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19 May 2006

Dear Sirs

Measurement Bases for Financial Accounting:
Measurement on Initial Recognition

1 This letter sets out the ASB's comments on the above discussion paper. The discussion paper and the responses to it will provide valuable input to the measurement phase of IASB and FASB project on conceptual frameworks. We would like to thank AcSB staff for work on this project to date and their participation in the roundtable events on the above subject which we hosted in London on 24 April. We found these useful in furthering our understanding of the issues and provided insight into the views of the participants.

2 Although we agree with some of the paper's conclusions, we are disappointed by much of its discussion. Specifically:

(i) The paper's central argument relies on the theory of efficient markets[1], but few if any assets are traded on such markets. Work in economics in the last few decades has seriously questioned the extent to which markets are efficient and given important insights which the paper does not address.

(ii) Although the paper attempts to address assets which are not traded on efficient markets, it adheres to the objective of fair (market) value in such cases. Because other measurement bases are evaluated against this objective, the assessment of their advantages and disadvantages is seriously flawed.

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1 The paper refers to 'efficient markets', but we believe that its assumptions amount to specifying what, in general economic terminology is often referred to as 'perfect markets'. Perfect markets are a subset of efficient markets where the equilibrium market price is unaffected by individual transactions.

Because of these shortcomings, we do not believe the paper produces solutions and approaches that correspond to commercial and economic reality closely enough that its ideas can be applied in a wide range of circumstances, or provide a satisfactory basis to guide accounting thinking.

3 The ASB has long advocated wider use of current values where it would constitute an improvement in financial reporting. We are concerned that an approach that over-emphasises the advantages of efficient market fair values and does not adequately address the conceptual merits of alternatives may hamper rather than promote the evolution of financial reporting towards the wider use of current values in appropriate cases. In the UK and certain other countries use of current values for fixed assets has been permitted for many years and is currently required by central government (which includes many highly specialised fixed assets). It would be a serious detriment to financial reporting if it were perceived that measures other than market-derived fair values did not have the potential to enhance financial reporting.

4 The attached memorandum enlarges on the concerns we have expressed above as well as setting out other general comments (Section A). It also responds to the questions raised in the Invitation to Comment (Section B).

5 We look forward to working with AcSB and other standard-setters on this very important subject. If you wish us to expand on any aspect of this response, please contact me, Andrew Lennard or Jennifer Guest. We would also be glad to comment on any specific aspects that we have not addressed here.

Yours sincerely

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cc: Elizabeth Hickey
Technical Director,
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'MEASUREMENT BASES FOR FINANCIAL ACCOUNTING - MEASUREMENT ON INITIAL RECOGNITION'

Memorandum prepared by the Accounting Standards Board (UK)

SECTIONA: GENERAL COMMENTS

Scope

1 It is difficult to reach firm conclusions on the measurement basis (or bases) to be used on initial recognition, without some consideration of subsequent remeasurement. We look forward to discussing the entire issue of measurement bases as the IASB and FASB work progresses.

2 The scope limitations on the paper (CV3; LV12[2]) are disappointing. Although we appreciate that every project must have its boundaries, we would suggest that some of the issues that have not been considered would have provided useful insights which would have informed the discussion. In particular, we regret the absence of any indications of reporting financial performance. We would suggest this is a necessary corollary to any comprehensive discussion of measurement.

3 It is possible that there is an implicit assumption that some of the topics excluded from the scope of the paper—for example foreign currency transactions and income tax—would not affect the principal fair (market) value conclusions of the paper. But this is not self-evident and needs to be discussed and agreed. We also regret the omission of any discussion relating to performance obligations (LV177).

The objective of financial statements

4 When the paper introduces the objectives of financial statements (CV10,11: LV 30-33) it is careful to mention that the frameworks currently regard reporting information that is useful in assessing the stewardship of management as an important factor. However, much of the discussion in the paper focuses on 'decision-relevance' and does not discuss the stewardship perspective of financial reporting. We have drawn to the attention of the IASB that the stewardship objective is, in our view, and in the view of many of our constituents, of fundamental importance.

5 A stewardship perspective does not necessarily preclude the use of more relevant measures than historical cost, but it does require that the effects of changes in the carrying amounts of assets where required by the measurement basis are clearly distinguished from the gains and losses that result from transactions.

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[2] In this Memorandum we use 'CV' to refer to paragraphs in the Condensed Version of the paper and 'LV' to refer to paragraphs in the Main Paper.

