30 Cannon Street, London EC4M 6XH, United Kingdom
Tel: +44 (0)20 7246 6410 Fax: +44 (0)20 7246 6411
Email: iasb@iasb.org Website: www.iasb.org

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 – Comment Letter Summary – Summary of Responses (Agenda Paper 6A, Appendices A and B)**

COMMENT LETTER SUMMARY - APPENDIX A

Summary of responses

Q1. **Identification of possible measurement bases**

1. Almost a majority of respondents agree that historical cost, current cost including reproduction cost and replacement cost, net realizable value, value in use, deprival value and fair value comprise a complete list of identified possible measurement bases (39 respondents). Other respondents made the following recommendations:

   (a) Consider the following additional measurement bases:

   - market value (6 respondents),
   - components approach to fair value which is implicit in IAS 39 (separate and measure risk components individually which is useful in illiquid markets),
   - expected value,
   - face value or nominal value and paid-in (issued) capital (bases used in IFRS),
   - transaction price, both purchase and contractual price,

- manufacturing cost, and
- estimated value;

(b) Consider entry and exit value versions of fair value as the underlying concepts are theoretically different (3 respondents);

(c) Acknowledge that current cost, replacement cost and reproduction cost are not separate measurement bases and that in different jurisdictions different terms have been used to refer to essentially the same measures. Recommend excluding current cost as reproduction cost is a subset of replacement cost as it represents the cost of reproducing the service potential embodied in an asset [Australian Accounting Standards Board - CL83];

(d) Explain why certain bases are excluded, such as appraisal value and entity-specific bases;

(e) Exclude deprival value (7 respondents), because:

- It is a decision rule, not measurement base,
- There are few circumstances where deprival value is relevant, other than those noted in the paper, or
- View deprival value as an economic term and question whether it is appropriate for accounting (not used in IFRS today); and

(f) Distinguish the list between initial recognition and re-measurement as certain bases are only appropriate to one. For example, historical cost is only appropriate on initial recognition (3 respondents).

Q2. **Working terms and definitions of identified measurement bases**

2. More respondents agree with the working terms and definitions proposed than those who do not (27 respondents agree versus 11 respondents who raise concerns). One respondent supports developing a list of agreed upon definitions to reduce the noise and miscommunication during debate. Respondents recommend and express the following concerns:

Working terms

(a) Rename fair value, as it is problematic and does not have definitional quality or clarity, to market price/value or modelled market price (3 respondents), or add a specific market value definition to “fair value”;

(b) Rename current cost to most advantageous cost;

(c) Rename reproduction cost to replacement cost as preparers interpret reproduction cost as the cost of reconstructing an asset and rename replacement cost to substitution cost;

Definitions

(d) Recommend describing the bases with the perspective of achieving the reporting objective of decision usefulness;

(e) Explain the relationships between the different measurement bases, as they are not mutually exclusive. Adopting a tree format may assist to express the relationships (refer to diagram in CL18). From a valuation perspective, "fair value could encompass a range of values depending on the valuation framework required by accounting standards." For example, market value is a subset within fair value and is defined as an "estimated price received," before the costs of realization. [Royal Institution of Chartered Surveyors - CL18];

Fair value definition

The amount for which an asset or liability could be exchanged between knowledgeable, willing parties in an arm's length transaction.[1]

(f) Need to define fair value more precisely. Substantial clarification is required for the definition to be operational;

(g) Be based on the exit concept. Several respondents prefer a definition converged with the FASB's definition (16 respondents), because it is more operational. The International Valuation Standards Committee supports the FASB definition "in context of the proposed standard as it brings greater certainty to the objective of Fair Value Measurement for financial reporting, it does not invalidate the fact that in considering transactions between individuals and businesses generally, Fair Value does not always equate to Market Value."[CL19] Several respondents recommend that the differences between, and impact of selecting an exit versus a neutral fair value definition be analyzed (3 respondents);

(h) Include a market orientation or reference (3 respondents), as key principles should be explicitly stated in the definitions to reduce complexity and misinterpretation. For example, include reference to which reference market or to the market measurement objective in the definition;

(i) Disagree with including a market perspective to the definition (3 respondents). Many respondents interpret the fair value definition to include a transaction price determined between two parties. (8 respondents) Respondents believe it is important to understand the differences between different values, such as entry versus exit, market value and a calculated amount, before any changes are considered;

(j) Use more neutral terminology;

(k) Change the term "arm's length transaction" to "a transaction with unrelated parties" as these terms are more precise and less colloquial;

(l) Judge fair value in context of "an orderly transaction for an asset or a liability that allows for exposure to the market for a period prior to the measurement date that is usual and customary… and reflects market conditions existing at the measurement date" from the proposed FASB Fair Value Measurement Standard.

