the asset or owe the liability" is intended to ensure a strict market orientation in contrast to entity-specific values. This is consistent with the objective of SFAS 157 to determine an exit value based on the market participant view. But as we have already pointed out, we believe that there are only limited circumstances in which this measurement basis is applicable and relevant. Instead, a measurement basis that takes into account the entity's ability to generate future cash flows through the use of the asset, i.e. the value in use, is often more relevant. We believe that actual transaction prices are less subjective and more relevant than fair values determined based on hypothetical transactions on hypothetical markets.

Q4. Do you believe an entry price also reflects current market-based expectations of flows of economic benefit into or out of the entity? Why or why not? Additionally, do you agree with the view that, excluding transaction costs, entry and exit prices will differ only when they occur in different markets? Please provide a basis for your views.

For a sales transaction to take place, there needs to be a market participant willing to sell at a certain price and another willing to buy at that price. Therefore, whether a given market price is an entry price or an exit price is merely a matter

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of perspective. This argument applies equally to hypothetical transactions. In this sense, an entry price also reflects current market-based expectations.

We believe that it is essential to clarify the terms “exit price” and “entry price”. The appropriate market for determining an asset’s entry price is the entity’s relevant procurement market, whereas for the exit price, the entity’s relevant sales market is the appropriate market. In cases where assets are bought with no intention of reselling them but for internal use only, the relevant transaction market is the procurement market. From the perspective of an individual entity these prices normally differ because the entity has in the meantime taken certain measures to add to the value, e.g. through conversion of goods or moving goods to a specific location.

In addition inefficient markets and markets which are not transparent might result in differences between entry and exit prices.

Furthermore, the relevant unit of account is potentially a source of differences between entry and exit prices. For example, when a reporting entity buys assets individually and combines them afterwards, the proportionate value of an asset might be different because of synergies or portfolio effects. The same is true when the process is reverse, i.e. buying a portfolio and selling individual items afterwards.

Q5. Would it be advisable to eliminate the term „fair value“ and replace it with terms, such as „current exit price“ or „current entry price“, that more closely reflect the measurement objective for each situation? Please provide a basis for your views.

As explained above, we would appreciate the elimination of the term “fair value” and its replacement with terms that more closely reflect the measurement basis actually used in specific situations according to the applicable measurement objective. In this regard we would like to note that „current exit price“ or „current entry price“ is not in itself a measurement objective as indicated by the question.

Q6. Does the exit price measurement objective in SFAS 157 differ from fair value measurements in IFRSs as applied in practice? If so, which fair value measurements in IFRSs differ from the measurement objective in SFAS 157? In those circumstances, is the measurement objective as applied in practice an entry price? If not, what is the measurement objective applied in practice? Please provide a basis for your views.

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As noted in our response to the preceding question we have to disagree again with the question's notion, that exit price is representing a measurement objective of accounting. This said, we share the Board's opinion that some fair value measurements required by IFRSs are not consistent with the fair value as defined in SFAS 157, e.g. IFRS 3, IAS 16, IAS 17, IAS 38 or IAS 39. Whether an entry price or an exit price is appropriate should be decided on a standard-by-standard basis. We believe that an exit price based on the market participant view similar to that defined in SFAS 157 will be applicable only in rare circumstances.

Q7. Do you agree with how the market participant view is articulated in SFAS 157? Why or why not?

We do not support the application of a fair value based on the market participant view of SFAS 157 for the scope of fair value as currently used in the IFRSs. If there are new projects the measurement basis needs to be determined based on the relevant measurement objective. As already mentioned, we believe that there are only limited situations in which a fair value based on the market participant view is the appropriate measurement basis.

If, however, after a thorough due process the IASB will come to the conclusion that exit price based on the market participant view would be appropriate according to the related circumstances and underlying measurement objective, we agree with the way it is articulated in SFAS 157.

Q8. Do you agree that the market participant view in SFAS 157 is consistent with the concepts of „knowledgeable, willing parties“ and „arm's length transaction“ as defined in IFRSs? If not, how do you believe they differ?