Perhaps more importantly, it suggests that financial statements should report values that are relevant to the entity on which they seek to report, rather than those that may be guessed to be relevant to hypothetical 'market participants'. It can also move the relative weight attached to relevance or reliability.

6 The statement of the paper that, the decision-usefulness of the financial statements is maximised if the entity's performance is measured against market value needs to be substantiated by evidence to be credible.

A conceptual analysis

7 Whilst it is unrealistic to expect conceptual work to lead to unambiguous solutions to all accounting issues, the conceptual framework should seek to provide helpful guidance to lead accounting standards and practice in many areas that are commonly encountered. We are not convinced that efficient (or perfect) markets, as described in the paper, are in fact the norm for a large number of common assets and liabilities. (The paper itself acknowledges this (CV104, LV 232ff).)

8 The ASB do not agree with the assumption of the discussion paper that perfect markets are the norm. Perfect markets are found in text book theory, but they are rarely evidenced in the real world of business; indeed this is what differentiates markets and prices; imperfect markets are where inefficiencies are profited from. Indeed this is one of the reasons for the difference between the cost and the fair value of an asset (the other being inflation). An asset's value is different depending on the context and position of the participant.

9 Whilst we might agree that fair (market) values should be used for assets that are traded on efficient markets, we would not agree that the same rationale should inform the choice of a measurement basis for assets that are not. A key point seems to be the assertion that the "it is the cash equivalent expectations attribute of assets and liabilities that is the primary focus of business activities, it seems appropriate that this should be the primary focus of accounting measurement" (LV 48).

10 We would thus strongly question the suggestion that "in selecting the measurement basis for fair value on the initial recognition of an asset or liability, one should select the reliable basis that is most consistent with the fair value measurement objective and apply it as consistently as possible with this objective" (LV417).

11 In short we do not agree that, in the case of assets for which there is no single efficient fair (market) value, one should attempt to estimate what that fair value would be, if a suitable market existed. Such a procedure is purely hypothetical, and

seems to incur a significant risk that the resulting information may be misunderstood—for example as implying that assets stated at fair value could be readily exchanged for cash.

12 It is not clear that the discussion in the paper is as even-handed as its authors intended it to be. Significant objections to the theory of 'efficient markets' are rapidly dismissed. For example, much reliance is placed on the possibility of arbitrage (eg in LV101), but the many theoretical and practical difficulties of arbitrage are not discussed (see, for example, Schleiffer 'Inefficient Markets' OUP 2000): reference is made to "price bubbles" (LV105)—but these are dismissed as unimportant, although finance literature strongly suggests that they do happen and offers some explanations for why this is so. In contrast, for example, the paper questions the use of replacement cost by appealing to the picturesque but perhaps unrealistic example of a business that purchases a Cadillac to deliver pizzas (LV 326).

13 Businesses exist to make profits, which they are able to do because their relative advantages enable them to sell their products for more than the costs they incur in producing them. The very existence of trade and business relies on the existence of 'imperfect markets'—in other words markets populated by entities of diverse skills, expectations and preferences. In the light of this fundamental point, it seems unrealistic to propose that all businesses should prepare their financial reports on the basis that they trade in perfect markets.

14 It seems to us to be appropriate that a tradesman should report his newly-acquired van at a higher amount than the dealer from whom he has just purchased it, rather than both seek to use the same single fair value—they are different economic entities subject to different economic constraints and opportunities. It seems inappropriate to suggest that the tradesman should report a loss, simply as the result of the acquisition of a vehicle which he needs for his business—clearly this would provide a disincentive to potentially profitable investment. We would emphasise that the difference between the tradesman and the dealer arises from their different economic positions rather than simply management's intentions and expectations.

15 As the paper proposes that the value of an asset should be assessed by reference to the market in which the asset or liability was acquired or issued, it could be suggested that it accommodates the point made in the previous paragraph. The tradesman's van would be valued by reference to the market of vans offered for sale by dealers, whilst the dealer would (at least on initial recognition) look to the market available from his supplier. However, it appears that this is a pragmatic overlay to a

theory founded on market-based fair values, and our point is that the situation is so general and widespread that it should be accommodated within the mainstream of theory and not require recourse to ancillary rules.

16 Market prices are prices, not values. At most it can be reasoned that they reflect the value of assets to marginal purchasers and sellers, but market prices do not necessarily provide a reliable guide to the value of assets to any other owner, except, arguably, in the unusual case of a perfectly competitive market where the owner is able to sell and purchase the asset at the current market price and supply and demand are both perfectly elastic.

