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Le Président

AB/ PS

N°

DISCUSSION PAPER ON MEASUREMENT ON INITIAL RECOGNITION

Dear Sir,

I am writing on behalf of the “Conseil National de la Comptabilité” (CNC) to comment on the above “Discussion Paper”. Our detailed remarks are set out in Appendix 1 and summarised below.

Firstly, we wish to express our disagreement with the process employed. We disagree with making proposals for measurement via a discussion paper without first completing the update of the Framework. The discussion on measurement cannot take place without reference to the objectives and the qualitative characteristics of financial statements as set out in the Framework.

The present “Discussion Paper” relies on a number of unsupported assumptions and assertions set out in 4. below which have not been subject to prior validation. The demonstrations, which the paper attempts to achieve therefore, appear unfounded.

The absence of convincing arguments demonstrating the supposed improvement introduced by fair value measurement on initial recognition leads us to continue to see considerable merits for the historical entry cost model.

The issue of measurement requires a comprehensive unbiased public debate. We understand that the IASB has undertaken in front of the Economic and Monetary Affairs Committee of the European Parliament to organise such a debate. We therefore await the outcome.

1. The issue of measurement is closely linked to several IASB projects: Revenue Recognition, Performance Reporting and the conceptual Framework, Convergence with FASB etc. It is not clear how the objectives of the "Discussion Paper" fit in with these projects. We also note that the comparisons between fair value and the other various measurement bases can only be viewed as tentative given that the IASB is currently finalising an exposure draft dealing with fair value measurement generally. The IASB may consider that soliciting views is informative about the issue of measurement on initial recognition, but we wonder what purpose this will serve as, at the time of writing, the fair value measurement exposure draft is yet to be issued for comment (we acknowledge the fact that the FASB is currently finalising its equivalent project).

2. The relevance of the proposals on measurement depends on the concept of financial position and performance to which it refers. We think the "Discussion Paper" should define clearly what it is attempting to achieve in this respect. It would appear to be proposing the measurement of performance against market values including immediate recognition of profits and losses arising where market values differ from transaction prices on initial recognition (see, for example, §412 of the Full Version). The "Discussion Paper" would appear to be advocating the recognition of "day one profit" in the results of an entity. If this is the case, it should be made clear.

It is the relevance of such concepts for measuring performance and the implications for evaluating stewardship, which should be discussed and justified. These discussions and justifications go beyond the declared scope of the "Discussion Paper".

3. The scope of the "Discussion Paper" is voluntarily limited to measurement on initial recognition. We do not believe that measurement on initial recognition can be dealt with separately from subsequent measurement:

- (a) Because there is a direct effect on revenue recognition.
- (b) Because applying market value on initial recognition would appear to be a commitment to using market value for subsequent measurement.
- (c) Because there are potentially repercussions for other standards e.g. IAS 36 which refers to the "value in use" concept for subsequent periods.

4. The "Discussion Paper" relies on a number of fundamental assumptions for which little or no justification or argumentation is given. There is generally a lack of academic demonstration and illustrative examples.

The following are a summary of the main unsupported assumptions made in the paper:

4.1. *Fair value means market value* (see §92 of the Full Version).

4.1.1 In our view, the IASB definition of fair value quoted in §88 of the Full Version does not necessarily imply the existence of a market as defined in the "Discussion Paper". Moreover, §93 of the Full Version recognises that fair value is open to other interpretations but the "Discussion Paper" does not examine the respective merits of these other interpretations.

We consider that single transactions could meet the above-mentioned definition irrespective of the existence of an observable market (see also 4.1.2 below).

4.1.2 “...A transaction price ...should not be described as fair value on initial recognition.. unless there is persuasive evidence that it does have the essential properties of market value.” (§106 of the Condensed Version)

This statement would seem to create the presumption that individual transactions (in this case where there is no observable market as defined by the “Discussion Paper”) even when carried out by knowledgeable, willing parties at arms length are not at fair value unless there is proof to the contrary. In our view, this is an unsupported reversal of the widely-held current presumption that **such transactions are at fair value unless there is evidence to the contrary.**

The “Discussion Paper” eliminates the historical transaction cost model in an unsatisfactory manner, by reversing the burden of proof relating to the fair representation of the transaction.

Whether a transaction price is at fair value or not is the central issue of this “Discussion Paper” because if transaction prices were always at fair value there would be no discussion.

We note that The “Discussion Paper” is ambiguous on this issue as illustrated by §109, which stipulates that “In many situations it will be reasonable to assume the transaction price exchanged for an asset or liability reasonably reflects its market value on its transaction date.”