We agree that the market participant view in SFAS 157 is, in principle, consistent with the respective concepts of current IFRSs. However, we refer to our contentions set out in our cover letter pertaining to the reduction of reliability in all cases where no liquid market exists.

Q9. Do you agree that the fair value of a liability should be based on the price that would be paid to transfer the liability to a market participant? Why or why not?

We do not agree with the Board that the fair value of a liability should generally be based on the price that would be paid to transfer the liability to a market par-

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ticipant when fair value is defined as an exit price based on the market participant view. In most cases this measurement basis would only reflect hypothetical transactions which do not represent reality and economic substance. An exit price approach for liabilities would allow for a settlement of the liability at the reporting date, too. Nevertheless, we believe that there are only limited situations, if any, in which it is appropriate to use exit price when measuring liabilities. In addition to the problems arising from the accounting for an entity's own credit risk (please refer to our answer to question 16), liquid markets for liabilities rarely exist.

Q10. Does the transfer measurement objective for liabilities in SFAS 157 differ from fair value measurements required by IFRSs as applied in practice? If so, in practice which fair value measurements under IFRSs differ from the transfer measurement objective in SFAS 157 and how do they differ?

In our view, the measurement of liabilities should be based on the perspective of the reporting entity. Therefore, the measurement of liabilities should be based on the method of settling or transferring the obligation that is compatible with the entity's intention and practice. If the entity intends to settle a liability by performance (by payment or otherwise fulfilling the terms of a contract, e.g. guarantee obligations) or by a direct agreement with the debtor on immediate settlement the respective amount required to settle the liability should be recognised. Only when the entity intends to transfer the liability, for example, because an easily accessible and liquid market exists, this scenario should be used as a basis for the measurement of the liability.

Q11. In your view is it appropriate to use a measurement that includes inputs that are not observable in a market as fair value at initial recognition, even if this measurement differs from the transaction price? Alternatively, in your view, in the absence of a fair value measurement based solely on observable market inputs, should the transaction price be presumed to be fair value at initial recognition, thereby potentially resulting in the deferral of day-one gains and losses? Please give reasons for your views.

In our opinion, measurement on initial recognition should be based on the actual transaction price as a basic principle, as we have previously set out in more detail in our comment letter on the Board's Discussion Paper on Measurement Bases – Initial Recognition, except when there are indicators that the transaction price is biased.

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The main reason is that on initial recognition the entry price notion is conceptually more relevant, since the informational value of day-one profits or losses is quite questionable. The use of an exit price based on the market participant view on initial recognition would imply a completely different understanding of revenue recognition and performance, which we do not support.

Furthermore, using the actual transaction price has the advantage that the reliability of the measurement increases and additional costs for the determination of an alternative measurement base as well as problems of practicability are avoided. An exception from this principle for financial instruments may be acceptable in the rare circumstances described in current IAS 39.AG76, i.e. only if the model-based estimate of fair value is based entirely on observable market inputs.

Our concerns as to the informational value of day-one profits or losses are even more pronounced when a measurement base is used that includes inputs not observable in a market, since the reliability of such measurements is severely impaired. Therefore, the “deferral” of day-one gains or losses would not result in a loss of information.

Q12. Do you believe that the provisions of SFAS 157, considered in conjunction with the unit of account guidance in IAS 39, would result in a portfolio-based valuation of identifiable risks of instruments considered in aggregate, or an in-exchange exit price for the individual instruments? Please give reasons for your views.

The concerns of some of the Board members (Discussion Paper, Part I, paragraph 31) point to the importance of an adequate definition of the unit of account. We share the FASB’s opinion that this is only possible in the respective individual standards (SFAS 157.6), e.g. for financial instruments in IAS 39, because it is dependent on specific circumstances. In the case of the valuation of a portfolio of financial instruments the appropriate unit of account should be defined based on the reasonably expected transaction from the perspective of the reporting entity. If, for the reporting entity, only the sale of the portfolio as a whole is relevant this fact would need to be taken into account. Additional requirements may be necessary to limit the exercise of discretion, to ensure that the reliability aspect is not compromised.

