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Director, Accounting Standards
Canadian Accounting Standards Board
277 Wellington Street West
Toronto, ON M5V 3H2
Canada

RE: Discussion Paper, Measurement Bases for Financial Accounting – Measurement on Initial Recognition

Gentlemen:

Please accept the enclosed comments on the Discussion Paper "Measurement Bases for Financial Accounting – Measurement on Initial Recognition". The comments represent perspectives of students currently enrolled in the University of Wisconsin-Milwaukee School of Business MS and MBA Program. We appreciate the opportunity to respond to questions contained in the Discussion Paper and hope that the Board will take our comments into consideration.

After reviewing and discussing the Discussion Paper (DP), we are pleased to provide the following comments specific to certain key questions raised by the Board in the Exposure Draft.

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.

We are in agreement that the list of identified possible measurement bases discussed in the paper encompasses the bases that should be considered. Specifically, the discussion paper examines fair value, historical cost, current cost, net realizable value, value in use, deprival value, and present value. Also presented are possible changes that the IASB may implement regarding the definition of the preceding bases of measurement. In relation to historical cost, the IASB is considering omitting the phrase "…or in some circumstances at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of the business." We agree with this consideration because it may be confusing, as it describes expected value measurement rather than being consistent with the historical cost objective. While this change may minimize confusion, we find the discussion of historical cost in the context of initial recognition either problematic or at a minimum unclear. Specifically, how is historical cost relevant in the measurement of a transaction at initial recognition? Whose historical cost? The example we discussed involved an exchange of real estate properties in a small town where, for the sake of discussion, we assumed no readily market value was available. The carrying value (net depreciated cost) of property A is $5.8 million and the carrying value of property B is $5.5 million. The property tax bill indicated an assessment value of $6 million. The original price at acquisition of properties A and B were $7.3 million and $7 million, respectively. If the carrying value is determined to be the most relevant and reliable amount, we concluded that the respective parties would not record a gain and record the carrying amount, i.e., historical cost, as the value at the measurement date. The DP defines "historical cost" as – "assets are recorded at the fair value of the consideration given to acquire them at the time of their acquisition…" We doubt the Board intended to require, in our example, measurement at the date of exchange the original acquisition amount. Our recommendation is that the Board should consider replacing the term "historical cost" with current carrying value or possibly eliminating historical cost from the discussion of measurement at initial recognition.

Also proposed is a change to the definition of fair value. Currently, there is no mention of market value in the measurement objective. It is suggested that more explicit terminology is used, such as inclusion of "fair market value" within the fair value definition. We agree with this consideration because an observable market price is necessary in the measurement of fair value. Finally, it is important to note that present value is not a measurement basis, but instead a technique that can be applied to estimate a number of the above measurements in certain circumstances.

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 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.

We are in agreement that the market versus entity-specific measurement objectives and differences in defining the value-affecting properties of assets and liabilities are the fundamental sources of differences between asset and liability measurement bases on initial recognition. The differences created from having a market measurement objective versus an entity-specific measurement objective are quite evident. The market value measurement objective is based on market prices where as an entity-specific objective allows management to use their insight to include expectations and intentions. These two objectives will result in two different values for measuring assets and liabilities on initial recognition.

The second cause of differences in values upon initial recognition stems from differences in defining the value-affecting properties of assets and liabilities, e.g., differences resulting from measurement using entry market or an exit market. We especially noted the commentary in paragraph 77 of the condensed version of the DP describing wholesale and retail markets. Our conclusion is that the measurement at initial recognition should be in the appropriate reference market. A transaction occurring in the wholesale market should be measured accordingly. Measurement should not be based on a hypothetical market.

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.*

We are in agreement with your proposed definition of transaction costs as follows, "Incremental costs that are directly attributable to the acquisition, issue, or disposal of a financial asset or financial liability. An incremental cost is one that would not have been incurred if the entity had not acquired, issued, or disposed of a financial instrument." Nevertheless, we observed the inconsistency in today's accounting for transaction costs and believe further debate is needed on this topic. A decision to expense transaction costs should only be made after considering all points of view.

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.

In the proposal, it is suggested that the most relevant measurement bases should be selected provided that an acceptable level of reliability is achieved. We agree with the proposal. Especially with reference to trade-offs between relevance and reliability, we think that the proposal provides a consistent approach to measurement bases at initial recognition. However, we feel that the term "acceptable level of reliability" is problematic since it is subject to interpretation. Regarding our concern, the DP goes further and defines the term reliability as "faithful representation" in paragraph 88 of the condensed version. Particularly, it is measured in terms of whether it is able to reasonably represent what it purports to measure. In order to limit the room for judgment, we would suggest defining specific criteria for each measurement basis that must be met to reach an acceptable level of reliability.

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 analysis of fair value and alternative basis 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.

We are in agreement with your assessment that fair value is the most relevant measure of assets and liabilities with regard to initial recognition. Furthermore, we also agree that in the cases that fair value cannot be determined (i.e. lack of an appropriate market) that a best estimate of value should be performed.

During our discussions, we compared the hierarchy described in the DP with the Fair Value hierarchy contained in the Financial Accounting Standards Board (FASB) recent document on this issue. Since conversion of accounting standards is a top priority, a reconciliation of the two documents is essential. The DP hierarchy levels 2 and 4, we believe, need further development if the decision is made to retain this hierarchy. For example, in the case of warranties where a deep and liquid active market may not exist and the measurement takes into account a mixture of market and entity-specific inputs, which level does the resulting value fall into? The answer may have a significant effect on the perception of the usefulness and reliability of the information.

Again, we appreciate the opportunity to voice our opinions regarding these matters.

Sincerely,

University of Wisconsin-Milwaukee
School of Business
MS-PA Focus Group