[1] See the main paper, paragraph 88.

This guidance should be included to ensure fair value measurements are conducted in the going concern context and do not involve a forced sale;

(m) Excluding the concept of settlement of a liability may impact the measurement of liabilities (3 respondents), including insurance liabilities. Respondents are concerned as to recognition of profits or losses, especially when there is no liquid market, or when fair value cannot be measured reliably. On the hand, another respondent believes that replacing "settled" with "exchanged" does not change the meaning;

Market value definition – a proposal

(n) Consider IVSC definition developed 14 years ago and which is widely recognized and adopted. "Market value is the estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller in an arm's-length transaction after proper marketing wherein the parties had each acted knowledgably, prudently, and without compulsion."[2] (3 respondents);

Historical cost definition

Assets are recorded at the fair value of the consideration given to acquire them at the time of their acquisition. Liabilities are recorded at the fair value of the consideration received in exchange for incurring the obligations at the time they were incurred.[3]

(o) Make it clear that the vast majority of assets and liabilities will be measured at cost as the fair value of the consideration paid or received is equal to the current cost of the asset or liability at the time of acquisition (4 respondents);

(p) Clarify the historical cost definition to apply only as a possible basis when it cannot be justified to equal fair value of the item received[4];

(q) Should exclude the phrase "fair value" from the definition, because the term is already used within the definition of another measurement concept (3 respondents). A few other respondents prefer the IASB definition that refers to 'the amount paid or consideration given" or "cash equivalents paid" (3 respondents). Fair value is considered to be of secondary importance as it is only used in absence of cash payments;

(r) Should refer to constructed assets as well as to acquired assets as constructed assets are not acquired at a single point in time;

(s) Disagree with excluding in the liability definition the phrase "or in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents to be paid to satisfy the liability in the normal course of business" as see that it is an expected value measurement and not consistent with the historical cost objective (3 respondents);

(t) Recommend that the definition for liabilities refer to "the value at origination" as a liability may be incurred without any consideration having been received;

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[2] International Valuation Standard, IVS 1 *Market Values Basis of Valuation* (2005).
[3] See the main paper, paragraph 77.
[4] See the condensed paper, paragraph 120.

Current cost definition

Reproduction cost is the most economic current cost of replacing an existing asset with an identical one. Replacement cost is the most economic current cost of replacing an existing asset with an asset of equivalent productive capacity or service potential.[5]

(u) Amendments should be better explained as the proposed definition is not based on accounting concepts, unlike the other definitions which are based on the IFRS definitions;

(v) Clearly distinguish the differences between reproduction cost and replacement cost;

Value in use definition

The present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life.[6]

(w) State whether entity-specific or market expectations are used to estimate future cash flows expected (4 respondents);

(x) Explain how useful life is to be interpreted;

(y) Consider IFRS definition used in IAS 36;

Deprival value definition

The loss that an entity would suffer if it were deprived of an asset. It is the lower of replacement cost and recoverable amount on the measurement date, with recoverable amount being the higher of value in use and net realizable value.[7]

(z) Exclude as it is a compound value; if not, recoverable amount should be added;

(aa) Disagree if the reference to replacement cost might imply ignoring reproduction cost because reproduction cost can sometimes be the most economic way to currently acquire the productive capacity or service potential of an asset. Clarify whether replacement cost and reproduction cost are meant to be mutually exclusive. If reproduction cost is not regarded as a subset of replacement cost, the definition should refer to "current cost" instead of "replacement cost" [Australian Accounting Standards Board - CL83]; and

Net realizable value

The estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.[8]

(bb) No comments.

3. *Historical cost definition – interpretation of "at the time acquisition".* Several respondents question the application of the proposed definition to constructed assets

[5] See the main paper, paragraph 81.
[6] See the main paper, paragraph 86.
[7] See the main paper, paragraph 86.
[8] See the main paper, paragraph 84.