The “Discussion Paper” should therefore define more clearly when and why transaction prices are not at fair value and focus its discussion on those cases.

4.2 *Market value is more relevant than other measurement bases and in particular “entity-specific” bases such as historical cost* (see §123 to §130 of the Full Version)

No convincing arguments are given to demonstrate the greater decision usefulness of market value over “entity-specific” measurement bases.

4.3 *Only one market value for an asset or liability exists on a measurement date* (see §131 to §138 of the Full Version).

The “Discussion Paper” recognises the existence of market inefficiencies (§136 of the Full Version) and multiple markets for an identical asset or liability which are just two explanations of why a single market value might not exist on a measurement date.

5. The reliability of market valuation on initial recognition is not demonstrated.

The uncertainties affecting the reliability of market valuation include :

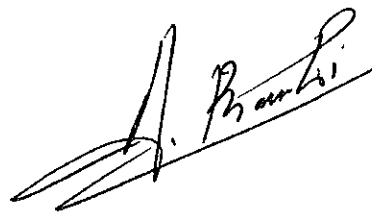
- Where no active market exists
- Where a market exists but is inefficient
- Where wide bid-asked spreads exist.

In conclusion, the “Discussion Paper” neither demonstrates the superior relevance or the reliability of the market measurement base on initial recognition, as opposed to historical cost.

Indeed, no indication is given as to how frequently a market-based measurement will be possible in practice.

We therefore continue to support historical cost as a basis for measurement on initial recognition considering that, subject to evidence to the contrary, it represents a “fair value” as defined by the IASB.

Yours sincerely ,

A handwritten signature in black ink, appearing to read 'A. Bracchi', written over a diagonal line.

Antoine BRACCHI

APPENDIX 1

Discussion Paper: Measurement on Initial Recognition

Question 1—Do you agree that the list of identified possible measurement bases (see paragraphs 33-51 of the condensed version and paragraphs 69-74 of the main discussion paper) sets out the bases that should be considered? If not, please indicate and explain any changes that you would make.

Question 1 CNC commentary

The paper lists the following measurement bases: historical cost, current cost (i.e. reproduction cost and replacement cost), net realisable value, value in use, fair value and deprival value. The list appears comprehensive according to our knowledge of the present state of academic research.

Question 2—Do you agree with the working terms and definitions, and supporting interpretations, of each of the identified measurement bases (see paragraphs 33-51 of the condensed version and paragraphs 77-96 of the main discussion paper)? If not, please explain what changes you would make. In particular, do you have any comments on the term “fair value” and its definition (in light of the discussion in paragraphs 46-48 of the condensed version and paragraphs 88-93 of the main discussion paper)?

Question 2 CNC commentary

(a) Historical cost.

We request clarification of how the phrase “at the time of acquisition” should be applied to assets constructed over a period of time. In this case, is historical cost the aggregate of the fair value of the consideration given for the partial acquisitions? Or is it the fair value of consideration at the date the asset becomes operational?

We propose to maintain the current definition of historical cost given in the current IASB glossary (see paragraph 35 of the condensed discussion paper), which includes the concept of “cash or cash equivalents” for assets and of “amounts of proceeds” and “cash to be paid” for liabilities.

(b) Value in use

It is not clear whether the value in use refers to “entity-specific” or market expectations for future expected cash flows.

(c) Deprival value.

We are unsure how “deprival value” might be applied in particular to initial measurement.

The notion of “the loss an entity would suffer if it were deprived of an asset” would seem less relevant on acquisition than in subsequent periods. We can imagine difficulties in estimating the full long term effects e .g loss of customers, image etc.

(d) Fair Value

1. We note that the definition of fair value given in paragraph 46 of the condensed “Discussion Paper” is different to the one in the IASB Glossary with respect to liabilities, which are “exchanged” instead of being “settled”. We believe that the respective merits of the value to settle model vs. the value of exchange model have not been discussed in the paper. The term “exchanged” has already a market bias as compared to settled, with which we do not agree.

2. We note that the definition of fair value does not necessarily imply the existence of an active liquid market since a single transaction might fulfil the conditions of “knowledgeable, willing parties in an arm’s length transaction”. The “Discussion Paper” interprets “fair value” as “market value” without any real justification.

It is unclear what fair value is exactly attempting to reflect, especially in circumstances where markets:

- do not exist or are not liquid enough. How would differences with an entity-specific measurement be identified in this case?
- are not efficient; or
- there are multiple markets.

