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

Comments on DISCUSSION PAPER "Measurement Bases for Financial Accounting – Measurement on Initial Recognition"

Dear Sir or Madam;

We, Japanese Institute of Certified Public Accountants, are pleased to comment on DISCUSSION PAPER "Measurement Bases for Financial Accounting – Measurement on Initial Recognition" (hereinafter called "the DP").

Overall Comments
We consider the DP is useful as material for discussion about measurement bases. However, we do not agree with the proposals of the DP.

The DP shows the conclusion that fair value is the most relevant measure of assets and liabilities on initial recognition of assets and liabilities. With regard to financial assets and financial liabilities, IAS 39 already requires that initial measurement should be based on fair value and Japanese GAAP adopts similar requirement. However, for initial recognition of non-financial assets and liabilities, we believe that the current practice, which measures assets and liabilities at historical cost in principle and uses fair value (or replacement cost as its substitute) only when fair value (or replacement cost) clearly differs from historical cost, is better than the proposal of the DP from the viewpoints of both adequate determination of income and practicability.

It appears to us that the primary criteria in the DP for analyzing the possible measurement bases is whether they can enable users of financial statements to obtain from only the balance sheet the information for evaluating the entity's capacity to generate future cash flows. However, such objective is never attainable, given impossibility of objective measurement of internally generated goodwill. Therefore, information about profit or loss is also essential for evaluation of the entity's capacity to generate future cash flows. From this perspective, the approach of the DP, which disregards the function of information provided by the income statement, is deficient for attaining the purpose of evaluating the entity's capacity to generate future cash flows.

The DP states that it addresses only measurement on initial recognition and does not deal with issues of recognition and remeasurement. However, its discussion seems to be based on the premise that income should be determined by the pure "asset and liability approach" and likely to bind the possible conclusions on remeasurement. We disagree that income should be determined by the pure asset and liability approach, for the reasons mentioned above.

Furthermore, we feel some biases in the discussions in the DP. It underlines merits on the ideal situation in evaluation of fair value measurement objective, whereas it tends to emphasis demerits on the limited situation in evaluation of other measurement objectives, particularly historical cost. It seems to be based on the thinking that merits and drawbacks from the ideological viewpoints is far more important than those from the practical viewpoints. Such discussion seems to disregard application to real issues in several aspects, considering that fair value measurement often involves reliability issues.

<u>Comments on Questions specified in "INVITATION TO COMMENT"</u>

We reply to questions on which we have comments.

Q1

We believe that consideration about deprival value would be unnecessary because it is just a combination of other measurement bases and unlikely to be suitable for measurement objective on initial recognition.

Q2

We have no objection to the proposed definitions. However, attitude toward the FASB's plan to adopt the definition based the exit value concept should be made clear.

Q6

We agree that genuine entity-specific measurement objectives, such as value in use, are less relevant than market value in the aspect of measurement on initial recognition. However, the comparative analysis shown here cannot be considered to demonstrate the superiority of fair value over historical cost, because the most of discussion have little connection with comparison between historical cost and fair value.

Q9

We disagree with (b), although we agree with (a).
We believe that reliable measurement of fair value is difficult for non-contractual assets, because market price does not usually exist even if units of account are defined by (b). Therefore, it would not result in obtaining better measures than historical cost on initial recognition. When we use historical cost, the issue of unit of account does not matter.

Q11

We disagree with the proposed definition of transaction costs, because the term "recoverable" is used in the meaning significantly different from the concept of "recoverable amount" in IAS 36. It is very confusing. If "recoverable" is used in the same meaning with IAS 36, some transaction costs would be "recoverable".
We agree with the conclusion that transaction costs defined as such are not part of the fair value of an asset or liability on initial recognition. However, in our opinion, it is the very proof that it is inappropriate to prioritize fair value over historical cost in the aspect of measurement on initial recognition. We believe that costs directly attributable to acquisition of assets, other than those held for trading, should be included in measurement on initial recognition from the viewpoint of adequate computation of income.

Q14

We do not agree.
We believe that measurement of non-financial assets and liabilities on initial recognition should be basically historical cost and fair value should be used only when

historical cost clearly differs from fair value. When historical cost approximates to fair value at initial recognition, we consider historical cost is more appropriate for the reason stated in comment on Q11 above.
With regard to the discussion of measurement date on initial recognition in paragraphs 410-415, we disagree that assets and liabilities should be measured as of the date they are initially recognized when fair value as of the initial recognition date differs from the contracted amount. Gain or loss recognized when the asset is measured at fair value as of the initial recognition date is obviously holding gain or loss. If recognition of such gain or loss should be required prior to the disposal of the asset, it would be inconsistent unless recognition of holding gain or loss is required on remeasurement. We cannot agree that recognition of such gain or loss should be made mandatory.

Q15

We agree that a single transaction exchange price or an estimate by a measurement model or technique is not always fair value. However, we disagree with the view denying the commonly accepted presumption that a transaction price arrived at between a buyer and a seller dealing at arm's length is fair value. Such transaction price should be presumed to be fair value on initial recognition, unless there is convincing evidence to the contrary.
If the proposal of the DP is literally introduced in accounting rules, every transaction price of assets and liabilities for which there is no market price must be tested for whether there is evidence that it is fair value. It would be an obviously unrealistic requirement and impose undue burden on preparers and auditors of financial statements, which is unlikely to be justified by the benefit for the users.

Q16

Some of the analyses about historical cost seems to include confusion with discussion on subsequent remeasurement and is therefore inadequate. Historical cost approximates fair value on initial recognition, in normal situations. As far as entities act rationally, assets are acquired on the premise that historical cost can be recovered. Therefore, we do not agree with the argument in the DP that historical cost is less relevant than fair value because it does not reflect the recoverable cost.
In addition, we believe that the DP's emphasis that historical cost involves allocation problems is a biased argument. Assets for which historical cost involves allocation problems are mainly inventories or self-constructed property, plant and equipment. For such assets, reliability of fair value measurement is also low because generally there are

no market prices for them.

With regard to the DP's conclusions about net realizable value, value in use and deprival value, we have no objections, because they are obviously irrelevant as measures on initial recognition.

Q17

We agree that substitutes for fair value should be applied on bases as consistent as possible with the fair value measurement objective, on the premise that those are used as substitutes for fair value. However, we disagree that historical cost should be positioned as a substitute for fair value. We believe that historical cost is more appropriate measure on initial recognition unless it clearly differs from fair value.

Q18

We do not agree. We believe that measurement on initial recognition should be historical cost unless it clearly differs from fair value.

Very truly yours,

Satoshi Komiyama
Executive Board Member—Accounting Standards
The Japanese Institute of Certified Public Accountants