THE INSTITUTE OF
Chartered Accountants
IN IRELAND

CA House, 83 Pembroke Road,
Ballsbridge, Dublin 4
Tel: +353 1 637 7200
Fax: +353 1 668 0842
Email: ca@icai.ie
Web: www.icai.ie

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

16 May 2006

Dear Sir

The Accounting Committee (AC) of the Institute of Chartered Accountants in Ireland considered the Discussion Paper of the Canadian Accounting Standards Board on "Measurement on Initial Recognition", published by the IASB, at its meeting on 11 May 2006.

The response of AC to the specific questions raised in the Paper are set out in the Appendix to this letter.

AC welcomes the publication of this Discussion Paper to identify the appropriate measurement bases to be adopted on the initial recognition of assets and liabilities on the balance sheet.

This particular issue has major long term implications for financial reporting in the future and AC believes that the IASB should be very cautious before applying some of the ideas included in the paper in the short term. It might be worthwhile carrying out a number of pilot tests on the impact of adopting the suggested four level hierarchy to see what practical problems might emerge as well as the overall cost of implementing such a process. However, it is a welcome step in the debate about moving financial accounting from historic costs to fair values.

Pat Costello, Chief Executive Judy Fay, FCA, Secretary
Belfast Office: 11 Donegall Square South, Belfast BT1 5JE Tel: 048 9032 1600 Fax: 048 9023 0071 Email: ca@icai.ie

AC consider that changes in financial reporting should be evolutionary, rather than revolutionary. Financial reporting exists and is understood in an economic environment which cannot be expected to cope with revolutionary changes. Before a significant move to fair values is mandated, users and preparers should have an opportunity to comment on the underlying Framework, and time to become familiar with the significantly different financial reporting results shown by fair value accounting.

AC found the paper persuasive, but quite theoretical, whereas financial reporting must be practical in order to be accepted and understood by users. AC also found that the principles discussed in the paper had more application to assets than to liabilities. In this context AC recommends further consideration by IASB and AcSB of the work of Andrew Lennard at thee UK ASB on liabilities. AC also suggests that IASB should carefully co-ordinate the principles espoused in this paper and those proposed in the proposed provision of IAS 37 on "Non-financial liabilities".

AC noted that the paper concentrates on Measurement on Initial Recognition and considers that it is difficult to assess the appropriate measure for this, without also considering the appropriate measure to use on an ongoing basis e.g. during the cash generating life of a non-financial non-current asset.

To further the debate AC recommends experimenting with a live company in a similar manner to the research study carried out a number of years ago by the Institute of Chartered Accountants of Scotland – "Making Corporate Reports Valuable" – in which they applied their initial concepts to a subsidiary of a listed company in Scotland – codenamed Melody Plc.

Yours faithfully

Anne Sykes

Anne Sykes
Secretary, Accounting Committee
The Institute of Chartered Accountants in Ireland

Appendix

The Accounting Committee of the Institute of Chartered Accountants in Ireland wishes to reply to the specific questions posed in the Discussion Paper as follows:

Q1. 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.

AC agrees that the DP has covered all the main possible valuation bases that have been covered in the academic literature over the years in Chapter 3.

Q2. 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)?

AC agrees that the working terms and definitions and supporting interpretations are acceptable and encompass the essential characteristics of the alternative measurement bases. The definition of fair value equates with the traditional view of arms length transactions and market prices or estimates of market prices.

Q3. 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.

AC agrees with the view that identified bases should come from two fundamentally different sources – those based on market value and those on entity expectations and is not aware of any other acceptable alternatives. AC also agrees with the general conceptual analysis on identifying value affecting properties of assets.

Q4. 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.

(c) 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)?

AC agrees that the use of expressions such as "at arms length", "number of willing participants", "price to clear the market", price in an "open and active market" do reflect the essential properties

The definition of market as a "body of knowledgeable, willing arms length parties carrying out sufficiently extensive exchange transactions in an asset or liability to achieve its equilibrium price, reflecting market expectation of earning or paying the market rate of return for commensurate risk on the measurement date" appears to be fairly comprehensive.

AC also agrees with the view that fair value is the most appropriate measurement base provided it can be reliably measured and that market values are more objective and therefore more relevant than entity specific measurements.

Q5. 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.

AC agrees that entity specific measurements reflect management intentions and should take into account private information e.g. trade secrets. AC agrees with the DP's conclusion that market values provide a more objective basis to hold management properly accountable.

Q6. 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.

AC agrees that the table provided comparing market and entity specific objectives clearly analyses the advantages and disadvantages of both market and entity specific objectives. AC agrees with the proposal that market measurements are superior to entity specific measurements, at least on initial recognition.

Q7. (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.

AC consider that in theory there should be only one market value but that value could differ between valuers particularly when taking into account the value affecting properties of assets and credit risk for liabilities. It would therefore be very difficult to provide a definitive market value.

(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.

As noted above, AC considers that these differences do make it difficult to calculate a definitive market value. AC agrees with the comments that the entry price is the most appropriate to adopt and agrees with the example provided of a retailer purchasing an asset from the wholesaler. The added value on exit is clearly a remeasurement issue and thus the price purchased from the wholesaler should be the market price on initial recognition. AC also agrees that even if an entity does not avail of bulk discount it should record the net price as fair value. It will mean a loss is recorded on initial purchase but that reflects poor purchasing. The conclusion that the most advantageous price be adopted in multiple market situations appear appropriate.

Q8. 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.

