Date

23 May 2006

Le Président

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Dear Mr. Martin,

Re: IASB Discussion Paper "Measurement Bases for Financial Accounting – Measurement on Initial Recognition"

1. FEE (Fédération des Experts Comptables Européens, European Federation of Accountants) is pleased to submit its comments on the IASB Discussion Paper on Measurement Bases on Initial Recognition. FEE as a founding organisation of EFRAG has also contributed to the EFRAG consultation process by submitting our views on their preliminary comments. We refer to the EFRAG preliminary comments (draft letter of 9 February 2006) where we are in agreement with their comments; where we are in disagreement our own views are put forward. However, we have not considered the final EFRAG submission to CICA in our own response.

2. We have some general remarks concerning the Discussion Paper. We regret that the paper focuses exclusively on initial measurement because we think the issues of initial measurement are closely linked to the subsequent measurement. Decisions taken at initial recognition impact the subsequent measurement. It is difficult to draw a conclusion on measurement at initial recognition without considering subsequent measurement by isolating both.

3. The paper seems to assume that for most assets or liabilities, there is a perfectly efficient market. This may be the case for certain classes of financial instruments but not for other assets. Some plants or equipment are specific to an entity and do not have individual market value. Also, the paper seems to consider that the fair value of a group of assets can be the sum of the value of the individual assets. This assumption is not relevant for non-financial instruments.

4. We think that a number of conclusions drawn in the paper are not well justified. The paper concludes that market value is superior to entity-specific measurement objectives based on unconvincing assertions without exploring why market value would be different from entity-specific value at the transaction date.

5. We disagree with the proposed treatment for transaction costs. We believe they should be included in the acquisition costs at initial recognition under both measurement objectives. Paragraph 35 of chapter 3 should address transaction costs as part of historical costs. Also it is not obvious to differentiate between recoverable in the market place or not because we believe

transaction costs are specific to a transaction and influence the price paid. The discussion on transaction costs in paragraphs 86 – 87 is too limited as it does not address why transaction costs are not part of fair value on initial recognition. Also, the paper assumes that assets can be sold on the same market as they are bought but it is rarely the case. The exit market is not relevant to assess the recoverability of transaction costs.

6. We observed that the discussion paper appears to confuse, especially in Chapter 4, the objectives and the instruments suitable to reach those objectives. For example, market versus entity-specific measurement is not two distinct objectives of financial statements. As set out in the Framework, the objectives of accounting are "decision usefulness" as well as "stewardship" or "accountability of management". The use of measurement concepts and accounting policies is not an end in itself but a means to fulfil the objectives of financial statements. Denominating the concepts analysed in Chapter 4 "objectives" is inappropriate. The table set forth in paragraph 59 reveals this weakness. Whereas the left column depicts the objectives of financial accounting (and the qualitative characteristics), the headline purports to depict objectives, too. Instead, the market versus entity-specific distinction just applies to certain attributes of measurement concepts.

7. The various conclusions proposed in the paper will have an effect on the financial performance of entities. It is not clear what view of the entity's performance the paper wants to demonstrate. We are concerned about the loss of the current notion of entity's performance. The discussion about measurement is moving away from the concept of transaction and performance, by proposing a value at which the entity was supposed to acquire an asset and not the value at which it acquires it. An entity makes profit by buying something and selling it for more with a margin. This added value will presumably not be in the performance reporting but included in the initial value under the proposals. The conclusions of the paper raise several questions. Measuring at fair value raises the issue of when gains and losses have to be recognised. In particular, we would appreciate clarifying if a day-1-profit recognition would be recognised under the different valuation bases and also how to recognise the gain in a bargain transaction or the loss when the price is higher than the market. We believe initial measurement should be at the value of the asset or liability as it is when acquired or assumed, and not as it would be the day after or in another transaction.

8. We are not convinced by the arguments underlying some conclusions and by the implications of these conclusions. Some examples would have helped to demonstrate the difference between measurement bases. We believe that at initial recognition, they are likely to give the same value in most situations. An analysis of the reason for differences between measurement bases and the way to account for these differences would be a very valuable discussion, as well as a discussion on the cost or benefit of each concept of measurement.

9. Financial reporting must be practical if it is to be accepted and understood by users. Pilot tests, possibly including applying the concepts to actual companies, would assess the practicality of the Paper's proposals, identify problems to be addressed, and give an indication of the overall cost of implementation.

10. The Paper's proposals have significant long term implications for financial reporting in the future. Therefore, and having regard to our concerns highlighted above, we counsel against implementing these proposals in the short term, particularly without further consideration of the subsequent measurement of assets and liabilities and of the outcome of the performance reporting project.

11. Our comments on the answers to the questions raised in the Exposure Draft are included in the appendix attached.

We would be pleased to discuss any aspect of this letter with you.

Yours sincerely,

David Devlin
President

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 agree that the list is comprehensive. We suggest however to describe the bases with the perspective of achieving the reporting objective of decision usefulness.

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)?

We agree with EFRAG's draft comment that the definition of historical costs is not appropriate and should cover constructed assets. The definition ignores the notion of accumulation of costs, for assets being constructed. We question, under the proposed definition, what the cost of an asset during the construction phase would be.

We do not consider deprival value as a measurement basis. It is a compound value. If deprival value is a measurement basis, then the recoverable amount should also be part of the list.

We support EFRAG's draft comment on the need to define fair value more precisely.

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.

We agree with the two sources of differences between measurement bases but we would have expected the paper to discuss the reasons behind the differences between market-based measures and entity-specific measures at initial recognition. In practice, we suppose that different measurement bases would be equal. The analysis of the causes of differences at initial recognition would be an appropriate discussion for this paper. We also would have expected to see arguments to justify why market-specific measurement objective is superior to entity-specific measurement objective.