Question 3—*It is proposed that there are two fundamental sources of differences between the identified bases for measuring assets and liabilities on initial recognition:*

- (a) *market versus entity-specific measurement objectives, and*
- (b) *differences in defining the value-affecting properties of assets and liabilities.*

(See paragraph 52 of the condensed version and paragraph 97 of the main discussion paper.) This proposal and its conceptual implications are the subject of chapters 4 and 5. Do you agree that these are the fundamental sources of differences between asset and liability measurement bases on initial recognition? If not, please indicate the fundamental sources of differences you have identified, and provide the basic reasons for your views. For any different fundamental sources you have identified, please indicate how these might be examined and tested.

Question 3 CNC commentary

- (a) We disagree that the conceptual opposition set out in Q3 (a) between “entity-specific” and “fair value” measurement objectives (see our remarks on “fair value” definition in Q.2 above.) is always applicable. Where markets do not exist, are not liquid enough or are inefficient, individual transactions may, subject to evidence to the contrary, still be presumed to take place at fair value as defined in paragraph 46 of the condensed version of the “Discussion Paper”.

The relevance of the proposals on measurement depends on the concept of financial position and performance to which it refers. We think the “Discussion Paper” should define clearly what it is attempting to achieve in this respect. It would appear to be proposing the measurement of performance against market values including immediate recognition of profits and losses arising where market values differ from transaction prices on initial recognition (see, for example, §412 of the Full Version). It is the relevance of such a concept for measuring performance and its implications for evaluating stewardship which should be discussed and justified. We do not consider that these discussions and justifications have taken place in the “Discussion Paper”.

- (b) §136 of the full version of the “Discussion Paper” suggests that, according to FASB research, after adjusting for entity specific and value affecting differences, further differences may occur due to market inefficiencies.

Question 4—*The paper analyzes the market value measurement objective and the essential properties of market value.*

- (a) *Do you believe that the paper has reasonably defined the market value objective and the essential properties of market value for financial statement measurement purposes (see paragraphs 54-56 and 105-112 of the condensed version and paragraphs 99-110 and 236-241 of the main discussion paper)? If not, please explain why not, and what changes you would propose, or different or additional considerations that you think need to be addressed.*
- (b) *Do you agree with the proposed definition of "market" (see paragraphs 55-56 of the condensed version and paragraphs 107-110 of the main discussion paper)? If not, please explain why you disagree, and indicate any changes you would make and any issues that you believe should be given additional consideration. Do you agree with the fair value measurement objective as proposed, and its derivation from the market value measurement objective (see paragraph 102 of the condensed version and paragraphs 111, 228 and 229 of the main discussion paper)?*

Question 4 CNC commentary

(a) We do not agree that markets necessarily produce a "single price" as stated in §54 of the condensed version. "A range of prices" might be more appropriate in view of the inefficiencies of most markets.

(b) The definition of market in §55 of the condensed version refers to "a body of knowledgeable, willing arm's length parties carrying out sufficiently extensive exchange transactions".

We suggest that the notions of "body" and "sufficiently extensive transactions" require clarification given the assertion in §106 of the condensed version that "a few infrequent transactions do not necessarily constitute a market.... And that a transaction price ...should not be described as fair value on initial recognition ...unless there is persuasive evidence that it does have the essential properties of market value."

In our view, even where the transactions are limited they may be at fair value and perhaps at market value (depending on the definition of a market) when carried out by knowledgeable, willing arm's length parties. In this respect we support the "pragmatic position" quoted in §107 of the condensed version.

. The example of acquisition prices for which there is no observable market (§110 to 114 of the condensed version) would tend to indicate that there may not exist in such cases a single "fair value" but only "historical cost", as fair values would otherwise appear to be different according to the acquirer. If this were the conclusion, it would lead to a different interpretation of "fair value" to the "single market value" approach adopted in the Discussion Paper.

Amongst the issues requiring further consideration, we suggest that further research is required in explaining differences between individual transaction and market prices. §108 of the condensed version refers to situations where transaction and market prices may be different : "Every day people get bargains or pay more than fair value for goods and services". §109 states that in many situations it will be reasonable to assume that the transaction price exchanged for an asset or liability reasonably reflects its market value on the transaction date. In practice, how would the Discussion Paper determine whether a transaction price was within the spread of market values or outside it? What signification would the "Discussion Paper" give to the different transaction prices?

(c) According to §102 of the condensed version, the fundamental objective of fair value is to reflect the market value of an item on the measurement date. This conclusion cannot be automatically deduced from the definition of fair value given in §46 of the condensed version. The correlation fair/market value is a basic assumption of the Discussion Paper and is not supported by argumentation. We do not agree that the objective of fair value is necessarily to represent the market value of an asset or liability. For example, the fair value definition in §46 might equally apply to individual transaction prices for which no active market exists.