AC agrees that a promise to pay has the same fair value on initial recognition of a liability and that credit risk enters into the determination of the fair value. AC is not convinced, however, that the same can be applied to an asset and that promise is only considered in the post initial stage when assessing the credit worthiness of the customer. AC accepts that before an initial sale, credit worthiness would be considered overall but not perhaps on the specific sale itself.

Q9. 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).

AC agrees with the portfolio approach for groups of similar assets or liabilities as a unit of account and that in both portfolio and individual items the unit of account is an appropriate reference point to reflect value affecting properties.

(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).

AC agrees that the process of aggregation is essential in many situations and agrees with the view that the lowest level of aggregation is the appropriate unit of account whereby it can be ready to contribute to the generation of future cash flows.

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

Q10. 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.

AC recognises that there are multiple markets but the best evidence of fair value is the market in which the asset or liability was acquired or issued. The examples provided clearly bring out the problems of bulk discounts, wholesale/retail issues and performance obligations. AC also accepts that in order to identify the most advantageous market price as the fair value it would be essential to back it up with supporting guidance and therefore would agree that further research into that might be undertaken in order to provide possible guidance.

Q11. 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.

AC agrees with the definition of transaction costs as being incremental costs directly attributable to the acquisition or disposal of the asset/liability. AC also agrees with the example that if the entity can effectively pass on customs duty to a buyer then it is not part of the fair value of the asset.

Q12. 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.

AC noted that all conceptual frameworks, including that of the IASB, take the view that when the two qualitative characteristics of reliability and relevance come into conflict then relevance should override reliability. AC supports this view.

Q13. 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.

AC agrees that there are two main sources of uncertainty in getting to a reliable measurement base – that of unreliable estimates and that of arbitrary allocations to assets and liabilities resulting in economic uncertainties. Clearly it is difficult to assess their impact on measurement but AC agrees that both should be considered in evaluating the reliability of the measurement base.

Q14. 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.

AC agrees that if fair value can be reliably measured it should form the basis on which assets and liabilities should be initially recognized. The discussion of the appropriate date when an asset is delivered at a later time from the original contract follows logically from the DP and will result in gains/losses being recorded as a result of good or bad purchasing. However, there will be additional record keeping costs with possible changes to accounting systems which should always be considered in arriving at the most appropriate solution.

Q15. 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.

AC agrees that undoubtedly there are occasions when the fair value is not capable of reliable measurement, particularly when there is no directly observable price and an acceptable surrogate is not achievable.

AC agrees that a single price is not necessarily equal to fair value as different parties have different expectations of the fair value of an asset and the example provided in the DP clearly brings out that issue. Valuation models are getting better and AC does not accept the proposal that entity specific expectations by themselves cannot be demonstrated to reliably represent market expectations. Clearly in many cases they are a good substitute for fair value but care is required to ensure that the inputs to the model are objectively determined.

Q16. Do you agree with the paper's analyses and conclusions with respect to the comparative relevance and reliability of:

(a) historical cost (see paragraphs 120-137 of the condensed version and paragraphs 281-319 of the main discussion paper);

AC Accepts the conclusion that historical cost is less relevant than fair value on initial recognition but it can be close in many instances to fair value in which case it may be regarded as a substitute in certain situations.

(b) current cost — reproduction cost and replacement cost (see paragraphs 138-154 of the condensed version and paragraphs 320-361 of the main discussion paper);

AC accepts that current cost is a useful substitute to fair value if fair value cannot be determined and accepts the view that replacement cost is more relevant than reproduction cost particularly in times of changing technology. The important aspect is to maintain operating capacity not reproduce the same asset.

(c) net realizable value (see paragraphs 155-161 of the condensed version and paragraphs 362-375 of the main discussion paper);

AC accepts the view that realisable values are exit prices and focus too much on sale and not on future cash flows that could be derived from using the asset. It is clearly less relevant than the two bases discussed above.

(d) value in use (see paragraphs 162-169 of the condensed version and paragraphs 376-392 of the main discussion paper); and

AC considers that in theory this is the closest substitute to fair value since it takes into account future cash flows to be derived from the asset but is usually developed through entity specific expectations and thus its reliability and objectivity are subject to debate. This makes it less relevant from a practical viewpoint than HC or current cost.

(e) deprival value (see paragraphs 170-178 of the condensed version and paragraphs 393-409 of the main discussion paper)?

AC consider that in theory this is the best method since it covers the most logical approach that a manager would adopt in a given situation. Clearly if an entity can earn profit by replacing an asset and then selling it or generate future discounted cash flows in excess it would in the interests always to replace that asset. Similarly if replacement cost is higher than NRV or NPV then logic would suggest the higher of the latter valuations should be adopted since the asset will not be replaced and if the entity were deprived of the asset it should go for the best deal – the higher of the two figures. That approach was adopted in the UK some years ago in the quest to solve inflation accounting.

In practice, it is very time consuming and subjective and it may be that the theoretical benefits attached to deprival value are outweighed by the practical costs of implementation.

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.

Q17. 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.

AC considers that any alternative bases to fair value must be as consistent as possible with the objectives of fair value and be supported by appropriate disclosures. AC, however, does agree with the proposed measurement hierarchy as a step forward in getting to reliable measures for both assets and liabilities on initial recognition.

Q18. 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.

AC agrees with the four levels of hierarchy proposed as an appropriate practical solution to the problem of not being able to reliably measure fair values in all situations.

Q19. 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.

AC considers that the DP has provided an excellent contribution to the debate about moving financial reporting towards fair values. However, there are serious practical issues which are dealt with in the covering letter.