MAZARS

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Canadian Accounting Standards Board
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Dear Sir

Measurement Bases for Financial Accounting: Measurement on Initial Recognition

Mazars welcomes the opportunity to comment on the Discussion Paper – Measurement on Initial Recognition (referred to as the discussion paper) as prepared by the staff of the Canadian Accounting Standards Board (AcSB). Our general comments on the discussion paper are given below and responses to specific questions are attached to this letter.

GENERAL COMMENTS

Overall

Whilst we welcome the paper from the perspective of provoking discussion on the topic on measurement in financial reporting we have strong reservations over many aspects of the paper and the conclusions reached with regard to initial recognition of assets and liabilities. Furthermore as a result of scope restrictions and other limitations we do believe that it is possible to draw meaningful conclusions of this issue. In particular we remain unconvinced that the market value measurement objective provides superior information to entity specific measurement objectives. In addition we consider that in many instances the cost necessary to collate the information needed to meet these requirements would be prohibitive and would certainly outweigh any benefits.

Theoretical approach

We are concerned that the theoretical approach taken in the discussion paper by assuming 'perfect' markets and hence price equilibrium does not fit well in a real world economic context: we are faced with multiple markets, a range of prices on the same markets, market inefficiencies and unit of account issues. In practice there are few occurrences of truly active markets. Whilst the paper acknowledges most of these difficulties we are concerned that it does not come anywhere close to proposing solutions suitable in practice.

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Scope

Whilst noting that this discussion paper was only intended as a preliminary investigation into measurement bases for assets we nevertheless consider that the limited scope chosen is not a suitable platform from which to reach any meaningful conclusions in this area. The wider picture clearly needs to be considered. In particular in our opinion reaching conclusions on initial measurement when revenue recognition and measurement of expenses is excluded from the paper's scope is inappropriate. In our view it is essential when debating revenue to develop reasoning on what financial position and performance should portray.

Market value measurement objectives

We believe that the fundamental proposition that market value measurement objectives provides superior information over entity specific measurement objectives relies on assertions which are not properly sustained by any supporting argument. Entity specific measurement objectives are not well featured in the discussion paper and we consider there is no more valid argument to turn them down.

Relevance and reliability

We would agree in principal that relevance should prevail when an acceptable minimum level of reliability is met. However, in our opinion the discussion paper seems to go too far to achieve relevance at the expense of reliable information. In addition the discussion elaborates on what impacts reliability, without drawing any specific conclusion. Our concern in this area is that the paper infers that insufficient reliability can be overcome by disclosure. We would strongly disagree that this is the case. We consider that lack of reliability will destroy relevance of financial statements.

We also question the neutrality in which every measurement basis is being assessed in the discussion paper in terms of relevance and reliability. Although one of the clearly stated objectives is to validate that fair value is the preferred measurement attribute, every measurement basis is assessed as good or bad, depending if it has the same attributes as fair value. These measurement bases are not assessed in terms of decision usefulness or predictive value, as they ought to be. We believe that the case made against historical cost, featuring it as one of the weakest measurement bases does not hold true. We consider that historical cost (except in a few notable instances e.g. financial instruments with a quoted market price) is actually the most appropriate measurement basis is many instances.

Fair values

We have considerable reservations about the fair value approach that the discussion paper clearly favours. Interestingly, the paper follows a very strict logic approach to fair value which leads it to conclude that fair value cannot be measured reliably when there are no observable prices or no market based values that can be reliably modelled. It also leads to the conclusion that the transaction price equals fair value only if it can be justified. This in our view tends to demonstrate that fair value would nonetheless rarely be a possible measurement attribute and that in some ways the quest for fair value looks like the accountants' grail.

Fair values can only be measured reliably when there is truly an active market. Our concern is that most assets and liabilities are not traded in an active market and therefore it is not long before one moves down the 'hierarchy of reliability' and starts to rely upon 'valuations using indirect market inputs, using extrapolation and corroborated through correlation with market data' or 'valuation using the entity's own internal estimates and assumptions to create a hypothetical market price'.

The discussion paper itself refers to 'substitutes for fair values' at level 3 or 4. We have reservations with regard to reliability surrounding this approach especially at level 4. In addition surely such a time consuming and expensive approach for measuring initial values of assets and liabilities cannot be the best way to proceed. Hence, we consider that a historical cost approach (except where we have assets which are traded in an active market when fair value can be ascertained) to be both a superior and easier option than the fair value approach advocated in this discussion paper.

Next stage

Whilst the paper advocates that 'the project will proceed in stages' it is currently unclear how this project fits alongside the conceptual framework project. Given our reservations over the current scope of this discussion paper and initial conclusions reached we believe that the IASB needs to think carefully about the next stage to ensure it operates in a 'joined-up' way with other projects currently under consideration.

We would be pleased to discuss our comments with you and are at your disposal should you require further clarification or additional information

Yours faithfully

Jean-Louis Lebrun
Chairman of the Group Governance Council

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SPECIFIC QUESTIONS

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.

Yes, we agree with the list of identified possible measurement bases.

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 comment 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 have some reservations concerning the definition used for 'historic cost' in para 34 (condensed version) and believe that the definition provided in the Glossary of terms *(accompanying the full text of International Standards)* is more appropriate for this measurement basis. This refers to "assets are recorded **at the amount of cash or cash equivalents paid or the fair value** of the consideration given to them at the time of their acquisition...." whereas the working definition in the discussion paper solely refers to the fair value of the consideration. For instance in the cases of assets constructed over time We believe there are instances such as when assets are constructed over time that these additional words ate helpful as apposed to redundant.