(an issue discussed in paragraph 310 of the paper)(11 respondents). EFRAG explains the issue and its alternative view as follows:
"We note that paragraph 34 [of the condensed version] defines the historical cost of an asset as the fair value of the consideration given to acquire that asset at the time of the asset's acquisition. We are concerned about how the phrase 'at the time of the asset's acquisition' might be interpreted when, say, the asset is being constructed over a period of time. In particular, we have seen it suggested that the date of acquisition of a constructed asset is the date it becomes operational, which would mean that under the paragraph 34 definition the historical cost of an asset that is constructed over a period of time would be the fair value – at the date the asset becomes operational – of the consideration given to build the asset. That is not our view of the historical cost of the asset. We think that the paper assumes that in a construction contract there is a single transaction; however, in our opinion there is not a single transaction, so the choice of measurement date is not as straightforward as the paper suggests. Either a different view needs to be taken of what is meant by 'at the time of the asset's acquisition' or the focus should be more on the accumulated cost incurred (perhaps excluding cost inefficiencies in certain cases, but that would need further thought) rather than the fair value of the consideration given."[CL 84]

4. The paper does not interpret 'at the time of acquisition' but does interpret "initial recognition" of a non-contractual asset to include the time period needed to plan, develop, acquire components, construct, install, test, and generally put in a position to contribute to generating future cash flows through sale or use.[9] Respondents recommend that the cost of a constructed asset be based on the accumulation of each consideration instead of just when the asset is operational. The interpretation of these terms needs to be discussed and clarified.

5. This issue also has implications on the capitalization of interest during the construction period, which is discussed in Appendix C of the main paper. Based on that analysis, the paper proposes that there is a case for the capitalization of interest at the market rate of return.

Q3.**Fundamental sources of differences**

The paper proposes that there are two fundamental sources of differences between the identified bases for measuring assets and liabilities on initial recognition:
(a) market versus entity-specific measurement objectives, and
(b) differences in defining the value-affecting properties of assets and liabilities.[10]

6. Respondents strongly agree with the two fundamental sources of differences identified (83% of respondents who answered the question, or 39 respondents). Supportive respondents make the following recommendations and express the following concerns:

[9] Paragraph 68 of the main paper and paragraph 32 of the condensed paragraph.
[10] See Chapters 4 and 5 in the main paper or the condensed paper.

(a) Provide a more complete discussion of the reasons behind the differences between market-based measures and entity-specific measures at initial recognition. In practice, a respondent supposes that different measurement bases would be equal;

(b) Study value-affecting properties and market sources in further detail. Discussion of these differences should have been a "central core" to the paper (4 respondents);

(c) Consider in more detail other factors identified in the paper including information asymmetry, bid-ask spreads, market accessibility, and unit of account;

(d) Consider the concept of capital adopted, for example, current value concepts of capital that include operating capability and current cash equivalents (which involve a different treatment of transaction costs);

(e) Suspect there are other sources of differences to consider;

(f) Define and further elaborate the unit of account of assets or liabilities as the concept is a vital pre-condition for determining value-affecting properties;

(g) Distinguish between valuations based on entity inputs versus market inputs;

(h) Consider how certain entity-specific information, or private empirical data, may be of superior value to market data. (2 respondents) Such data excludes management intentions and is often requested by market participants. Accordingly, a respondent proposes that Management's Intention Measurement Objective, a third and least desirable measurement objective, be considered in order to differentiate these different sources of data; and

(i) Consider how the use of portfolio-specific information, that is not publicly available, may be appropriate when the information relates to the characteristics of an item and there is no indication that market participants would not reflect such information.

7. Those respondents that disagree provide the following rationale (8 respondents):

(a) Need to develop a better understanding, within accounting literature and the profession, of what constitutes a market and when a market measure should be used. Need to consider whether differences between a market measure and a measure derived by <u>any</u> sub group or observation of a market, including an entity preparing financial reports, is another fundamental source of differences;

(b) Paper does not explain how these sources produce actual differences between fair value and the other measurement bases;

(c) Question whether these sources of differences really apply;

(d) There is no consideration that different types of transactions (actual or hypothetical, past or future, entry or exit), types of markets (i.e. less active markets) or types of industries create differences (3 respondents);

(e) Disagree that differences are always between market and entity-specific as, where markets do not exist or are illiquid, individual transactions may be presumed to be fair value (paragraph 46 of condensed paper);

(f) Paper obscures the difference between measurement bases and the objective of financial reporting. The market-value measurement objective is not an objective in itself and should not be considered as such (2 respondents);

(g) Sources of differences are dependent upon the concept of income and the definitions of both assets and liabilities; and

(h) Paper focuses on differences that affect valuations instead of those that affect measurement bases, for example, the types of costs that should be included in historical cost measurement.