Question 5—*Do you agree with the definition and discussion of entity-specific measurement objectives (see paragraph 57 of the condensed version and paragraphs 112-116 of the main discussion paper) and their relationship to management intentions (see paragraph 58 of the condensed version and paragraphs 117-121 of the main discussion paper)? If not, please explain why you disagree.*

Question 5 CNC commentary

As regards paragraphs 57 and 58 of the Discussion Paper condensed version, we do not agree with the underlying assumption that entity-specific measurement objectives are necessarily different to those of the market, especially in circumstances where the market is not liquid, inefficient or inexistent.

A so-called entity-specific price may well be within the range of prices observed on a market and integrate the main assumptions of other market players.

Transaction prices reflecting “entity-specific assumptions” would normally meet the criteria of the “fair value” definition (knowledge, willingness, and arm’s length).

§118 of the full version states some important arguments in favour of measurements reflecting management’s intentions: management knows better their own business than the market, they are accountable for their plans and expectations.

The arguments set out in §119 of the full version in favour of market values are not necessarily more convincing.

In particular the superior relevance of market values vs. management based values is not demonstrated.

Question 6—*Do you agree with the comparison of market and entity-specific measurement objectives (see paragraph 59 of the condensed version and paragraph 122 of the main discussion paper) and with the proposed conclusion that the market value measurement objective has important qualities that make it more relevant than entity-specific measurement objectives for assets and liabilities on initial recognition (see paragraphs 60-61 of the condensed version and paragraphs 123-129 of the main discussion paper)? If not, please explain your views.*

Question 6 CNC commentary

We disagree:

Question 6 can be broken down into two parts:

1.The opposition of “market and entity specific measurement objectives” on initial recognition.

We believe that an individual entity’s transaction can be assumed to take place between knowledgeable, willing parties at arm’s length and represent fair value **unless there is evidence to the contrary**. The transaction price would therefore correspond to the fair value of the asset or liability according to the definition given in §88 of the full version of the “Discussion Paper”. Under this assumption, the individual entity’s price is generally a

“market” value at the time the transaction takes place. Therefore, we do not agree that there is necessarily an opposition between market and entity specific objectives.

The “Discussion Paper” does not analyse when and for what reasons the historical transaction price, which is “entity specific”, is different to fair value. We do not therefore consider that it has demonstrated that there is systematically a difference between market and entity specific measurement objectives on initial recognition. Without that demonstration the relevance of the “Discussion Paper” is limited because the main issue is insufficiently addressed.

2.The conclusion that the market value measurement objective is more relevant on initial recognition

We do not believe that the “Discussion Paper” has demonstrated that the market value measurement objective is more relevant on initial recognition.

The answer depends on the objectives of performance measurement attributed to the financial statements, for example:

1.The “management” approach, which compares the historical transaction price, paid to actual cashflows generated by the management.

2.The “market” approach which compares a market price, if we suppose this is different to the historical transaction price, to actual cash flows.

The superiority of the “market” approach appears to be an underlying assumption, which is not supported by arguments in the “Discussion Paper”.

We also believe that it is premature to conclude on this subject since it is also dependant on decisions that are not yet made on the revenue recognition, performance reporting projects and on the revision of the framework.

Question 7

(a) *It is reasoned that there can be only one market (fair) value for an asset or liability on a measurement date (see paragraph 62 of the condensed version and paragraphs 131-138 of the main discussion paper). Do you agree with this conclusion? If not, please explain why you disagree.*

(b) *It is proposed that differences between apparent market values for seemingly identical assets or liabilities on initial recognition may be attributable to:*

(i) *differences between the value-affecting properties of assets or liabilities traded in different markets, or*

(ii) *entity-specific charges or credits.*

(See paragraph 63 of the condensed version and paragraphs 131-138 of the main discussion paper). However, the paper notes the existence of multiple markets for some assets and liabilities, and the possibility that they may be due to market access restrictions that require further investigation (see paragraphs 74-82 of the condensed version and paragraphs 95-109 of the main discussion paper).

Do you agree with these proposals, within the caveats and discussion presented? If not, please explain why you disagree.

Question 7 CNC commentary

7(a) We do not agree with the statements made in the Discussion Paper concerning the existence of only one market value for an asset or liability on a measurement date.

This is because:

1. There may be more than one reference market for an identical asset or liability.
2. Markets may not be efficient so that a range of prices may well be representative of market values within a particular market.

We would suggest that the CASB provide examples to illustrate the operation of “perfect markets” according to the definition of the “Discussion Paper” and demonstrate how these apply to the most commonly held assets and liabilities of an entity.