Q13. Do you agree that a fair value measurement should be based on the principal market for the asset or liability or, in the absence of a principal mar-

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ket, the most advantageous market for the asset or liability? Why or why not?

We disagree with the concepts set out in SFAS 157.8, i.e. principal or most advantageous market, because the relevant market should be determined based on the reasonably expected transaction viewed from the perspective of the reporting entity. Whether the relevant market needs to be a procurement market or a sales market should be defined in the respective individual IFRSs. For example, for the determination of the current exit price of its goods, a retailer should refer to the retail market where he would sell his goods. In contrast, a wholesaler should determine the current exit price based on the prices in the wholesale market.

Q14. Do you agree that a fair value measurement should consider attributes specific to the asset or liability that market participants would consider in pricing the asset or liability? If not, why?

Under a fair value definition based on the market participant view it is appropriate to consider attributes specific to the asset or liability that a market participant would consider when pricing the asset or liability. But, in the absence of a liquid market, we are not convinced as to the relevance of taking into account attributes a hypothetical market participant would consider. Inherently these attributes show a lower degree of reliability and are also normally difficult to determine. If the reporting entity carefully and appropriately considers all attributes which may be specific for the asset or liabilities we cannot see any advantages in the artificial exercise considering attributes a hypothetical market participant would consider.

Q15. Do you agree that transaction costs that would be incurred in a transaction to sell an asset or transfer a liability are an attribute of the transaction and not of the asset or liability? If not, why?

Assuming that fair value is defined as an exit price, it is, in a first step, conceptually sound that transaction costs are not regarded as an attribute of the asset or liability but rather as being specific to the transaction. If location were an attribute of the asset the costs incurred to transport the asset to the specified location would have to be considered when determining the fair value.

However, from a conceptual point of view there is disagreement with the views expressed in SFAS 157. Because this standard assumes in its model a hypo-

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thetical exit for measurement purposes it is conceptually sound to reflect in such an exit model all additional (hypothetical) costs incurred in such an assumed transaction. Only when considering such transaction costs in the measurement, the real net cash inflow from selling an asset will be portrayed. SFAS 157 is applying an inconsistent model in that a hypothetical exit is assumed but not all related costs are reflected. The same applies to liabilities.

This means that in the case of an exit orientation to be applied for an asset, costs to sell should be deducted. Where an entry orientation is appropriate, for example, for goods acquired by a retailer, any additional costs of acquisition should be added to the entry price.

Q16. Do you agree that the risk of non-performance, including credit risk, should be considered in measuring the fair value of a liability? If not, why?

In our opinion, it is not appropriate to measure all liabilities at fair value. In particular, we are concerned that any change in a debtor's creditworthiness would result in the recognition of a gain or loss by the debtor. We question whether the change in fair value of liabilities caused by changes in the debtor's credit risk is relevant to users of the debtor's financial statements and are concerned that the results rather may be perceived as confusing and counterintuitive. In particular, if an entity's credit risk deteriorates, the fair value of its liabilities declines and the entity records a gain. We do not believe that a decline in creditworthiness should result in recognising a gain.

Furthermore, the effects of changes in credit risk on the fair value of liabilities may reflect changes in the internal operating structure and conditions of the entity, rather than changes in external conditions of financial markets.

In addition, changes in the credit standing of an entity are usually accompanied by adverse changes in the value of the entity's internally generated intangible assets (in particular, internal goodwill). However, these adverse changes are generally not recorded under existing IFRSs. Thus, there is a fundamental inconsistency and "mis-matching" in reporting the effects of changes in credit standing on an entity's liabilities. While a deterioration of the creditworthiness causes a reportable gain from the decrease of the fair value of the entity's liabilities, a loss from the corresponding decline of internal goodwill is ignored.

