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25 May 2006

Dear Sir/Madam

Discussion Paper
Measurement Bases for Financial Accounting – Measurement on Initial Recognition

We are responding to your invitation to comment on the above discussion paper on behalf of PricewaterhouseCoopers.

Following consultation with members of the PricewaterhouseCoopers network of firms, this response summarises the views of member firms who commented on this Discussion Paper. "PricewaterhouseCoopers" refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

We welcome the Discussion Paper as a thought provoking contribution to the debate on the use of different measurement bases in financial reporting. This paper demonstrates the important role that national standard setters and others can play in the examination of new approaches to accounting issues. We believe that there now must be a wider global debate on the issue of fair value and other bases of measurement for financial reporting. The proposals set out in the Discussion Paper should be considered in the context of that debate.

In particular, we believe that the measurement debate should be set in the context of the IASB and FASB joint conceptual framework and performance reporting projects, and meet the overall objectives of financial reporting. Such a debate must embrace the measurement and timing of initial recognition as well as subsequent measurement. A decision to apply fair value at initial recognition, if taken in isolation, will undermine any future debate about the relevance of fair values for subsequent measurement and give rise to additional measurement inconsistencies in the current accounting model. In addition, any debate on the relevance of fair value for initial or subsequent measurement must address the relationship between the expected costs and the benefits to be achieved.

Preparers and users of financial statements are currently dealing with the challenge of increased application of fair value accounting imposed by the existing standards issued by the IASB, the FASB and other standard setters around the world. There is ambiguity in the accounting literature relating to the measurement of fair value in different circumstances, resulting in diversity in application. Such diversity has led to justified criticism that imposing a requirement to measure certain assets and liabilities at fair value is not achieving the promised consistency of application necessary to give a high level of confidence to users of financial statements. This is the background to the FASB's current project on Fair Value Measurement.

The FASB's draft standard on Fair Value Measurement is intended to define fair value as used in US GAAP and provide high level measurement guidance. This should lead to greater consistency in the interpretation and application of fair values where they are currently required in US GAAP financial reporting. The IASB have stated that they will issue an exposure draft based on the FASB's proposals, once these have been issued as a standard. The IASB should conduct further research and take stock of progress once it has published a fair value measurement standard based on the FASB proposals and has had the opportunity to assess its implementation in practice. The IASB should complete this research before it makes any further proposals to adopt additional fair value measures.

Many companies have just prepared their first annual IFRS financial statements. The IASB should pause and identify those issues creating the greatest difficulty in communications between preparers and users. Detailed research needs to be conducted to ensure these issues are addressed. In particular, consideration will need to be given to the implications for performance reporting arising from mixed measurement models.

In the light of our comments above, we do not consider that preparing formal answers to the detailed questions posed in the Discussion Paper would be useful at this time. We have however prepared a summary of other comments on the draft proposals identifying those that we consider warrant further research and effort and those where we consider that a different direction would be more useful. We attach this summary as an appendix to this letter.

If you would like to discuss any of the issues raised in this response, please do not hesitate to contact Ian Wright, Global IFRS Leader (44 207 804 3300) or John Brendon, Global Chief Accountant (44 207 804 4816)

Yours faithfully

PricewaterhouseCoopers LLP

Discussion Paper
Measurement Bases for Financial Accounting – Measurement on Initial Recognition

Appendix to PricewaterhouseCoopers response letter

This appendix summarizes other comments on the draft.

General comments

1. The Discussion Paper provides a comprehensive analysis of the measurement issues arising on initial recognition of assets and liabilities. The subsequent measurement of assets and liabilities is outside the scope of the paper. In our opinion this disconnect is inappropriate. The principles underlying timing and measurement at initial recognition and subsequent measurement have to be considered concurrently to deliver a coherent financial reporting model.

2. The comparative analysis of different measurement bases against the criteria in the conceptual frameworks of the different standard setters is a sound basis for evaluation.

3. There is naturally a high degree of overlap between the issues considered in the Discussion Paper and those addressed by the FASB in its draft standard on Fair Value Measurement. Some of the views expressed in the Discussion Paper contradict the proposals in the FASB's draft standard, a fact that the authors of the Discussion Paper readily acknowledge. We recognise that this is largely a result of timing and suggest that a common valuation hierarchy is agreed after companies have greater experience of applying the Fair Value Measurement Standard.

Draft proposals that we consider warrant further research and effort

4. **Plans to reduce inconsistencies**
   The Discussion Paper highlights differences of measurement requirements and practices within and between existing standards and in the terminology used. Such options and internal inconsistency reduces the comparability of financial statements and of items within financial statements. For example, some standards allow a choice between cost and another valuation basis, mix market and entity specific data in a single valuation basis and apply different valuation bases to assess assets for impairment.