We would further suggest, as stated in our commentary on Q.6 above, that when two knowledgeable parties negotiate at arm's length, the resulting price should be considered to represent the market value of the asset or liability exchanged unless by exception the circumstances suggest otherwise. In our view, the “Discussion Paper” should concentrate on defining these circumstances and determining the nature and the usefulness of information to be given on any difference between the transaction price and the supposed market value.

(b) We disagree with the proposition that differences between apparent market values are necessarily explained as in points (1) and (2) above.

As stated in §136 of the full version of the “Discussion Paper” market inefficiencies can result in different market prices for identical assets and liabilities on a measurement date after adjusting for value-affecting differences and entity-specific effects.

Question 8—*Do you agree that a promise to pay has the same fair value on initial recognition whether it is an asset or a liability, and that the credit risk associated with a promise to pay enters into the determination of that fair value with the same effect whether it is an asset or liability (see paragraph 65 of the condensed version and paragraphs 142-147 of the main discussion paper)? If you do not agree, please explain the basis for your disagreement.*

Question 8 CNC Commentary

We disagree:

1. We find it difficult to comment on initial recognition valuation without taking into account subsequent valuations and their impact on performance reporting.
2. We are unhappy with taking account of an entity's credit risk in valuing its liabilities. If we consider applying this principle to subsequent remeasurement, a deterioration in an entity's credit rating would lead to a reduction in the entity's liability and to recognition of a profit.
3. We do not consider the “Discussion Paper” has produced any convincing arguments for preferring the “market value” to an entity-specific approach. Entity-specific parameters, such as an entity's capacity to pay and its supplier policy, would appear relevant to determining the value of that entity's liability in the normal course of business.
4. The substitution of an “exchange” for a settlement value for liabilities in the “fair value” definition reflects the preference for a “market” value as compared to entity-specific but without any real justification.

Question 9—*The paper makes the following proposals with respect to defining the unit of account of the asset or liability to be measured on initial recognition:*

- (a) *The appropriate individual item or portfolio unit of account on initial recognition is generally the unit of account in which the reporting entity has acquired the asset or incurred the liability (see paragraphs 67-70 of the condensed version and paragraphs 149-154 of the main discussion paper).*
- (b) *The appropriate level of aggregation for non-contractual assets on initial recognition is the lowest level of aggregation at which an identifiable asset is ready to contribute to the generation of future cash flows through its sale or use (see paragraphs 71-73 of the condensed version and paragraphs 157-161 of the main discussion paper).*

Do you agree with these proposals within the caveats and discussion presented? If not, please explain why, and in what respects, you disagree.

Question 9 CNC Commentary

We find it difficult to answer these questions without referring to a definition of financial situation and performance. This question is intimately related to the timing of revenue recognition and it would be premature to conclude at this stage.

First, we believe that this issue cannot be treated independently from the subsequent measurement principle. It would be difficult to support a model where principles for initial and subsequent measurement are not consistent.

(a) We also think the “unit of account” issues may well be linked to the reference market one (see Q10). An entity may have access to more than one “entry” market corresponding to different units of account: e.g. individual units or portfolios. This could be the case of a bank that can make loans on an individual basis and buys portfolios of similar loans. In this case identical items might be valued differently on initial recognition based on the unit of account rationale. We do not think this issue has been considered and sufficiently analysed in the Discussion Paper.

We believe it is unclear whether the “Discussion Paper” considers that it is possible to recognise a day 1 profit in certain circumstances.

(b) The example given in §158 of the full version relates to equipment configured to a specialised use within an assembly line. §158 states that the entry market in which the equipment was purchased no longer establishes its fair value because of its transformation. §158 questions whether the appropriate unit of account is the equipment or the assembly line. §161 proposes that “the appropriate unit of account for non-contractual assets on initial recognition is the lowest level of aggregation at which an identifiable asset is ready to contribute to the generation of future cash flows”.

The choice of the unit of account in the above example depends, in our view, on entity-specific considerations, such as whether or not the equipment is dedicated to one production line serving one market. The entity’s production process will determine whether the machine generates cash flows directly (e.g. where the production is sold directly to customers) or via the production line (where the production is integrated into another product before being sold) or both. It would be possible to measure the historical cost and determine the forecast cash flows generated by the acquisition. However, where as in this case, the value of an asset is primarily a reflection of its value to a specific business we are doubtful as to whether a “market value” exists or if a sale value does exist, for example on a second hand market, whether it is relevant to the users of the financial statements of the entity.