If an entity is in some financial difficulties, the fair value of the entity's debt may already reflect the market's expectation that the entity will possibly not continue as a going concern (in other words, to some degree the market may evaluate the entity on the basis of its expected insolvency value). That may create a dis-

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continuity in accounting if the entity appropriately continues to account for its assets on a going concern assumption while the book values of liabilities and their changes are impacted by expectations that it may not continue as a going concern.

The risk that an entity will fail to repay its liabilities when due can be described as an implicit put option of the debtor to transfer its remaining (financial and non-financial) assets to the creditor in the case of insolvency instead of settling the liability according to the contractual terms. Theoretically, it would be possible to separate from a liability the value of that implicit put option (which does not meet the definition of a financial asset as far as it refers to non-financial assets). Separating the put option would result in the liability being valued at the present value of its contracted cash flows discounted at the current risk-free interest rate. The option could presumably be separately accounted for as a specific type of intangible asset of the entity to be amortised using the effective interest method, although one might also argue that it should directly be offset against equity. We support separation of the option from the liability on the grounds that it results in measuring the liability at the amount that the entity is obligated to pay without any reduction for the market's evaluation of the statistical probability that the entity will not meet its obligation. Alternatively, an approach might be considered that measures financial liabilities without taking into account changes of the reporting entity's own credit risk.

Q17. Is it clear that the „in-use valuation premise“ used to measure the fair value of an asset in SFAS 157 is different from „value in use“ in IAS 36? Why or why not?

We understand that the „in-use valuation premise“ used to measure the fair value of an asset in SFAS 157 is conceptually different from „value in use“ in IAS 36. But we believe that the highest and best use concept is not appropriate for the determination of fair values. The fair value hierarchy set forth in SFAS 157 has to be followed when determining a fair value according to SFAS 157. In this context, it is, however, unclear whether the fair value hierarchy or the concept of highest and best use would prevail. Consequently, the term „in-use valuation premise“ is rather misleading.

When the unit of account is defined appropriately in the individual IFRSs, there is no need for the „in-use valuation premise“. For example: An asset used as an integral part of a production line has to be measured. If the unit of account for its subsequent measurement is the production line, the fair value in use of that individual asset is dispensable.

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In our opinion, based on the arguments set forth above, the highest and best use concept should not be integrated into IFRSs.

Q18 Do you agree with the hierarchy in SFAS 157? If not, why?

In principle, we agree with the fair value hierarchy in SFAS 157. But it refers only to the inputs that valuation techniques use to measure fair value. It should be complemented by a hierarchy of valuation techniques (SFAS 157.18), as is the case in IAS 36. This hierarchy of valuation techniques should include requirements to ensure the selection of an appropriate approach from an economic point of view. Otherwise there is a danger that valuation techniques will be used although they are inferior from an economic point of view, just because more inputs exist that are directly or indirectly derived from market data. For example, valuation techniques based on the cost approach will tend to replace market-approach based valuation techniques, despite the fact that the latter are basically preferable.

The requirements concerning the determination of level-3 fair values are too abstract. They should be supplemented by additional guidance in order to increase the relevance and reliability of the values derived.

Q19 Are the differences between the levels of the hierarchy clear? If not, what additional information would be helpful in clarifying the differences between the levels?

The differences between the levels of the hierarchy are clear.

Q20 Do you agree with the provision of SFAS 157 that a blockage adjustment should be prohibited for financial instruments when there is a price for the financial instrument in an active market (Level 1)? In addition, do you agree that this provision should apply as a principle to all levels of the hierarchy? Please provide a basis for your views.

We do not agree with the provision of SFAS 157 that a blockage adjustment should be prohibited for financial instruments when there is a price for the financial instrument in an active market.