We consider the FASB definition "Fair value is the price that would be received for an asset or paid to transfer a liability in the current transaction between marketplace participants in the reference market for the asset and liability" as proposed in its draft Standard 'Fair value measurements' is more appropriate as it advocates an exit price approach. We also consider that fair value should be judged in the context of "an orderly transaction for an asset or a liability that allows for exposure to the market for a period prior to the measurement date that is usual and customary ... and reflects market conditions existing at the measurement date." Hence, fair value is an exit price but it is also made in a going concern context and does not involve a forced sale.

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.

We agree that that there are two fundamental sources of differences between the identified bases for measuring assets and liabilities on initial recognition, namely (a) market versus entity-specific measurement objectives, and (b) differences in defining the value-affecting properties of assets and liabilities.

We also consider the factors identified including information asymmetry, bid-asked spreads, market accessibility and unit of account to be appropriate.

However, we believe that the discussion paper has then failed to develop properly the arguments and rationale for a preferred option after identifying these two fundamental sources of difference. In particular we believe the assumptions made for a market approach to be inappropriate and the true merits of entity specific measurement objectives too easily overlooked. Given the additional scope restrictions on the paper we believe that the area has not been fairly analysed and tested.

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)?*

(a) We believe that the paper has reasonably defined the market value objective and the essential properties of market value for financial statement measurement purposes.

(b) Whilst we do not disagree with the definition of market as set out in Para 55 (condensed version) we nevertheless consider that this definition is rather 'idealistic' by expecting to "equate supply and demand for the asset and liability on the measurement date" in many instances except where there is a genuine <u>active</u> market in operation. Thus we do consider this to be a sensible definition to use in assumptions when assessing the merits of various measurement bases.

(c) As already conveyed in our response we do not agree with the fair value measurement objective as proposed.

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.

We do not agree with the definition and discussion of entity-specific measurement objectives and their relationship to management intentions. Where active markets are not in existence to start inserting entity specific expectations and assumptions will in our opinion not be appropriate and not aid in achieving a reliable outcome. Starting to substitute management assumption for market prices would be a dangerous path tread.

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.

No we do not agree. We consider that entity-specific measurement objectives are not well featured and the market measurement objectives rely on assertions that are not appropriately supported. Far more consideration needs to be given to the merits of entity specific measurement objectives.

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?
(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.

a) No we do not agree. Given that there are few, if any, completely efficient markets in practice the idea of one market price is considered an unrealistic assertion from which to draw conclusions.

b) We agree different values on initial recognition may be due to attributable to differences between the value-affecting properties of assets or liabilities traded in different markets or entity-specific charges or credits

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 its 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 consider that the credit risk associated with a promise to pay should be taken into account for fair value purposes whether it is an asset or a liability. We would highlight that the issue of subsequent changes in an entity's credit risk and the impact on fair value of liabilities needs to be considered further when looking at subsequent measurement requirements.

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).
(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 consider the issues surrounding defining a 'unit of account' so that there is only one fair value to be another weakness in the approach advocated. The appropriateness of aggregation (or not) will depend on the specific circumstances and seeking 'one' fair value given different markets, locations and units of accounts is simply too theoretical. Again a historical cost approach would appear to be advantageous in this area as the unit of account would simply be the units acquired at the relevant transaction price.

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 and research you would think should be carried out.

Multiple markets offering alternative prices simply highlights the problems with the fair value approach being advocated when clearly there is no perfect market price in operation. As a result we advocate a historical cost approach and would look to recognise the asset acquired or liability incurred at the amount of cash or cash equivalent paid or fair value of the consideration given in the market in which it was acquired.

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?

We have reservations concerning the way transaction costs have been clearly scoped out of fair value, although the discussion paper acknowledges that they may arise because of market inefficiencies. However, we believe that the debate on this issue has not been aided by the limitations in scope concerning the treated of such items in the income statement.

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.

We do not agree that relevance provides a valid basis for selecting one measurement basis rather than another. As mentioned we consider that historical cost is usually the most appropriate measurement basis to apply. We consider that in most instances any trade off for more relevant information at the expense of reliability to not be worth it.

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.

We agree with the two sources of measurement uncertainty identified in the paper.

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.

We do not agree that fair value is the most relevant measure of assets and liabilities on initial recognition of assets and liabilities. Given the problems and significant costs associated with obtaining reliable fair values we consider that in most instances historical cost is the most appropriate measure on initial recognition.

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.

We consider that fair value will in many common situations not be capable of reliable estimation on initial recognition.

We agree that a single transaction exchange price should not be accepted to be equal to fair value unless there is persuasive evidence that it is.

We also agree that 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.

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 320-361 of the main discussion paper);
(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);
(c) net realizable value (see paragraphs 155-161 of the condensed version and paragraphs 362-375 of the main discussion paper);
(d) value in use (see paragraphs 162-169 of the condensed version and paragraphs 376-392 of the main discussion paper); and
(e) 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 do not agree with the discussion paper's analyses and conclusions with respect to the comparative relevance and reliability. These measurement bases should be assessed in terms of decision usefulness or predictive value and not simply assess whether a measurement basis is good or bad, depending on whether it has or has not the same attributes as fair value.

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.

We do not agree with a substitution approach when we cannot obtain a reliable measurement estimate on initial recognition. We believe that reliability and relevance of financial statements will be severely undermined by using substitutions for fair value. Again we would not advocate a measurement approach where it would be necessary to frequently need to use substitute means to obtain a 'fair value'.

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.

We do not agree with the proposed hierarchy for the measurement of assets and liabilities as we consider that the use of fair value are only appropriate for a limited number of items where market prices are freely available.

We consider the current historical cost approach does not need to be radically changed.

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.

We believe that any further research should only be carried out as part of a comprehensive research programme looking at the whole area of measurement change covering initial recognition, subsequent balance sheet recognition, derecognition, revenue and expense recognition, fair value adjustments and consequential implications for capital maintenance.