Question 10—It is suggested that, in many cases, the best market source on initial recognition is the market in which the asset or liability being measured was acquired or issued. However, some significant situations are noted in which a different source may be appropriate, and research is proposed into possible multiple markets (see paragraphs 75-82 of the condensed version and paragraphs 162-182 of the main discussion paper). Do you agree that the paper provides a reasonable analysis of market sources and their implications on initial recognition? If not, please provide reasons for disagreeing, and indicate any additional analysis or research you would think should be carried out.

Question 10 CNC Commentary

(1) The market source on initial recognition is a question, which should be dealt with within the scope of the revenue recognition project as it has a direct impact on income. It is therefore premature to conclude on this question.

(2) The summary in §180 to §182 of the full version states that:

-a priori there can only be one fair value for a particular asset or liability on the measurement date

-that the appropriate reference is normally the “entry market” on which the asset was acquired but there are cases where there is no “entry market”. The “Discussion Paper” then proposes no solution other than “further investigation”.

—“there appear to be significant situations in which multiple markets for identical assets or liabilities do exist”. §182 proposes that, in these circumstances, “the most advantageous market price available to the entity should be selected”

Where the “most advantageous market price” is not the one obtained by the management this would presumably lead to a loss being recognised with an implied judgement on the management’s stewardship.

We would suggest that further research should be carried out on identifying the reasons why such differences might occur in order to verify the pertinence of the information to be provided to investors.

Question 11—The paper concludes that transaction costs, as defined, are not part of the fair value of an asset or liability on initial recognition (see paragraphs 86-87 of the condensed version and paragraphs 193-200 of the main discussion paper). Do you agree with the proposed definition of transaction costs? Do you agree with the above conclusion? If you disagree, please explain your reasons and what you believe the implications of your different view would be for fair value measurement of assets and liabilities on initial recognition.

Question 11 CNC Commentary

§198 of the full version of the “Discussion Paper” states that, under fair valuation, transactions costs are recognised as an expense rather than as part of the cost of an asset as on an “entity-specific” measurement basis.

1. It is not possible to comment on the treatment of transaction costs as an expense on initial recognition without considering the basis for subsequent valuation. In other words, the answer to this question depends on the overall view we have of measurement principles in relation to performance measurement, a subject which goes beyond the scope of the “Discussion Paper”.

2. The question as to whether transaction costs are part of the fair value of an item on initial recognition depends on what we are trying to portray with fair value measurement.

As defined in §195 of the full version of the “Discussion Paper”, transaction costs are “incremental costs ... directly attributable to the acquisition ... not recoverable in the marketplace at the measurement date.”

We note that the proposal is not consistent with existing IFRSs in particular with IAS 39 which requires most financial instruments to be measured at fair value plus any directly attributable costs.

By excluding costs “not recoverable in the marketplace at the measurement date”, the intention appears to be to present the immediately realisable market value of an asset or liability.

This view, for example in the case of an investment, ignores the entity’s economic approach which will be to consider the investment inclusive of transaction costs recoverable over the life of the asset against future cashflows.

We question the relevance of the proposed definition which is not consistent with the management’s view of the investment. The “Discussion Paper” does not produce supporting argumentation to justify the relevance for investors of the proposed definition of fair value.

3. §194 of the full version makes a distinction between transaction costs and costs recoverable on the market. Recoverable costs are included in the fair value on initial recognition. The example given is an importer whose costs can be passed on in the domestic market because the purchaser would have been forced to incur these costs to acquire the goods. We wonder whether the example given is an exception, or whether such situations are frequent, as we are unsure when this principle would apply in practice. We also question whether the inclusion of recoverable costs is tantamount to valuing on an “exit market” basis and as such would be an exception to the general “entry market” basis.

Question 12—*Do you agree with the proposal that, when more than one measurement basis achieves an acceptable level of reliability, the most relevant of these bases should be selected (see paragraph 89 of the condensed version and paragraph 202 of the main discussion paper)? If not, please explain why you disagree, and indicate how you would settle trade-offs between the relevance and reliability of alternative measurement bases.*

Question 12 CNC Commentary

It is difficult to comment because the “Discussion Paper” does not define what it considers to be “an acceptable level of reliability”.

Moreover, the term relevance is used in a biased manner in the “Discussion Paper”, in particular with respect to market value. The superior relevance of market value would appear to be a fundamental assumption so that relevance becomes synonymous of market value (see §227 to 229 of the full version). The superior relevance of market value is already suggested in Q.6.

As the “Discussion Paper” has already established tentatively the superior relevance of market value in Chapter 4 and Q.6, Q12 would appear to be asking whether we support market value provided it can be determined with “an acceptable level of reliability”.