The question of the (non-)consideration of blockage adjustments when determining the fair value or the value to be recognized in the balance sheet, respectively, cannot be answered viewed in isolation from the issue of the appropriate

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unit of account. Likewise, the perspective of the reporting entity has to be taken into account. When the entity intends to use or sell the financial instruments in a block rather than individually and such a sale is feasible, blockage adjustments have to be considered in the determination of the balance sheet value.

Similarly, blockage adjustments have to be considered in the determination of the fair value of an acquired entity in a business combination based on the purchase price when a controlling interest in the entity has been acquired and minorities remain. This requirement is applicable irrespective of the level of the fair value hierarchy the input factors stem from.

Q21 Do you agree that fair value measurements should be determined using the price within the bid-ask spread that is most representative of fair value in the circumstances, as prescribed by paragraph 31 of SFAS 157? Alternatively, do you believe that the guidance contained in IFRSs, which generally requires assets to be valued at the bid price and liabilities at the ask price, is more appropriate? Please explain the basis for your view.

From a conceptual point of view, it would be appropriate to value those assets for which the entry price notion is applicable at ask price, whereas assets for which the exit price notion is applicable would have to be valued at bid price. But when the bid-ask spread is not significant, for simplification, a consistently applied mid-market pricing would be acceptable.

Q22 Should a pricing convention (such as mid-market pricing or bid price for assets and ask price for liabilities) be allowed even when another price within the bid-ask spread might be more representative of fair value? Why or why not?

Please refer to our answer to question 21.

Q23 Should bid-ask pricing guidance apply to all levels of the hierarchy, including when the fair value measurement includes unobservable inputs? Why or why not?

Please refer to our answer to question 21. In our opinion, from a conceptual point of view, bid-ask spreads can be determined only when fair value is determined according to level 1 of the fair value hierarchy in SFAS 157.

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Q24 Do the disclosure requirements of SFAS 157 provide sufficient information? If not, what additional disclosures do you believe would be helpful to users and why? Alternatively, are there disclosures required by SFAS 157 that you believe are excessive or not beneficial when considered in conjunction with other disclosures required by IFRSs? Please provide a basis for your view.

We appreciate the fact that SFAS 157 requires additional disclosures for fair value measurements using significant unobservable inputs (level-3). These disclosures increase transparency about values and gains or losses resulting from their fluctuations, which is important for the users of financial statements because the informational value of those figures is impaired as a consequence of the low degree of reliability.

As IFRS 7 requires several disclosures concerning the fair value of financial instruments, the proposed new standard will need to be aligned with these requirements.

Q25 Does the guidance in Appendices A and B of SFAS 157 sufficiently illustrate the standard's principles and provisions as they would apply under IFRSs? If not, please specify what additional guidance you believe is needed and why.

Provided that the project is executed as set out in the Discussion Paper, we would, as already mentioned in our answer to Q18, appreciate the Board including stipulations relating to the hierarchy of valuation techniques in the future standard. Furthermore, in our view, more detailed guidance on these valuation techniques (SFAS 157.18) might be helpful. Finally, we would like to suggest incorporating an example to demonstrate the effects when an asset is acquired at an entry price differing from the exit price determined in compliance with SFAS 157. Such an example should be based on a case when the exit price is used for initial recognition, i.e. dealing, in particular, with the treatment of day-one gains and losses.

Q26 Does the guidance in Appendices A and B of SFAS 157 sufficiently illustrate the standard's principles and provisions as they would apply in emerging or developing markets? If not, please specify what additional guidance you believe is needed and the most effective way to provide this guidance (for example, through additional implementation guidance or through focused education efforts).

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In emerging or developing markets, in many cases fair value might not be the appropriate measurement base. As the markets are less developed, our concerns set out in our cover letter above, concerning the weaknesses of fair values that are not derived from liquid markets for the respective asset or liability are particularly valid.

Q27 Please provide comments on any other matters raised by the discussion paper.

We refer to our comments in our cover letter. Given that the discussions about a comprehensive concept of what financial reporting should portray have not been concluded, it is very difficult to comment meaningfully on the definition and guidance on fair value measurements as set out in the Discussion Paper.