Q4. **Market value measurement objective and the essential properties of market value**[11]

(A) The paper proposes to define the market value measurement objective as to measure an asset or liability at the price it would be exchanged for under competitive market conditions, reflecting the market's expectations as to the amounts, timing and uncertainty of future cash flows discounted at market rates of return for commensurate risk.[12]

(B) The paper defines a market as a body of knowledgeable, willing, arm's length parties carrying out sufficiently extensive exchange transactions in an asset or liability to achieve its equilibrium price, reflecting the market expectation of earning or paying the market rate of return for commensurate risk on the measurement date.[13]

8. On the surface, a majority of respondents (53% or 33 respondents) agree with the paper that the objective of fair value should be to reflect market value. However, many of the respondents who agree qualify their agreement in regards to the "sufficiently extensive exchange transactions" assumption (20 respondents). 29 other respondents disagree.

9. Respondents that do not support the market value measurement objective, market definition or aspects of them cite the following reasons:

(a) Disagree specifically with the "equilibrium price" concept (11 respondents) as it is too theoretical or idealistic and there are no, or few, such markets where the competitive process equates supply and demand. These limitations should have

[11] Also refer to the analysis on "What does or should fair value purport to represent?" and "Interpretation of the market concept" in the Agenda Paper, paragraphs 43- 49 and 55-58, respectively.

[12] See the main paper, paragraphs 99-110 and 236-241, or the condensed paper, paragraphs 54-56 and 105-112.

[13] See the main paper, paragraph 107-110 or the condensed paper, paragraphs 55-56.

been discussed. Another respondent believes "a range of prices may be more appropriate in view of the inefficiencies of most markets;"

(b) Concerned or disagree, because markets in the real world are not fully efficient, perfect or complete (31 respondents), thus, such a perrequisite could lead to many markets being excluded for some financial assets and liabilities and many non-financial assets and liabilities;

(c) Several respondents question how finance theory applies to accounting and believe further analysis is needed as to its features, why it is appropriate, its implications and shortcomings of its application. If the paper is only assuming information-efficiency, but not perfect and complete markets, more references to the relevant finance literature should have been provided. Respondents struggle to understand how this approach will operate in the real world;

(d) Exclude the phrase "to achieve its equilibrium price" as the reference to "a body of … parties" is a practical acceptance of the pricing convention (2 respondents). Other respondents believe the concept is too idealistic;

(e) Prefer the Webster's dictionary definition of a market ("… a body of persons carrying on extensive transactions in a particular commodity") as markets do not have a degree of perfection – probably no market is perfect, even for frequently traded commodities as stocks and shares;

(f) Believe a market is created when two or more entities are able to bid for assets such that the price will be affected by their decisions. (2 respondents) Consistent with the Dictionary of Real Estate Appraisal's market definition being "A set of arrangements in which many buyer and sellers are brought together through the price mechanism";

(g) Believe a market is created when there is a willing seller and a willing buyer (4 respondents);

(h) Paper's market definition is contrary to the widely understood interpretation of market, which refers to all types of markets including active and inactive markets. In the paper's definition, refering to only one market of "semi-strong efficiency" is both redundant and misleading. Recommend a modified term, such as "active, well-informed liquid market";

(i) Recommend that the size of the market and number of transactions are considerations in the analysis process to develop a value opinion and should not be concepts embedded in the market definition;

(j) Prefer the active market definition in IAS 39 AG71 being "quoted prices [that] are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and … represent actual and regularly occurring market transactions on an arm's length basis";

(k) Question why the paper recommends "inventing" a hypothetical market, in preference to using historical prices of real transactions;

(l) Need to provide guidance on how "sufficiently" (5 respondents), including effect of market anomalies, and "body of knowledgeable, willing…parties" are to be interpreted or made operational (2 respondents). A respondent notes that there will inevitably be a debate on how effectively judgment has been exercised;

(m) Clarify that "arms length" parties means independent parties;

(n) Propose a fourth criteria being "legal and financial ability to transact" as proposed in the working draft of the FASB Fair Value Measurement Statement, and to make the concept of "market participants" as unequivocal as possible. Another respondent recommends adding "able" parties to restrict the use of the definition to preclude those who are unable to participate in market transactions due to regulatory requirements, e.g. in regulated industries like insurance;

(o) Recommend that "knowledgeable parties" and "arm's length transaction" should not be concepts embedded in the market definition;

(p) Need to consider the implications of different rules and practices in markets around the world on the "knowledgeable" criterion as the type and amount of publicly available information and expertise may vary between markets which are setting prices deemed to be "market values";

(q) Developing hypothetical market values and models based on subjective assumptions will not assist users in assessing the timing and uncertainty of cash flows; and

(r) Question how the paper would determine whether a transaction price was within the spread of market values or outside it? What significance would the paper give to different transaction prices? Further research is required in explaining the differences between individual and market prices.

