



BASEL COMMITTEE ON BANKING SUPERVISION

BANK FOR INTERNATIONAL SETTLEMENTS

Chairman

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**Discussion paper on 'Measurement bases for financial accounting – measurement on initial recognition'**

Dear Sir/Madam:

The Basel Committee on Banking Supervision welcomes the opportunity to comment on the discussion paper *Measurement bases for financial accounting – measurement on initial recognition* drafted by the Canadian Accounting Standards Board and published by the International Accounting Standards Board (IASB).

The Committee has a strong interest in promoting sound and high quality accounting and disclosure standards for the banking and financial industry, and believes that this discussion paper raises a number of interesting and important issues. The comments made by the Committee should be read in the context of, and as a contribution to, the joint efforts of the IASB and the Financial Accounting Standards Board to revisit their conceptual frameworks. The Committee looks forward to contributing further to the various phases of the conceptual framework projects.

The Committee recognises that the selection of appropriate measurement bases is an issue of great interest and significance in the area of accounting. However, the Committee believes that this discussion paper needs to be set aside until work is concluded in other significant joint IASB/FASB projects (ie conceptual framework, fair value measurement) that significantly impact issues considered in this paper.

Please find more specific comments concerning the discussion paper in the attached appendix. These comments have been prepared by the Committee's Accounting Task Force (ATF), chaired by Prof. Arnold Schilder, executive director of the Netherlands Bank, and approved by the Committee. The Committee trusts that you will find its comments useful and constructive.

If you have any questions regarding our comments, please feel free to contact Sylvie Mathérat, deputy director, Commission Bancaire, (+33 1 4292 6579); Jerry Edwards, senior advisor on accounting and auditing policy, ATF (+41 61 280 8055), or Linda Ditchkus, Basel Committee Secretariat (+41 61 280 8007).

Yours sincerely,

Jaime Caruana

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## APPENDIX

Rather than answering each of the specific questions raised in the discussion paper, the Basel Committee on Banking Supervision<sup>1</sup> (the Committee) believes it more useful to provide comments on a number of broad conceptual issues that were identified as being of particular importance to its members.

### **The relationship of the discussion paper to the overall conceptual framework project plan**

The Committee believes that the selection of appropriate measurement bases is an issue of great interest and significance in the area of accounting. We are concerned, however, about the timing of this document in relation to the overall project plan developed by the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) for revision of their conceptual frameworks.

The IASB's and FASB's plan for their joint conceptual framework project consists of eight phases that appear to be ordered based on dependencies. For example, it would seem logical to determine the objectives and qualitative characteristics of financial reporting (phase A) before deciding the initial and subsequent measurement issues (phase C). Chapter 2 of the discussion paper uses existing notions of objectives and qualitative characteristics to provide a foundation for the analysis performed with respect to initial measurement. However, the IASB's and FASB's tentative decisions on objectives and qualitative characteristics have not yet been formally communicated and subjected to public comment. As a consequence, the Committee proposes that this discussion paper on initial measurement be set aside and revisited after phases with issues relevant to this discussion paper are completed.

### **Treatment of the concept of reliability**

As noted above, the objectives and qualitative characteristics of financial reporting (phase A of the conceptual framework project) have yet to be formally communicated and subjected to public comment. However, the IASB and FASB

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<sup>1</sup> The Basel Committee on Banking Supervision is a committee of banking supervisory authorities, which was established by the central bank Governors of the Group of Ten countries in 1975. It consists of senior representatives of bank supervisory authorities and central banks from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom and the United States. It usually meets at the Bank for International Settlements in Basel, where its permanent Secretariat is located.

have decided tentatively to eliminate the term “reliability” from the qualitative characteristics and replace it with a broader concept of “faithful representation”.

The Committee supports a more robust definition of the concept of “reliability” and objects to it being replaced. Instead of using the new term “faithful representation”, we recommend continuing to call the broader concept “reliability”. This is important, from our standpoint, in order to prevent obscuring some of the constructive debate that occurred in the past between the IASB and its constituents on the trade-off between relevance and reliability. The IASB’s discussion paper addresses this trade-off within the construct of its proposed measurement hierarchy and we see no need to confuse the debate by changing the terms that have long defined the arguments. Moreover, we are concerned that the proposed trade-off between relevance and reliability, which seems to put more emphasis on relevance, could send a negative signal to companies and auditors that the importance placed on accurate, dependable measurements has been diminished in the IASB’s new conceptual framework.

## **Implications for subsequent measurement**

The discussion paper acknowledges that “[t]he adoption of particular measurement bases on initial recognition might limit or preclude some alternatives on re-measurement.” It goes on to state that “any conclusions reached with respect to measurement on initial recognition are necessarily tentative and subject to reassessment when their potential implications for re-measurement are considered”. We firmly believe that the areas of initial and subsequent measurement, as well as concepts surrounding capital maintenance, are closely linked. Subsequent measurement of balance sheet items is at least partially predetermined by measurement on initial recognition, and both are intrinsically tied to the concepts of capital maintenance as the income recognised during initial and subsequent measurements represents a significant element of capital for many organisations (ie retained earnings).

In particular, the Committee is concerned about the implications that the discussion paper’s preference towards fair value measures on initial measurement may have for subsequent measurements of instruments for which fair value is difficult to measure reliably due to illiquidity in the market or the existence of multiple markets. In this respect, the discussion paper recommends additional research in the areas of “apparent multiple markets ... so as to be able to address their implications for accounting measurement purposes” and professional valuation standards and their application to items with no observable market. Therefore, we recommend that this discussion paper should be revisited in conjunction with research on subsequent measurement to ensure that decisions impacted by this paper do not inappropriately limit future options.

The discussion paper’s proposal to record fair values at initial recognition would possibly require immediate recognition of gains or losses. We believe that careful evaluation of the most appropriate initial valuation method would include consideration of an item’s intended use and the realisability of any gains or losses. Without this analysis, certain gains or losses may be inappropriately recognised upon initial recognition.

## **Differences in the fair value hierarchy**

The discussion paper contains a “proposed measurement hierarchy on initial recognition” that looks very similar to, but is not identical to, the fair value hierarchy contained in the FASB’s exposure draft entitled *Fair value measurements*. For example, the hierarchy contained in the FASB’s document contains a level for estimates with significant entity inputs (recently renamed unobservable market inputs) while the IASB’s discussion paper labels such measures substitutes for fair value, not fair value measurements themselves. Since the IASB expects to issue the FASB’s final standard as an exposure draft after the FASB completes its due process, the Committee recommends that the standards boards reconcile differences between the two hierarchies in order to resolve any inconsistencies and to avoid confusion on the part of constituents trying to compare both documents.