Nestec Ltd.

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CANADIAN ACCOUNTING STANDARDS BOARD
277 Wellington Street West
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Attn : Director, Accounting Standards

OUR REF VEVEY, 26 May 2006

DISCUSSION PAPER ON MEASUREMENT ON INITIAL RECOGNITION

Ladies and Gentlemen,

Please find below our answer to your invitation to comment on the above mentioned discussion paper.

1. GENERAL COMMENTS

We welcome the possibility to comment on this discussion paper which has the merit of opening a fundamental debate about the use of fair value which is not defined in the IASB conceptual Framework even if it is required or permitted in several accounting standards. Our comments refer to the condensed version of the DP.

As a group active in the consumer goods sector with a strong base of tangible assets and applying IFRS/IAS since 1989, we consider that the DP has failed to provide arguments for the use of fair value at initial recognition. The DP asserts that fair value is more useful for economic decisions. While users want reliable information that allow them to forecast the future cash flow generation of an entity, we doubt that fair value is the most relevant measurement base because it is by essence an exit cost (the price at which an asset could be exchanged at a given date between willing parties in an arm's length transaction) that could make sense for measuring assets that are going to be disposed of shortly after the balance sheet date. For an industrial an commercial company that holds assets for the long term, generally until they are consumed in the business, we do not believe that an exit cost would bring reliable information to the users because such cost would not reflect the funds that the entity has invested. Despite its imperfections we consider that historical cost provides a better base for projecting the cash flow generation of the assets.

2. ANSWERS TO SPECIFIC QUESTIONS AND OTHER POINTS

Question 1 – List of measurement bases that could be considered

We agree.

Question 2 – Working terms and definitions

We agree.

Question 3 – Fundamental sources of differences on initial recognition

We disagree and consider that the scope is too narrow and too theoretical. The paper should need to focus on what preparers and users need for their practical assessment of the financial statements and to distinguish between different types of enterprises. We consider that the paper is mainly geared to the financial sector and needs to further discuss the relevance of historical cost and not just to dismiss it.

Question 4a – Definition of market value measurement objective

We agree.

Question 4b – Definition of a market

The definition seems very theoretical to us and reflect an ideal situation. While it is true that the parties should normally not be under the compulsion to transact at different prices (§ 56), some participants may have different expectations which could result in forming prices that are different from those of the DP definitions.

Question 4c – Market value measurement objective

While we agree with the definition, we do not consider that fair value is always preferable to an entity-specific measurement.

Question 5 – Definition and discussion of entity specific measurement objectives

We agree.

Question 6 – Comparison of market value and entity-specific measurement objectives and conclusion that the former is more relevant

We disagree and consider that imposing a market value in all circumstances would result in less relevant information. Users normally try to understand an entity itself and, from this standpoint, values determined by the management are more valuable to them that values of what other market participants could pay for certain assets and liabilities. This is particularly true for the valuation of intangible assets.

Question 7a – Only one (fair) market value is possible on measurement date

We disagree for the reasons specified in our answer to question 6 and for the reasons mentioned in the general comments.

Question 7b – Differences between apparent market value

While the differences noted in § 63 indeed appear in the practice, they are not an evidence of the reliability of fair value at initial measurement. On the contrary, we consider that these differences are part of the initial measurement of assets.

Question 8 – A promise to pay has the same value for an asset and a liability

We agree in principle.

Question 9 – Unit of account to be measured at initial recognition

We would agree with the proposed approach for financial assets but we have some reservation for tangible fixed assets because the level of aggregation may be different between the capacity of generating cash flow and the useful life. Components used to determine the useful life have generally a lower level of aggregation than cash generating units.

Question 10 – Reference to the market in which the asset or liability was acquired or issued

We agree with the determination of the various situations in which an asset could be acquired but we would like to question the theoretical approach of the DP whereby the fair value is the most advantageous market open to an entity. Instead we would recommend that the fair value be the actual price of the transaction for acquiring the asset. To take the example of § 78, an entity being eligible for fleet discounts may want to order smaller quantities because the fleet discount does not cover its inventory holding costs. Regarding liabilities we have serious concerns about the reference to a third party issuer of the obligations. While this approach may work for liabilities that can easily be insured on the market like the example of warranties that was quoted in § 79, it does not work with single obligations like law suits, taxes, environmental liabilities, etc.

Question 11 – Transaction costs

The distinction between transaction costs (not included in the fair value) and costs that can be recovered in the market seems difficult to apply in practice especially as far as non financial assets are concerned. We do not see why the custom duties of a machine would be incorporated in its cost because they could be recovered in the price of the machine whereas the installation costs would be deemed to be not recoverable. Both costs contribute to put the machine in its current location and condition and would be recovered from the future cash flows generated from the machine. We therefore consider that the current practice for transaction costs should be maintained.

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Question 12 – Selection of the most relevant basis

We agree with the selection principle but we disagree with the DP that fair value is always the most relevant measurement basis.

Question 13 – Limitations on measurement reliability

We agree in principle but we consider that the notion of "sufficiently reliable" should be further developed.

Question 14 – Fair value is the most relevant measure on initial recognition

In an industrial and commercial company we do not consider that fair value is the most relevant measure on initial recognition except for specific assets such has trading financial instruments and assets held for resale where fair value is already requested by current pronouncements. Regarding tangible assets (be either current or non-current), we do not believe that fair value would bring an improvement to the users for the understandability of the financial statements. To take the example of the truck of §§ 179 and 180, the most relevant value of an asset and consequently its capacity to generate future cash flow is what an entity has paid for the asset (plus transaction costs if any as specified in our answer to question 11). The use of fair value for such type of assets would bring "as if" values to the balance sheet and would result in the recognition of opportunity gains and losses. The same applies to certain liabilities (please see our answer to question 10). We do not believe that the users would be better served with the measurement base proposed in the DP.

Question 15 – Fair value is not capable of reliable estimate in some common situations

We totally agree and this is why we do not consider that fair value is the most relevant measure.

Question 16 – Analysis and conclusions of comparative relevance and reliability

We totally disagree for the reasons already stated above. We consider that historical cost is a valid substitute for fair value of tangible current and non-current assets. While we acknowledge its imperfections as far as the allocation of overheads is concerned, we should not lose sight that costing techniques have considerably improved their reliability with the introduction of activity based costing. Moreover historical costs will always have the merit of representing costs that management has committed and could be undoubtedly accounted for. Market prices for tangible assets in an industrial company are not reliable because they reflect "as if" situations.

Question 17 – Application of substitutes for fair value consistent with fair value

We would tend to agree but we believe that in some circumstances parameters that would make the models consistent with fair value may lack reliability.

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Question 18 – Proposed hierarchy

Since we do not consider that fair value is the most reliable measurement base at initial recognition we disagree with the proposed hierarchy.

Thank you very much for your attention to the above.

Yours very truly,

NESTEC Ltd.

Ph. Gaberell
Assistant Vice President
Head of Financial Reporting Guidelines

cc: Mr. H. Wirz, Head of Group Accounting & Reporting, Nestlé S.A.

International Accounting Standards Board, London