(C) The paper proposes that the <u>fair value measurement objective</u> be derived from the market value measurement objective and is to estimate the exchange price that would result from a body of knowledgeable, willing, arm's length parties carrying out sufficiently extensive exchange transactions to achieve the equilibrium value for the asset or liability, given its liquidity limitations.[14]

10. Respondents made the following specific comments about the fair value measurement objective:

(a) Answer depends entirely on the objective or purpose of measuring assets and liabilities and is unrelated to how an item is valued or measured (2 respondents). A market value approach would be the most objective if the intent is to provide the price that could be achieved for those assets either through sale of the whole

[14] See the main paper, paragraph 111, 228-229 or the condensed paper, paragraph 102.

entity or if the asset is surplus. A cost based approach would be appropriate if the purpose is to provide investors and others with information on how management has managed its cash flows (2 respondents);

(b) Question why this objective is suitable for financial reporting purposes. Doubt that the measure of profitability is best served by measuring against market as most of the resulting gains and losses are either not realizable or will never be turned into cash;

(c) Disagree that fair value is to represent the market value of an asset or liability (2 respondents). Correlation of fair/market value is a basic assumption and is not supported by argumentation. Only certain standard setters have accepted this objective. EFRAG believes "this is a rather pointless debate about labels. If one starts by attempting to define fair value, we suspect that there is not a single correct view as to what 'fair value' represents—the term can mean what one wants it to mean. On the other hand, if one starts by concluding that a measurement basis that exhibits certain specified attributes is the one that should be used in financial statements and henceforth that measurement basis will be known as 'fair value', there will probably be a single correct view as to what 'fair value' means." [CL84]

(d) Agree with fair value objective except respondent recommends that fair value be explicitly distinguished from the market value measurement objective in respect of the number of market participants. Respondent believes that the exclusion of the active market requirement from the fair value definition is done on purpose and should be highlighted. This distinction recognizes that active markets do not exist for various assets and liabilities, yet will enable a single measurement basis to be applied as far as possible;

(e) Question use of market prices as the best indicator of fair value given prevalence of market imperfections resulting from irrational behaviour and inefficient markets; and

(f) Question the underlying reliance on market value when appropriate measures of fair value will depend on a range of factors. On initial recognition, assuming rational business decisions are made, the value of an asset is likely to be no less than its cost and no greater than that amount. There are limited circumstances when this assumption will not hold true, e.g. construct an asset.

Q5. **Entity-specific measurement objectives and relationship to management intentions**[15]

An entity-specific measurement objective looks to the expectations and risk preferences of management to assess the value of an asset or liability to the reporting entity by reflecting an entity's assumptions and intentions. [16]

[15] Also refer to the analysis on the "Interpretation and preference for entity-specific measurement objectives" in Agenda Paper, paragraphs 65-69.

[16] See the main paper, paragraph 99, 112-121, or the condensed paper, paragraphs 57-58.

11. Many more respondents agree with proposed definition compared with those that disagree (24 respondents versus 10), though certain respondents did not take a position (7 respondents). Respondents made the following comments:

    (a) Believe that measurements based on management's assumptions and expectations (and often some market expectations) provide a high degree of predictive value as they embody future cash-in and cash-out flows of assets and liabilities that reflect management's expected actual outcomes of future transactions (3 respondents). Results in better estimates than estimates based on hypothetical markets;

    (b) Users' role, not management's, is to assess and compare financial statements of different entities. Management is responsible for overall profitability and cash generation achieved by the one entity and should not be involved in comparing the entity's performance to the market's expectations;

    (c) Consider other reasons why an entity-specific value may differ from its value to others, such as known opportunities and synergies available to the entity;

    (d) Entity-specific measurement values are not necessarily different from market measurements when markets are not liquid or are inefficient. They could fall within a range of observable market measurements. Thus, entity-specific measurement values can be as relevant as market measurements in certain circumstances;