In view of all the reservations expressed in the paper (e.g. in the full version §180,181 and 188) and those we have expressed ourselves with respect to market inefficiencies “market value” as a general valuation convention would apparently have difficulty in attaining an acceptable level of reliability, no doubt with certain exceptions which the paper would do well to define.

As far as the relevance criterion is concerned, we do not consider that the demonstration of the relevance of fair value, for example as compared to entity specific measurement, has been achieved (See the example of the truck and our commentary on Q.14).

Question 13—Do you agree with the two proposed sources of limitations on measurement reliability—estimation uncertainty and economic indeterminacy—and supporting discussion (see paragraphs 90-100 of the condensed version and paragraphs 204-216 of the main discussion paper)? If not, please explain your view.

Question 13 CNC Commentary

We would refer to all the uncertainties with respect to market values quoted in our comments on Q.7 (a). §216 of the full version recognises that in the absence of a market price an estimated fair value may be open to significant measurement uncertainty. §216 also asserts that an observable market price is not subject to measurement uncertainties. We disagree with the latter assertion in particular because of the inefficiencies of markets. We would also point out that the “Discussion Paper” gives no indication of how frequently (e.g. for what types of assets and liabilities) reliable market prices are available.

We are not sure whether all of the uncertainties relating to measurement at market value can be classified as estimation uncertainty and economic indeterminacy but they are numerous.

Question 14—Do you agree that fair value is the most relevant measure of assets and liabilities on initial recognition of assets and liabilities, and therefore should be used when it can be estimated with acceptable reliability (see analyses of fair value and alternative bases in chapter 7, and discussion of measurement date on initial recognition in paragraphs 179-180 of the condensed version and paragraphs 410-415 of the main discussion paper)? If not, please explain why.

Question 14 CNC Commentary

We do not agree that the “Discussion Paper” has demonstrated that “fair value is the most relevant measure of assets and liabilities on initial recognition”.

1. Firstly, the “Discussion Paper” has not established clearly when fair value is different from the historical transaction cost.
2. Secondly the “Discussion Paper” has not demonstrated the greater relevance of fair value.

We refer to the example of the truck in §412 of the full version of the “Discussion Paper” which is intended to illustrate the application of the fair value principle.

In this example, the value of a truck is said to increase from 1000 to 1100 between the contract date and the delivery date. The paper proposes measuring the truck at 1100 and recognising a “profit” of 100.

§414 argues that recognising the “profit” provides useful information on “the results of the entity’s contracting decisions”.

We would question the relevance of recognising what is effectively the sales value of the truck:

1. The truck is presumably not held for sale but for use in the business. The valuation basis does not reflect the economic status of the asset in the business.
2. The cash flow-generating value of the truck within the business has not increased between the contract and the delivery date.
3. Although the “Discussion Paper” only deals with measurement on initial recognition, we presume that subsequent increases in the market value of the truck will not necessarily be recognised. If this is so, what relevance is there in recognising a gain arising between the signature of the contract and delivery?

In order to comment on the relevance of fair value as a measure of assets and liabilities we should consider:

1. The measurement issue as a whole, not just on initial recognition.
2. The view we have of measuring financial situation and financial performance.

These issues are not specifically dealt with in the "Discussion Paper".

The "Discussion Paper" seems to be recommending immediate recognition of market gains and losses, which involves anticipating results as if assets and losses were to be disposed of instead of being used to generate cash flows in the business.

The "Discussion Paper" has not made a sufficient case supporting the decision-usefulness of this information.

Question 15—Do you agree that fair value is not capable of reliable estimation in some common situations on initial recognition (see paragraph 104 of the condensed version and paragraphs 232-277 of the main discussion paper)? More specifically, do you agree that:

- (a) A single transaction exchange price should not be accepted to be equal to fair value unless there is persuasive evidence that it is (see paragraphs 106-114 of the condensed version and paragraphs 243-252 of the main discussion paper), and
- (b) A measurement model or technique cannot be considered to achieve a reliable estimation of the fair value of an asset or liability when the estimate depends significantly on entity-specific expectations that cannot be demonstrated to be consistent with market expectations (see paragraphs 115-118 of the condensed version and paragraphs 263-268 of the main discussion paper)?

Please provide explanations for your views on these questions if they differ significantly from the conclusions and supporting arguments presented in the paper.

Question 15 CNC Commentary

We agree that market value may not always be capable of reliable estimation e.g. there may be no active market.

We disagree with the presumption that a single transaction exchange price should not be accepted to be equal to fair value unless there is persuasive evidence that it is. As stated in our commentary on Q.6, we think a single transaction price resulting from a negotiation between knowledgeable parties at arm's length should be presumed to be a fair value unless there is specific evidence to the contrary. We disagree with the transfer of the onus of proof carried out in the "Discussion Paper".