Transaction costs

17 Transaction costs are often significant and central to a transaction, not peripheral or inconsequential and influence the behaviour of buyers and sellers in a transaction.

18 The paper suggests that transactions costs should be expensed when they are incurred—except for those that are 'value affecting', which should not be regarded as transaction costs. However, it would seem that often the only value that will be observable is the value of the asset, and it is difficult to determine what part (if any) reflects the transaction costs incurred in its acquisition. More fundamentally, it seems reasonable to suppose that a rational management would undertake an investment decision having regard to the total costs that will stem from it: how much is to be paid to the manufacturer and how much is to be paid in costs such as import duties is not relevant. Thus we see no reason why transaction costs on the acquisition of an asset should be expensed.

19 Equally, where an asset is fit only for disposal, we see no reason to reflect it at a higher amount than net realisable value. If a refrigeration plant beaks down, and cannot be repaired, is it to be stated at its scrap value, without deduction of the costs of extracting and safely disposing of its refrigerant (assuming this is required by law)? Furthermore, if the metal casing has to be transported to the scrap dealer, is the cost of that transportation to be recorded only in the period it is actually shipped? If the treatment of transportation and selling costs differ, it is not clear why this should be so. It may be noted that if repair is practicable, a key factor in deciding whether the plant should be repaired or scrapped will be its net realisable value.

The deprival value model

20 We welcome the paper's suggestion that where efficient markets do not exist, a current value may be found by reference to deprival value (or 'value to the business') reasoning. The paper suggests that the conventional description of the deprival model should be modified in the following two ways.

(i) Transaction costs should be excluded from replacement cost and from net realisable value.

(ii) Value in use should be calculated by reference to market derived information rather than from management's own forecasts and data.

We have commented on transaction costs above.

21 We agree that value in use is usually described in terms of discounting management's forecasts of cash flows. It is, however, not clear whether this has a conceptual basis, or simply is the result of an implicit assumption that there will be little or no alternative data. In many cases the point will be of little importance in any event since, if the asset were to be sold, management would be willing to share recent financial results and financial projections with a purchaser. Thus whilst we agree that in principle use of market-derived information could be required, it is not clear that this will have a significant impact in practice if, as we would suggest, the assumption would be that the current use of the asset (or cash generating unit) were to be maintained.

SECTION B: RESPONSES TO SPECIFIC QUESTIONS

Q1. Do you agree that the list of identified possible measurement bases (see paragraph 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.

The ASB agrees that the list of identified possible measures is comprehensive.

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 the light of the discussion in paragraphs 46-48 of the condensed version and paragraphs 88-93 of the main discussion paper)?

We broadly agree with the working terms and definitions of each of the identified measurement basis with the exception of historical cost and fair value.

We suggest that the historical cost definition/interpretation should make clear that the vast majority of assets and liabilities will be measured at cost – in the case of transactions, the fair value of the consideration paid or received is equal to the current value of the asset/liability at the time of acquisition.

There is a need to define fair value more precisely. Additionally, the use of fair value in the paper is more appropriately described as fair price. Market value would be a more appropriately accurate term to use, given the analysis in the paper. It is also a term which is more readily understandable and with consensus agreement on its definition.

At the measurement round table held in London on 24 April, the point was made by Chris Thorne (Board member IVSC) that there is no conceptual framework for the application of fair value, despite a short definition in IAS 16.

In general fair value is assumed to be the price that is fair to the particular parties in a transaction and is commonly used in share transfers and business combinations. In contrast, the market value definition (IVS1) which has been in existence for 14 years, is well tested, is now established in international regulation (eg EU Directive on Solvency Ratios) and is universally recognised and accepted.

Q3. It is proposed that there are two fundamental sources of differences between the identified bases of 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 assets 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 the paper has identified the fundamental sources of differences between assets and liability measurement on initial recognition. However, it is when there are differences between the various possible measurement bases on initial measurement, that analysis of these differences becomes interesting. We would have expected the value-affecting differences to be a central core to the paper.

Q4. The paper analyses 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 paragraph 111, 228 and 229 of the main discussion paper)?

