LIAJ Comments on Discussion Paper "Measurement Bases for Financial Accounting – Measurement on Initial Recognition"

- This paper premises that there can be only one market (fair) value for assets and liabilities on any measurement date. However, this is not relevant to many instruments (e.g. insurance contracts), for which there exists no secondary market. It is rather appropriate to discuss the relevance of each measurement base, based on the premise that the conceptual fair value may not be available through market data.
- The paper seems to be based on the principle that a transaction price of an asset or a liability differs from its fair value. However, it is thought that profit or loss of assets and liabilities should not be recognized on their acquisition, except in cases where we have at least sufficient evidence. As for insurance business, profit should be recognized so as to be consistent with the insurance business practice that insurers continue to provide policyholders with services over the term of each insurance contract. Service-based products such as insurance contracts differ from general financial products in that they are not marketable during the term of contract. For this type of product, then, it is not appropriate to recognize profit without ensuring sufficient reliability on inception through assessing associated contractual rights and obligations at market value based on the Level 1 and 2 premises. An accounting method whereby profit is recognized on the delivery of services is preferable. (For insurance contracts, profit is recognized when they are released from risks.) This is consistent with the conception of revenue recognition on accrual basis of the International Accounting Standards.
- Thus, this paper takes the perspective that the fair value measurement basis should also be relevant to goods and services that are not traded in the marketplace. However, this leaves issues to be addressed in theory and practice, and therefore further deliberations will be needed.
- In addition, regarding a schedule of profit recognition, there is an indivisible relationship between the initial and subsequent measurements, and thus it is not appropriate to only focus on the initial measurement for deliberations. Such deliberations should be advanced comprehensively, including issues on subsequent measurements.
- As far as issues requiring further deliberations remain, we would reserve our comments on respective questions at this stage, however we would like to provide our comments on the following as described below:

Q7. (a) It is reasoned that there can be only one market (fair) value for an asset or liability on a measurement date. Do you agree with this conclusion? If not, please explain why you disagree.

We disagree.

Q8. Do you agree that a promise to pay has the same fair value on initial recognition whether it is an asset or a liability, and that the credit risk associated with a promise to pay enters into the determination of that fair value with the same effect whether it is an asset or liability? If you do not agree, please explain the basis for your disagreement.

We disagree. Take the example of insurance contracts. From the perspective of insurance supervision, it may prove to be unsound accounting practise to reflect the credit characteristics of the underwriters themselves when valuing insurance liabilities. Taking into consideration the various users of financial statements, it may also be a problem to reflect the credit characteristics of issuers in the valuation of liabilities, not assets.