    (e) Ambiguity in the definition of "entity-specific", because financial reporting should reflect the economic resources controlled by the entity and the claims on those resources. Expectations should not affect measurement;

    (f) Disagree that economic constraints and opportunities are attributable to differences in expectations, such as volume purchase discounts or wholesale versus retail attributes. They are observable facts;

    (g) Disagree, as entity-specific measurement objectives are not necessarily driven by management intentions;

    (h) Need to distinguish between entity and management intentions (3 respondents), as it is hard to separate these different views;

    (i) Do need to consider management's intentions in certain situations, for example, if they intend to retire an asset (3 respondents). The entity's role is to assess the number of ways it can obtain value from an asset, excluding unrealistic options;

    (j) Recognize that entity-specific assumptions are subsumed into market prices as the entity is a market participant. A fundamental view that the paper does not recognize (2 respondents);

    (k) Irrelevant or difficult to see how management expectations and intentions affect initial measurement (3 respondents). For example, they do not affect the historical cost of an asset or liability on initial recognition, though such a cost is entity-specific. Consider certain exceptions, such as constructed assets;

(l) Paper obscures the difference between measurement bases and the objective of financial reporting. The entity-specific measurement objective is not an objective in itself and should not be considered as such (concern raised in response to Question 3, paragraph 7(i);

(m) Inconsistently used the term in the paper to describe any measurement basis other than fair value (3 respondents);

(n) Over simplified the categorization of inputs. For example, mortality tables are neither entity nor market specific, which can be verified and are often requested by market participants; and

(o) Recommend using the terms "observable" and "non-observable," used in the proposed FASB Fair Value Measurement Statement, to avoid confusion over the use of entity specific (non-observable) and market (observable).

Q6. **Superior relevance of market measurement objective**[17]
The paper compares the market and the entity-specific measurement objectives and proposes 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.[18]

12. Many more respondents disagree with these proposals then agree (35 respondents disagree versus 14). Respondents made the following comments:

Market measurements

(a) Believe that insufficient conceptual support or credible evidence to substantiate the superiority of the market measurement objective (22 respondents). For example, believe that insufficient reference or consideration is given to:
- How decision-usefulness is maximized;
- User needs or how they use market values in making resource allocation decisions;
- Stewardship objective, predictive value and their embodiment in assets and liabilities;
- Evaluating alternative concepts of capital;
- How information to assess future cash flows is improved;
- Efficiency of financial reporting or cost benefit constraints, especially when there is no active market;
- Theoretical or practical implications of arbitrage and price bubbles;
- How competitive forces work to resolve diverse expectations, which is an argument for greater reliability than greater relevance of the measure;

[17] Also refer to the analysis on the "Interpretation and preference for entity-specific measurement objectives" in Agenda Paper, paragraphs 65-69.
[18] See the main paper, paragraphs 122-129, or the condensed paper, paragraphs 59-61.

- Market-based prices are only spot or marginal prices agreed to between two market participants and do not reflect the value of the item from the perspective of all market participants;
- Impact of hypothetical market measurements;

(b) First need a common and clear understanding of what constitutes a market measurement;

(c) Observable market prices do not exist for many assets and liabilities (7 respondents). Proposals are based on financial markets which are not the norm or rare;

(d) Rejected entity-specific measurements too easily given that the analysis of markets did not consider non-active markets. (4 respondents) Challenge whether market measurements are superior in all circumstances;

(e) Assumes market information is publicly available and participants are knowledgeable, which is often limited in developing markets. Thus, entity-specific measurements will likely be used more in those markets;

(f) Conflicts with recent positions taken by the IASB in the *Management Commentary* paper and *Segment Reporting* Exposure Draft (5 respondents). If a management approach or entity-specific objective can provide information that greatly assists investors, as users will be able "to see through the eyes of management," why is a market measurement objective superior for determining an accurate value? ;

(g) Only applicable if an item has no unique features (2 respondents);

(h) Recommend that the proposal apply for items held for disposal (or trading) but not for items held for use in the business, which would result in more reliable measurements and more prudent recognition of gains and losses (2 respondents);

(i) Recommend historical cost on initial recognition (9 respondents) as:
- Transaction price represents initial investment cost, economic value or actual cash outflow;
- Result in a performance statement calculated on actual returns;
- Avoid day one gains or losses;
- Practical and should be used unless there is evidence to the contrary;
- If it differs from fair value, fair value should be used and day one gains and losses recognized;
- Represents the point of equilibrium between a buyer and a seller;

