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International Accounting Standards Board

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These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

Board Meeting:	**21 September 2006, London**
Project:	**Research Project: Measurement Objectives**
Subject:	**Discussion Paper: Measurement Bases for Financial Accounting – Measurement on Initial Recognition – Cover Note (Agenda Paper 6)**

Discussion Paper: Measurement Bases for Financial Accounting - Measurement on Initial Recognition

Cover Note

INTRODUCTION

1. This Agenda Paper series presents the comment letter summary on the paper, "Measurement Bases for Financial Accounting: Measurement on Initial Recognition," developed by staff of the Canadian Accounting Standards Board. The summary (Agenda Paper 6A) comprises the following:

    a. Comment Letter Summary

    b. Appendix A: Specific comments on questions asked in the paper

    c. Appendix B: List of Organizations who submitted comment letters

2. This Agenda Paper contains highlights of the main messages conveyed in, and lessons learned from, the responses to the Discussion Paper.

3. Board members are requested to review the materials provided in preparation for discussion in September 2006.

HIGHLIGHTS

4. Profile of respondents. 84 comment letters were received, many commenting on the issues in some depth. There was a strong response from financial statement preparers, accounting professionals, various national standard setters, and professional valuers. Many of the responses were from committees or groups representing the collective views of many individuals. However, no responses were received from financial statement users and there was a low response from academic accountants. The geographic distribution is similar to that which is typical in response to other IASB documents for comment, except that the number of responses from North America was low.

5. Relation to IASB projects. Many respondents question how the paper fits in with the joint Conceptual Framework project and the Fair Value Measurement project (both started after this paper). Some believe that the paper should not have been undertaken until the Conceptual Framework study of objectives and qualitative characteristics has been completed. It is to be noted that many of these respondents disagree with certain of the basic underpinnings of the existing conceptual framework and want a full debate of them prior to addressing their measurement implications. *[Remainder of paragraph deleted]*

6. Scope. Most respondents believe that the paper could not adequately consider measurement on initial recognition without addressing re-measurement. Further, many criticize the paper for not addressing financial performance reporting and revenue recognition issues, which they believe need to be included in any analysis of measurement bases. However, these concerns do not seem to have overly impeded the ability of respondents to comment on the analyses, issues and proposals set out in the paper.

7. Fair value relevance on initial recognition. The majority of the respondents are not supportive of the paper's proposals regarding the relevance of fair value on initial

recognition. In particular, they believe that fair value has no relevance to measuring assets, on initial recognition or subsequently, that are to be used in the production of goods or services. Several respondents feel that the paper should have given more consideration to the costs to develop and maintain procedures and controls to reasonably measure fair value. Many respondents are concerned that the IASB and FASB are pushing towards an inappropriate expansion of fair value measurement.

8. <u>Competing philosophies of financial reporting purposes.</u> Many respondents disagree with basic premises of the existing IASB Conceptual Framework that the paper reasons from. These respondents see the paper's conclusions as to the relevance of fair value on initial recognition to be a consequence of erroneously reasoning from faulty concepts of decision usefulness and predictive value. In particular, several preparers and accounting professionals from Europe and Japan set out a philosophy based on the primacy of the stewardship/accountability objective, which they argue is separate from the decision usefulness objective. Their interpretation of the stewardship objective generally leads to historical cost measurement for other than certain financial instruments on initial recognition. These respondents believe that their concerns are being swept aside without adequate study and debate.

9. <u>Reliability and its relationship to relevance.</u> Many respondents do not clearly distinguish relevance and reliability and, as a consequence, do not clearly distinguish the separate relevance and reliability analyses and proposals of the paper. Respondents appear to have different understandings of "reliability". Many respondents believe that the paper promoted relevance over reliability and therefore present an unbalanced view. (The paper tried to present both relevance and reliability (representational faithfulness) as being necessary to measurement.) Many criticize the paper for not providing clear guidance as to when a measurement should be considered to be of acceptable reliability. *[Remainder of paragraph deleted]*

10. <u>What does and should "fair value" purport to represent?</u> The responses indicate fundamental disagreements and uncertainties with respect to what "fair value" is

and what it should purport to represent. A small majority of respondents agree with the paper that the objective of fair value should be to reflect market value, but there seems to be no firm agreement amongst these respondents with respect to what should be accepted to represent market value. Some respondents see a distinction between "fair value" and "market value". Professional valuers see "fair value" as a generic concept encompassing market value and a number of other measurement bases. A few question why accounting clings to the term "fair value", if the objective is market value. There appear to be mixed views, strongly held, with respect to whether fair value should be defined as an exit value, or in some cases an entry value on initial recognition, or whether differences between entry and exit prices are explained by differences in the value-affecting properties of the assets or liabilities. Differing views and arguments are expressed as to the question of "multiple markets" for identical assets or liabilities. It is evident that respondents have different ideas as to what may constitute separate markets. Further, they make different assumptions as to what may be the properties of an asset or liability, or of an entity's situation, that may affect the measurement of its fair value on initial recognition. There is general agreement that further in depth study is necessary to clarify and agree on the definition of fair value, as the basis for a coherent debate on measurement issues.

11. <u>Interpretation of the market concept.</u> A majority of respondents criticize the paper's concept of "market", believing that the paper was advocating "perfect" and "fully efficient" markets. They note that such markets are very rare in practice, so that holding fair value to that test would result in it rarely being capable of reliable estimation. Such an interpretation of "market" is inconsistent with "commercial realism" and practice. (The paper did not intend this interpretation. It proposed that fair value derives its relevance from its determination by market forces, but it did not mean to imply that this requires perfect or fully efficient market conditions. It was attempting to examine and define how market forces work to define the essential elements of fair value.) The relationship between markets and fair value clearly requires further study and clarification.

12. <u>Entity-specific versus market objectives.</u> Many respondents believe that, contrary to the analysis and proposals of the paper, measurements reflecting entity expectations have greater relevance for the measurement of many assets and liabilities on initial recognition than market value (reflecting market expectations). Their arguments, most of which were analyzed in the paper, are based on a stewardship financial reporting objective, under which management can be expected to transact rationally on the basis of its knowledge and expectations, and that the objective of accounting has been, and should continue to be, to portray an entity's financial position and results of operations through the "eyes of management". Some believe that measurements based on entity expectations provide more relevant information for predicting future cash flows. *[Remainder of paragraph deleted]*

13. <u>Financial versus non-financial assets and liabilities and the case for historical cost.</u> Many believe that the paper should have separately considered financial and non-financial assets and liabilities. While most respondents accept the relevance of fair value for at least some financial assets and liabilities, many strongly support historical cost (transaction amount including transaction costs) on the initial recognition of assets or liabilities that are used in the production of goods or services, or assets that are acquired wholesale for retail sale. A common argument is that historical cost for these assets and liabilities should be viewed as being recoverable through the entity's business operations, and that their individual fair values on initial recognition are irrelevant to that objective. These respondents believe that the paper did not fully and adequately consider the strengths of historical cost, and overstated its weaknesses.