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.

(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)?

We support EFRAG's draft comment on paragraph 54 regarding the use of finance literature to define market value measurement objective.

We broadly support the proposed definition of "market". We agree with EFRAG that the definition is not of an efficient market although the paper assumes it exists for most transactions.

As mentioned in our general comments, we do not believe the arguments in the paper are persuasive to justify the tentative conclusion mentioned in paragraph 102, that fair value is more relevant than entity-specific measurement bases.

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.

The definition of entity-specific measurement objectives properly reflects entity-specific measurement objectives. However, it describes it in a simplistic way by exposing the reasons why market-based value would not be appropriate. Under this definition, we would argue that historical cost is not an entity-specific objective because there is no assumption made by management. We suggest that the paper elaborates on where to classify historical costs based on this definition.

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.

We, like EFRAG, do not agree with the conclusion drawn from the comparison of market and entity-specific measurement objectives because it is drawn without any argument of why market value is superior to entity-specific. We found the table on paragraph 57 is not so helpful in justifying the conclusion or analysing how the characteristics relate to financial reporting usefulness. Also, we observed that reliability is not part of the criteria although it is a qualitative characteristic in 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.

We disagree with the assumption that there is only one market value for an asset or a liability on a measurement date. We agree with the proposed differences between market values but believe there are also other differences, for example the location of the market. We believe there could be different market value for identical assets at different market's locations and with other different aspects of markets.

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.

We overall agree with the fact that the credit risk associated with a promise to pay enters into the determination of the fair value. However, we recognise that credit risk is an issue for subsequent measurement, which is not in the scope of this paper. Concerning subsequent measurement, we are concerned about the effects of accounting for an entity's own credit risk, and in particular the valuation of liability. Any deterioration in a debtor's creditworthiness could result in the recognition of a gain by that debtor when the fair value of its liabilities is perceived to have declined.

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.

We support EFRAG's draft response. We felt uneasy with this proposal on the unit of account because the consequences on any asset or liability are not clear and it focuses primarily on financial instruments. The issue is very linked to the debate on day-1-profit recognition, which is not part of this discussion paper. The appropriate unit of account would depend on when the entity decides to bundle items or unbundled portfolio.

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.

We support EFRAG's draft response and agree that further research is needed to explore other ways of valuation and to explain the differences between measurement bases. Also, we would appreciate a discussion in the paper on when historical cost is seen as an appropriate measure, apart from being a substitute for fair value.

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 share EFRAG's draft comment concerning the narrow meaning of fair value and the difficulty in distinguishing between recoverable costs and other transaction costs. We believe that conceptually transaction costs are assets and using fair value would not properly reflect this. Also, the paper seems to suggest transaction costs are excluded from fair value, but also from other value in the hierarchy. We do not agree with this idea because we believe transaction costs are part of historical costs which is, at least, acceptable as a substitute to fair value. We refer also to our general comments about transaction costs.

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.

We are concerned about the way the paper puts more emphasis on relevance than on reliability, compared to the Framework. Reliability is an important factor in selecting a measurement basis. No measurement basis can be relevant if it cannot be measured with a reasonable level of reliability.

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.

We agree with this discussion in the paper.

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.

We support EFRAG's concerns on the gains and losses resulting from fair value measurement. The paper has not convinced us that fair value is the most relevant measure in all cases (when it can be estimated reliably) and does not discuss the cost and constraints of applying fair value compared to its benefits. We believe the value in use would be more appropriate in some cases where the fair value would be irrelevant. When an entity has no intention to sell an asset, its value in use is more relevant than its fair value. We could accept fair value if an efficient market exists but this would rarely be the case in real practice. However, without a clear idea of what financial position and performance an entity should reflect it is difficult to conclude that fair value would be the most relevant measure.

Another topic not analysed in appropriate depth in the discussion paper is the cost-benefit-constraint: using fair value instead of historical cost on initial recognition would increase the cost of preparing financial statements considerably. Because historical cost has to be determined and considered in accounting anyway, e.g. simply by monitoring payment, the determination of fair value necessary under the model proposed by the discussion paper is always an additional step to be carried out by the entity therefore resulting in additional cost.

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.

We agree that fair value is not capable of reliable estimation in some common situations on initial recognition. We believe that a transaction price paid or received should be accepted as a proxy for its fair value on initial recognition, unless there is persuasive evidence that it is not. Our view is in accordance with paragraph 109 of the condensed version.

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.

We share EFRAG's views that the arguments used are not very convincing. The paper would have benefited from a discussion on the pros and cons of fair value and historical cost, and an analysis of the reasons for the differences between the two values. It only indicates weaknesses of each measurement basis compared to fair value. Theoretically, we would expect fair value and historical cost to be similar in an efficient market. We disagree with the position taken against historical cost in the paper.

We agree with EFRAG that historical cost is different from other entity-specific measures. It is not influenced by management intention.

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.

We support EFRAG's draft comment. It is rather theoretical to present the issue as simple as that. For example, it has yet to be proven that transaction costs cannot be capitalised when other measurement bases are used as substitutes for fair value.

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.

We do not agree with the proposed hierarchy because of the arguments discussed earlier in this letter, especially:

- fair value is not always the most relevant measure,
- historical cost is not given appropriate credibility (is presented below replacement cost and reproduction cost),
- transaction costs are not dealt with,
- no cost / benefit analysis.

We would prefer to see historical cost as higher relevance than current cost. The estimation techniques (Level 2 or 4) should only be used when benefits overtake costs.

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.

We suggest that the debate on measurement be considered together with the project on performance reporting.