



Our Ref.: C/FRSC

Sent electronically through the IASB Website (www.iasb.org)

10 September 2010

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

Dear Sirs,

[IASB Exposure Draft of Measurement Uncertainty Analysis Disclosure for Fair Value Measurements](#)

The Hong Kong Institute of Certified Public Accountants is the only body authorised by law to promulgate financial reporting, auditing and ethical standards for professional accountants in Hong Kong. We welcome the opportunity to provide you with our comments on the captioned Exposure Draft (ED). Our responses to the questions raised in your Exposure Draft are set out in the Appendix for your consideration.

In May 2009, the IASB issued an exposure draft to propose that if different unobservable inputs could have reasonably been used in place of one or more of the unobservable inputs actually used to estimate fair value, and those unobservable inputs would have changed fair value significantly, the entity would be required to state that fact. The entity would also be required to disclose the effect on fair value of using those different unobservable inputs, and how such effect was calculated.

The June 2010 ED proposes that the effect of correlation between unobservable inputs must be considered in this analysis, if such correlation is relevant when estimating the effect of using those different unobservable inputs on the fair value measurement. That is, when a change in one unobservable input would affect one or more of the other unobservable inputs used, that correlation must be considered when determining the amount by which fair value might have changed, had a different unobservable input been used.

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.

If you have any questions on our comments, please do not hesitate to contact me at ong@hkicpa.org.hk.

Yours faithfully,

Steve Ong, FCPA, FCA
Director, Standard Setting Department



Hong Kong Institute of CPAs

Comments on the IASB Exposure Draft of *Measurement Uncertainty Analysis Disclosure for Fair Value Measurements*

Question 1

Are there circumstances in which taking into account the effect of the correlation between unobservable inputs (a) would not be operational (eg for cost-benefit reasons) or (b) would not be appropriate? If so, please describe those circumstances.

The proposed requirements state that correlation should be taken into account when it is relevant but they do not provide guidance on how to determine whether the relationship between two or more variables is reliably correlated, other than to make clear that a statistical analysis (e.g., regression) is not required. We also note that there is an absence of specific examples of identified “correlations” between level 3 unobservable inputs in the illustrative example accompanying the ED or in the discussion in paragraphs BC18 to BC21. This leaves us unsure of what the IASB has in mind in this regard and in any event we are sceptical as to whether a meaningful calculation of statistical correlation between unobservable inputs is possible. We are therefore concerned that the majority of entities will be unable to operationalise the proposed requirement to take account of the effect of correlation between unobservable inputs.

Operationalising the requirement will be particularly difficult when the level 3 valuation of a particular asset is based upon numerous unobservable inputs. For example, a private equity investment may be valued using a method such as PE benchmarking for which the unobservable discount factor, used to discount the observable input (i.e. industry PE of listed companies), may be further distinguished into various sub-discount factors such as discount on operational scale, discount on liquidity, discount on management quality, etc. in such cases, we do not believe that it is operational to identify all relevant unobservable inputs that may have some level of correlation.

Question 2

If the effect of correlation between unobservable inputs were not required, would the measurement uncertainty analysis provide meaningful information? Why or why not?

We believe that a measurement uncertainty analysis that does not reflect known correlation among unobservable inputs of limited value. However, we consider the “measurement uncertainty analysis” proposed under the ED only provides information on possible different values but does not provide information on how the correlation of relevant unobservable inputs influenced the disclosed fair value. It is therefore of limited value to users and may in fact have the opposite effect than that intended by inappropriately indicating 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 fair value which has been identified by management as an appropriate measure for recognition.



Alternatives to measurement uncertainty analysis

Question 3

Are there alternative disclosures 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 Board 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.

We 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.