As previously stated, we do not believe that there is systematic opposition between entity-specific and market expectations. In particular, where there is no observable market it would seem reasonable to assume that the "best estimate" of a knowledgeable market player might be the best approximation of "fair value". In the latter case, it will neither be possible nor necessary to demonstrate that estimation based on entity-specific expectations is "consistent with market expectations".

Question 16—Do you agree with the paper's analyses and conclusions with respect to the comparative relevance and reliability of:

- historical cost (see paragraphs 120-137 of the condensed version and paragraphs 281-319 of the main discussion paper);
- current cost - reproduction cost and replacement cost (see paragraphs 138-154 of the condensed version and paragraphs 320-361 of the main discussion paper);
- net realizable value (see paragraphs 155-161 of the condensed version and paragraphs 362-375 of the main discussion paper);
- value in use (see paragraphs 162-169 of the condensed version and paragraphs 376-392 of the main discussion paper); and
- deprival value (see paragraphs 170-178 of the condensed version and paragraphs 393-409 of the main discussion paper)?

Please provide reasons for any disagreements, and any advice you may have as to additional analysis or research that you believe should be carried out.

Question 16 CNC Commentary

We are not satisfied with the paper's analyses and conclusions in the following respects:

1. The cases when historical cost and fair value are different are neither defined nor analysed.

We therefore do not know whether this is a significant or a marginal issue.

§120 of the condensed version begins by stating that there will often be persuasive evidence that the fair value of the consideration given will represent the fair value of the item at the measurement date. §120 further states that the paper only considers historical cost as a measurement basis when it is different to fair value. However, the paper neither describes when historical cost is different nor analyses the reasons for such differences. This is a fundamental weakness in the argumentation.

2. The underlying assumption that market value is a more useful decision making reference than historical cost.

The relevance of the proposals on measurement depends on the concept of financial position and performance to which it refers. We think the "Discussion Paper" should define clearly what it is attempting to achieve in this respect. It would appear to be proposing the measurement of performance against market values including immediate recognition of profits and losses arising where market values differ from transaction prices on initial recognition (see, for example, §412 of the Full Version). It is the relevance of such a concept for measuring performance and its implications for evaluating stewardship which should be discussed and justified. We do not consider that these discussions and justifications have taken place in the "Discussion Paper".

Question 17—*The paper discusses substitutes for fair value when the fair value of an asset or liability cannot be reliably estimated on initial recognition. Do you agree that, when other measurement bases are used as substitutes for fair value on initial recognition, they should be applied on bases as consistent as possible with the fair value measurement objective (see paragraph 186 of the condensed version and paragraph 417 of the main discussion paper)? If not, please explain why.*

Question 17 CNC Commentary

Q.17 raises in turn a number of other questions:

1. How frequently and in what circumstances it will be impossible to make a reliable estimate of fair value.

If this difficulty were too widespread then fair value would not be a viable measurement basis.

2. Where fair value cannot be estimated reliably, could this indicate that it is also not the relevant measurement basis? This could mean that another measurement base is more relevant in the circumstances.

Question 18—Do you agree with the proposed hierarchy for the measurement of assets and liabilities on initial recognition (see chapter 8)? If not, please explain your reasons for disagreeing and what alternatives you might propose.

Question 18 CNC Commentary

We disagree with the proposed hierarchy, which is based on the undemonstrated assumption that market value is superior to historical transaction cost.

As stated in §107 of the condensed version of the "Discussion Paper" it is a widely held belief "that the transaction price of an asset or liability arrived at between a buyer and a seller dealing at arm's length should be presumed to be its market price at the date of the

transaction, unless there is convincing evidence to the contrary."We do not believe that the "Discussion Paper" has produced evidence to refute this position.

Moreover, the "Discussion Paper" does not indicate how often it is considered that a market valuation will be possible in practice. Given the inefficiency of markets in general it appears unlikely that such valuations will be frequently available .We have therefore serious doubts that such a hierarchy could work in practice.

Question 19—Do you have comments on any other issues or proposals, including the proposals for further research (see paragraph 189 of the condensed version and paragraph 441 of the main discussion paper)? If so, please provide them.

Question 19 CNC Commentary

We would suggest that the authors consider:

- 1.The implications of initial measurement for remeasurement and performance measurement.
- 2.Analysis of when and why market values are different to transaction prices.
- 3.Criteria for choosing the reference market where multiple markets exist.
- 4.Analysis of situations where there is no market.
- 5.Test the market measurement principles with practical examples taken from the most commonly encountered situations in business.