> Market value measurement objective seems to be a term taken from the FASB Exposure Draft *Fair Value Measurements.* However it was not defined in the FASB standard. Its argued appropriateness is subject to, whether one believes that efficient markets are (a) invariably efficient, or (b) are invariably inefficient. (Please refer to Section A paragraphs 6-16). Since in practice we do not believe that efficient markets are the norm, we do not find credible the conclusion arrived at for market value measurement objective.
>
> Additionally we are of the opinion that, the paper's definition of efficient markets actually relates to perfect markets (in accepted economic theory) and so the concept is flawed when related to practice where markets are sometimes efficient and sometimes not, but rarely perfect.
>
> In relation to part (c) the paper needs to be more persuasive in its arguments to enable the reader to buy into the conclusion that fair value is more relevant (being market based) than entity-specific. So far we are not persuaded that in the absence of an efficient market, the market value measurement objective is appropriate and is more relevant than other bases.

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 or the discussion. The paper is inconsistent in its usage of the term 'entity specific'. Although it is defined as "A measurement of an asset or liability of an entity that is based on the expectations of management of the entity" (see Appendix A to the long version of the paper) it is often used to describe any measurement basis other

than fair value - which seems specially worrying in the light of the suggestion that there can only be one market (fair) value for any asset.

We believe that it is arguable whether entity-specific measurement objectives are less relevant than market ones. Focus should shift to the user's need for the answer. (Please refer to Section A paragraphs 4-6). In the absence of an efficient market, we believe that entity-specific measures are more relevant than market ones because they reflect the economic reality of transactions and it is this that users of accounts are fundamentally intereste d in.

It is also interesting to note that with regard to the arguments used by the IASB on defining segments in ED 8 Operating Segments, it was argued that the best basis for the reporting of segments was management's own internal reporting. Hence it may seem somewhat inconsistent to argue that market rather than entity-specific is more relevant when measuring assets and liabilities.

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.

The relevance of either market or entity-specific measurement objectives is subject to the assumption of the paper that markets are invariably efficient, which is not a view we share. The logic of the reasoning of the paper is sound but the original assumptions are flawed.

Furthermore, the paper assumes without explanation (other than the logic of sticking to the same course whilst on it) that a measure that is a very good proxy for market value is a more relevant measure for accounting purposes than a measure that is not a good proxy for market value.

Q7. (a) It is reasoned that there can only be 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 the apparent market values for seemingly identical assets or liabilities on initial recognition may be attributable to:

(i) differences between the value-effecting 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 possibly 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.

Since we believe that, in the absence of an efficient market, fair value is subject to the position of the entrant or player in the market, we do not believe that it can be reasoned there is only one market (fair) value.

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 a 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 agree with the logic of the argument that there should be no difference of treatment for assets or liabilities; however we are concerned about incorporating the reporting entity's own credit risk in the carrying amount of its liabilities and would question if this move would improve the quality of the information provided to users.

Q9. The paper makes the following proposals with respect to defining the unit of account of an 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 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 with the caveats and discussion presented? If not, please explain why, and in what respects, you disagree.

The logic of this part of the paper is a result of a continuation from earlier assumptions, hence while we have no contention with the proposals as they are presented, we are unsure from the presented discussion, exactly how preparers should portray their financial position and why that should meet the needs of users.

Should financial statements move nearer to portraying the market capitalisation of a company or should they reflect the state of affairs of a company at a given moment in time? It is difficult to judge the conclusions reached in this part of the paper without defining clearly the objectives of financial statements.

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 markets 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 agree with the initial analysis put forward in the paper and additionally agree that more research is needed into multiple markets and their implications for measurement on initial recognition.

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 193-2000 of the main discussion paper). Do you agree with the proposed definition of transaction costs? Do you agree with the above conclusions? 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.

With regards to transaction costs, we follow the logical reasoning of the paper that transaction costs should omitted when measuring fair value, because they are costs which are not recoverable in the market place; however we are of the view that, the recoverability (or not) of costs is central to pricing mechanisms and not necessarily about accounting measurement.

Rational investment decisions are made regarding total costs; not total costs less transaction costs. Transaction costs are internalized to the transaction and have a bearing on the value of the subsequent assets; we therefore do not believe that transaction costs should be expensed.

In addition we would suggest that, if the reporting entity is indifferent as to what makes up the total cost, then the paper needs to explain persuasively why users are not indifferent, as there is an inconsistency of logic here. (We also comment on transaction costs in paragraphs 17-21 of Section A.)

Q12. Do you agree with the proposal that, when more than one measurement 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 basis.

