The Association of Corporate Treasurers

Comments in response to:
Discussion Paper: Measurement Bases for Financial Accounting – Measurement on Initial Recognition

A Discussion Paper from the IASB, November 2005

19 May 2006

The Association of Corporate Treasurers (ACT)

Established in the UK in 1979, The Association of Corporate Treasurers is a centre of excellence for professionals in treasury, including risk and corporate finance, operating in the international marketplace. It has over 3,500 members from both the corporate and financial sectors, mainly in the UK, its membership working in companies of all sizes.

The ACT has 1,500 students in more than 40 countries. Its examinations are recognised by both practitioners and bankers as the global standard setters for treasury education and it is the leading provider of professional treasury education. The ACT promotes study and best practice in finance and treasury management. It represents the interests of non-financial sector corporations in financial markets to governments, regulators, standards setters and trade bodies.

General

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Summary

The ACT is grateful for the opportunity to comment on the paper. We have a number of fundamental concerns regarding the arguments made and conclusions reached in the paper and address these first in the comments below. We believe our concerns to be so fundamental that they call into question the relevance of some of the 18 questions for which comment has been specifically sought and so we have declined to comment on these. However we have addressed those questions which reflect our more general concerns and which we believe are relevant.

General Comments

1. Before considering accounting bases in detail, there is a need to consider the purpose of the financial statements and what function they should serve. Whilst there is a reference in the paper to stewardship (as one of several criteria against which the market and entity-specific objectives are assessed), we do not believe that enough emphasis has been placed on this. The role of financial statements in reporting on stewardship and enhancing accountability is a key one. However, we believe it has been given inadequate consideration in the paper, and, particularly, in the conclusions reached.

2. We do not believe it is possible to arrive at sound conclusions by considering measurement at initial recognition in isolation, without regard to either when initial recognition should occur (the paper proposed that initial measurement should coincide with this) or subsequent re-

measurement. Any discussion of re-measurement needs to address the circumstances in which it would be reasonable or acceptable to change the measurement basis after initial recognition.

The failure to address the issue of re-measurement is puzzling and weakens the credibility of the paper.

3. It is unclear how this paper will fit into the current agenda of the IASB and link into the results of work in progress, particularly the fair value measurement and the conceptual framework projects. Both of these will deal with many of the issues raised here and may arrive at different conclusions to those reached in this paper. Therefore, greater clarity of the IASB's thinking on this subject would be appreciated since at present we are unsure of this and also of what has prompted the publication of this discussion paper.

Comments on specific questions raised in the "Invitation to Comment"

Question 1: 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.

The paper lists the following possible measurement bases: historical cost, current cost, net realisable value, value in use, fair value and deprival value. We agree that this is a full list of the different bases that should be considered.

Question 2: 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 light of the discussion in paragraphs 46-48 of the condensed version and paragraphs 88-93 of the main discussion paper)?

With respect to historical cost, we are unsure how it is proposed to treat an asset constructed over a period of time. We believe that the cost should be the accumulation of all relevant costs at the amount incurred at the time however and would not agree with any move to valuing the component parts at the time the constructed asset became operational. We have no comments on the other measurement bases.

Question 3: No comments

Question 4: No comments

Question 5: No comments

Question 6: 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.

We have no comments with respect to the comparison of the two objectives however we disagree with the conclusion that the market value measurement objective is more relevant. There is insufficient support for reaching this conclusion and not enough consideration given to the benefit of entity specific valuations, given that in the absence of an intention to sell an asset, its ability to generate future cash flows arises from how it is utilised in the business, in combination with other assets. In such circumstances we fail to understand the relevance of market value.

For example, an asset may have a market value of £1.0m and a value in use in one business of £1.5m and in another business £0.8m. Assuming the financial statements are prepared on a going concern basis, but with values bases on fair value rather then historic cost, then what is the relevance of the £1.0m market value?

Question 7: No comments

Question 8: Do you agree that a promise to pay has the same fair value on initial recognition whether it is an asset or 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 (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.

While we agree that the credit risk does indeed enter into the determination of fair value, since we do not accept that fair value is an appropriate measurement bases for all asset and liabilities on initial recognition, this is not wholly relevant. Notwithstanding this, in the context of initial measurement, we do not agree that the change in an entity's own credit risk should be reflected in the carrying amount of its liabilities since, ordinarily, management's initial expectation will be that such liabilities will be paid in full and accounts will be produced on a going concern basis on this assumption. It is wholly inapproporiate for companies to speculate on possible compromises with creditors in preparing their accounts. (Of course, pro-forma accounts prepared on particular assumptions can be helpfully provided in proposing compromises to creditor and to shareholder meetings. This should not be the concern of the present paper.)

Furthermore, this question cannot be isolated from re-measurement which highlights the difficulty of focussing only on measurement on initial recognition without considering the subsequent implications.

Question 9: No comments

Question 10: No comments

Question 11: No comments

Question 12: No comments

Question 13: No comments

Question 14: 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 accept that the paper makes the case for fair value measurement on initial recognition. This seems to emanate from the conclusion that the market value measurement objective is superior (which we do not accept) and that the fundamental objective of fair value is to reflect the market value of an item on the measurement date.

Following this to its logical conclusion of fair value on re-measurement, the balance sheet would comprise of lists of assets and liabilities stated at amounts close to fair value.

Leaving aside the issues of how performance would need to be analysed between operating activity and fair value movements, we ask what benefit would derive from such a fair value balance sheet. This would not reflect the up to date value of the business or recognise the value generated by combining the assets together (and with un-accounted assets such as general goodwill items, management expertise, etc) in order to create a higher value than the sum of the parts. Rather it would be an estimate of the sum of the individual components at a previous point in time.

Question 15: No comments

Question 16: No comments

Question 17: The paper discusses substitutes for fair value when the fair value of an asset or liability cannot be readily 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 this since we do not accept that market value measurement objective fair value is superior, and we therefore also disagree that the most appropriate measurement bases on initial recognition is fair value. Furthermore, in the event that it is not possible to estimate fair value reliably, it seems that the superiority of the market value measurement objective is thereby questioned and therefore so is the relevance of fair value.

Question 18: 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.

Since we disagree with many of the fundamentals upon which the hierarchy is based (explained variously above), we do not agree with the proposed hierarchy.

Question 19: 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.

Please see the general comments at the beginning of this letter.

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