   We support the aim of greater consistency in financial reporting but, as noted earlier, we do not believe that measurement on initial recognition can be considered in isolation from subsequent measurement nor from performance reporting issues.

5. **Emphasis on the reliability of a measurement basis**
   The Discussion Paper stresses reliability as one of the most critical attributes of a measurement basis in its analysis of different bases and draws a clear distinction between reliability and volatility. The Paper cautions that the reliability of a model based estimate of fair value is dependent on the quality of the data input to the model and whether the data input is market based. The Paper also recommends that disclosure about measurement uncertainty should be an essential element of financial reporting, as it is fundamental to an understanding of the reliability of a measurement.

   We agree that disclosure of measurement uncertainty should be an essential element of financial reporting. Information on the quality of earnings and on gains and losses is essential for market confidence. The need for enhanced disclosures to enable users of financial statements to make informed assessments of an entity's financial performance has been discussed and addressed, in part, in IFRS 7 for financial instruments and, more widely, in the FASB's Fair Value Measurement project. Both these projects attracted a lot of comment about what users of financial statements wanted. The authors of the Discussion Paper may find it useful to refer to those comments in further developing the debate.

6. **Entity specific measurements should not be described as fair value**
The Discussion Paper includes a comparison of market-based measures and entity- based measures against the criteria in the standard setters' frameworks and concludes that there are merits in both types of measure. The Paper observes that in an ideal world, an entity would apply and disclose both types of measure but that it is not possible to have the attributes of both in a single measurement. The Paper also notes that an entity specific measure is not fair value and recommends that fair value substitutes are not described as fair value.

   We recognise that there is a diversity of opinion on this topic and therefore recommend that a study should be conducted, in conjunction with the FASB and the IASB, to determine the appropriate definition of fair value. We note that an entity specific basis of measurement is not consistent with the current definition of fair value in IFRS.

7. **Proposal for cooperation between the IVSC, the IASB and national standard setters**
The Discussion Paper notes that the International Valuation Standards Committee ('IVSC') developed the property valuation standards regularly used in financial reporting valuations without direct input from the accounting standard setters.
The Paper recommends that the IVSC, the IASB and the national standard setters get together to examine how well the standards and guidance meet financial reporting objectives.

   We support the proposal that the IVSC, other valuation professionals and the standards setters should develop a framework for greater cooperation and ensure that valuation standards are developed in an environment that encourages proper due process. One of the key challenges to the consistent application of fair value accounting is the lack of a real basis of understanding between standard setters and valuation experts. We would welcome more dialogue between them to ensure that there is sufficient underlying explanation in accounting standards to drive the development of appropriate valuation methodologies.

8. **Dismissal of replacement cost**
The Discussion Paper dismisses replacement cost as a proxy for fair value, as it frequently uses entity specific assumptions, but does not suggest any alternative for valuing the assets to which this measure is normally applied such as plant and machinery, and certain specialised buildings.

   We agree that a measure based on entity specific assumptions does not meet the IFRS definition of fair value. However, current standards allow replacement cost to be used as a proxy for fair value when no market-based measure is available e.g. for the valuation of plant and equipment under IAS 16 and IFRS 3. An alternative measurement basis must be proposed if replacement cost is not permitted.

9. **Classification of assets and liabilities**
The Discussion Paper classifies assets and liabilities as 'contractual' or 'non-contractual' for the purposes of subsequent analysis but then uses a patent as an example of a non-contractual asset.

Under IFRS 3 and SFAS 141, a patent is an asset arising from 'contractual or other legal rights'. We suggest that the basis of classification as contractual or non- contractual used in the Discussion Paper is aligned with that in IFRS 3 or, alternatively, that the Discussion Paper articulates its classification more clearly to avoid any misunderstanding of the nature of different types of asset.

10. **Treatment of block adjustments**
    The Discussion Paper proposes that block adjustments are included in fair value if the unit of account is a block.

    There is currently diversity in practice as, under US GAAP, certain but not all investment entities are permitted to make block adjustments whilst no such exemption exists under IFRS. We believe that it is premature to propose a single solution for all entities until some of the underlying fundamental issues have been agreed.

11. **Treatment of transaction costs**
    The Discussion Paper proposes that recoverable transaction costs are included in the fair value of an asset or liability.

    Under current accounting standards, there is inconsistency between the treatment of transaction costs when certain assets or liabilities are transacted individually and the treatment when similar assets and liabilities are components of a business combination. We suggest the treatment of transaction costs is addressed as a separate project.