The ASB statement of principles referred to in paragraph 202 of the long version states that;

"When the most relevant information is not the most reliable,…it will usually be appropriate to use the information that is the most relevant of whichever information is reliable". (Accounting Standards Board, *Statement of Principles, Chapter 3.34)*

Hence if an accepted level of reliability can be achieved, relevance should be the dominant factor. However we see no reason to necessarily place a greater importance on relevance than on reliability if an acceptable level of reliability cannot be achieved. (Please refer to our answer to question 13 suggesting the importance of defining the meaning of sufficient reliability). We acknowledge that placing more importance on relevance over reliability is consistent with other decisions taking place at the IASB on other standards. The IASB ED 8

Operating Segments, also places more importance on relevance over reliability or comparability.

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 proposed sources and the supporting discussion; however we would like to see the paper address the meaning of sufficient reliability, because the level of assessment needs to be more clearly defined.

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 basis in chapter 7, and discussion of measurement date on initial recognition in paragraphs 179-180 of the condensed version and paragraphs 410-145 of the main discussion paper)? If not, please explain why.

We agree that fair value is the most relevant measure of assets and liabilities on initial recognition, when an efficient market does exist. However we do not agree that fair value is the most relevant measure of assets and liabilities on initial recognition, when an efficient market does not exist.

We do not share the view that one can necessarily estimate with an acceptable reliability, because the reliability is subject to the person in charge of the estimation. We believe that this part of the paper enters too much into the realms of theory and idealism and should focus more on what would work in practice and what the needs of users are. Thought also needs to focus on keeping costs of the preparer to a minimum, balanced with the perceived usefulness.

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 and asset or liability when the estimate depends significantly on entity-specific recommendations 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 also agree with the statement that a few infrequent observable transactions do not necessarily constitute a market and that a transaction price paid or received for an asset or liability may not be its fair value on initial recognition, although this depends on how one wishes to define fair value.

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);

(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 realisable 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

(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 to additional analysis or research that you believe should be carried out.

The paper's analyses and conclusions with respect to relevance and reliability of the different measures are logical but subject to the paper's original assumptions, so it is natural that analyses and conclusions are not necessarily objective. More analysis of the differences between the resulting measurement amounts would have been helpful here. The paper comes to conclusions by ordered progression starting with the assumption that fair value is the most appropriate measurement. It is therefore biased towards fair value. The most thorough and objective route to take for the paper would have been to exhaust all the possible measurement criteria in different combinations before coming to conclusions.

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 basis 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 147 of the main discussion paper)? If not, please explain why.

When it is not possible to estimate a fair value reliably, fair value may not actually be the most relevant measurement basis. We suggest that the paper has used a blinkered view here and placed more importance on consistency with the fair value measurement objective rather than analyse whether this is in the best interests of the user. If being consistent does not produce the best answer then it does not make sense to be consistent. Some acknowledgement here that that the best answer may be a mix of measures might help for solving for the problem.

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 agree / disagree with the proposed hierarchy for the following reasons:

Level 1 we agree with

Level 2 We acknowledge that conceptually level 2 should be the next preferred choice after level one. We also agree with the example used referring to properties, (paragraph 428), however in practice we are concerned that level 2 may actually result (in some circumstances) in fair values which are inappropriate because a hypothetical market is assumed. (Our answer is dependent on the measurement of estimates with sufficient reliability we highlighted in our answer to question 15).

Therefore on a practical level in the absence of an efficient market we would in some cases rather revert to more reliable traditional forms of measurement which are entity-specific (Levels 3 & 4). We do not believe that just because they are entity-specific this makes them inferior to market measures.

We would also make the point that the recommended procedure and controls the paper recommends to be put in place for level 2 are onerous for companies and the added value which can be attributable to the result is questionable. Furthermore in some circumstances level 2 may not achieve results which can be assumed to be fair values.

Indeed if one uses hypothetical estimates for fair value in level 2; these estimates are produced by management and are hence entity specific. In these circumstances it would be more accurate and objective to revert to more traditional and reliable entity specific measures such as replacement cost.

Level 3 & 4 We agree with

Our alternative proposal is that there should be a cut off after level 1, whereby if estimates can be deemed to be reliable then level 2 is appropriate whereas, if replacement cost or historic cost is deemed to be more appropriate and relevant then these should be used.

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 this subject matter is both complex and controversial and hence believe it would be beneficial if more research could be conducted, as suggested in the paper in order that some of the main controversial issues can be surpassed and for there to more solidity behind assumptions before conclusions are reached. Research needs to lead us to the best answers, which may not necessarily be the easiest ones to fit into a new standard.