(j) Acceptance of the market value objective will result in use of more models based on subjective management decisions as majority of assets and liabilities have no observable market price. Not an acceptable alternative (3 respondents). Need to recognize that certain internally-generated intangibles are not measurable;

(k) Comparison table is helpful in analyzing how characteristics relate to decision usefulness but does not support why market measurements should be superior (4 respondents);

(l) Beliefs that paper is proposing a full fair value model[19];

Entity-specific measurements

(m) Provide greater predictive value than market measurements, thus, are more relevant to users (2 respondents);

(n) More consistent over time which creates more comparability over time and between entities (2 respondents);

(o) More applicable for on-going use and unique type items (2 respondents) — items which cannot be readily transferred or exchanged;

(p) More reliable than market values which may vary significantly between reporting dates;

(q) Consider how such information is utilized in business;

(r) Not always irrelevant or inferior to market measurements (2 respondents);

(s) Can be objective, verified by audit and improved by using some market information;

(t) Consider the use of private empirical data and entity-specific objectives that both exclude management intentions until realized and create a superior measurement (as described in Appendix A, paragraph 6(i));

(u) Preferred by users for measuring intangible assets;

Other

(v) Need to first determine the purposes of financial reporting before any measurement decisions can be made (2 respondents). Includes selecting what the performance statement should measure and when it should be measured, and assessing users' needs and preferences;

(w) Users are more interested in earnings than cash flows, thus, it is useless to compare to market value;

(x) Market and entity-specific measurement objectives reflect attributes of how measurements could be made but do not reflect the objectives of financial reporting (2 respondents); and

(y) Believe that the revised definition or interpretation of reliability is inappropriate.

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[19] See the Agenda Paper, *Expanding the use of fair value*, paragraph 73.

Q7. **One market (fair) value**
(A) The paper proposes that there can be only one market (fair) value for an asset or liability on a measurement date.[20]
(B) The paper proposes that differences between apparent market values for seemingly identical assets or liabilities on initial recognition may be attributable to:
(i) differences between the value-affecting properties of assets or liabilities traded in different markets, or
(ii) entity-specific charges or credits.
However, the paper notes the existence of multiple markets for some assets and liabilities, and the possibility that they may be due to market access restrictions that require further investigation.[21]

13. Many more respondents disagree with these proposals than agree (28 respondents versus 12). Another 8 respondents also provided comments without expressing agreement or disagreement with the proposals. Respondents made the following comments:

One market (fair) value

(a) Disagree or have concerns with the "only one market (fair) value" proposal given the existence and consideration of multiple markets, multiple market values or inefficient markets (36 respondents or 75% of those who commented). Yet, some respondents agree in theory or based on proposed market definition (9 respondents);

(b) Question why the paper makes this proposal when differences in market values and existence of multiple markets is acknowledged (4 respondents). No empirical evidence is provided to substantiate any of the paper's proposals which results in a fundamental flaw in the paper;

(c) Recommend historical cost as it is more relevant and reliable (4 respondents) given the difficulties in choosing a relevant market. There is no conclusive support to reject historical cost measurements on the basis that they can be manipulated by management. An entity should be expected to take rational actions and not pay more for an item than its value-in-use (otherwise, entity would incur a loss). Thus, fair value should include a transaction price negotiated between two knowledgeable parties at arm's length. The paper should focus on defining the nature and usefulness of the information given, rather than on any difference between the transaction price and supposed market value;

(d) Belief of multiple market values may be due to the lack of understanding of when market values exist and when fair value is implied from incomplete data (2 respondents);

(e) Most advantageous market concept is impracticable and not verifiable. There may be more than one reference market for an identical asset or liability;

[20] See the main paper, paragraphs 131-138, or the condensed paper, paragraph 62.
[21] See the main paper, paragraphs 131-138, 95-109 or the condensed paper, paragraph 63 and 74-82.

(f) Agrees that it is unnecessary to consider entry versus exit prices, though others feel this analysis is over simplified. Recommend that real world economic phenomena be analyzed in more detail to more fully understand the differences between entry and exit prices;

(g) Recommend a converged position with the FASB;

(h) Need to consider practical issues. Recommend that guidance, including examples, be provided for proposals to be operational (5 respondents). For example, how to compare securities in similar industries that are traded in different markets or determine fair value in volatile high tech industries and emerging markets. Such guidance should consider the range of counties and industries that apply IFRS;

(i) Consider the recommendation three on market valuation methods in the Special Report on Global Derivatives—Derivatives: Practices and Principles, issued by the Group of Thirty in July 1993. Those recommendations have been broadly implemented in certain industries and would provide further insight on the pricing and valuation of financial instruments;

(j) Consider the use of ranges of market prices as used in international taxation for transfer pricing. Refer to the discussion prescribing fair value measurements in OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations;

Differences between market values

(k) Attributable to more sources than identified. Respondents recommend considering differences between markets and market participants (3 respondents), such as:
- Different market locations;
- Differences between credit risk of the transacting parties;
- Imperfect knowledge or other inefficiencies;
- Existence of arbitrage opportunities;

(l) Attributable to other than value affecting properties (2 respondents) as could be linked to choices made by an entity, which would not necessarily be made by market participants, or due to the purchase of different quantities;

(m) Attributable to the use of different valuation techniques and different assumptions used when valuing identical assets or liabilities (5 respondents). Typically, such values are formulated in ranges in the absence of a transparent liquid market. Such variations impair the relevance and reliability of the measurements. Market values should not be based on hypothetical markets;

(n) Clarify what entity-specific charges are, though a few respondents agree that they are irrelevant to the market view; and

(o) Clarify what the measurement date means as market prices fluctuate throughout the day, or recommend the use of mid-market pricing conventions or the closing price.

14. A strong majority of respondents agree that more research is required on:
- Multiple markets;
- Nature and causes of price differences between markets;
- Information asymmetry;
- Irrational behaviours; and
- How the banking & finance industry provide prices for markets.

Q8. **Fair value of a promise to pay and consideration of credit risk**
The paper proposes 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.[22]

15. Many more respondents agree with this proposal than disagree (32 respondents versus 8). However, 12 of these respondents went on to raise concerns about what this principle holds for re-measurement. Respondents made the following comments:

Initial measurement

(a) Including credit risk will produce contradictory and economically unfaithful results (3 respondents). Practical difficulties of measuring own credit risk are overwhelming;

(b) Question how such information would improve the quality of financial reports (2 respondents). Historical cost is a more relevant measure on initial recognition;

(c) Including a discount for own credit risk will result in a value that will not represent the amount the contract will be settled at (3 respondents) – but an exchange amount. Reporting an amount lower then the settlement amount is contrary to what the holder/lender would demand, illegal, unfair trading practice and would violate state policyholder protection laws. Credit risk is reflected in the ongoing servicing cost of the liability;

(d) Substituting exchange for settlement reflects the market measurement perspective without providing sufficient justification;

(e) Distort an entity's financial position as certain liabilities cannot be traded, especially insurance liabilities;

(f) Does not consider real-world markets which are neither complete nor perfect and where asymmetric information between the lender and borrower cause prices differences (3 respondents);

[22] See the main paper, paragraphs 142-147, or the condensed paper, paragraph 65.

(g) Value of the receivable would be determined by adjusting the price to consider the risk of default, thus, would not equal the promise to pay (2 respondents);

(h) Differences will arise from discounting promises to pay at different rates, which reflect entity-specific measurement objectives. Respondent does not believe that discount factors can be set from a market perspective;

(i) View on the proposal depends on *when* a gain or loss would be recognized;

(j) Consider separately recognizing credit risk on balance sheet and income statement;

(k) Decrease comparability between entities for identical liabilities;

(l) Consider how differences in credit ratings determined by different rating agencies should be handled;

Re-measurement

(m) 12 respondents went beyond the paper to voice concerns of incorporating changes in own credit risk in the re-measurement of liabilities, for the following reasons:

- Assumes the entity is no longer a going concern;
- Significant concerns with measuring a liability at fair value, such as restrictions on the ability to discharge the liability;
- Not reliably measurable;
- Serious doubts about recognizing credit risk changes in income;
- Decline in credit risk would not generally be offset by impairment in asset as it is unlikely to be recognized, e.g. internally developed goodwill;
- Distort the entity's performance; and

(n) Recommend that gains arising from deteriorated credit risk should only be recognized on default.

16. Two respondents explain, that based on their experience in consumer markets, they see little evidence that credit risk directly affects the fair value of short term promises to pay that are exchanged for goods and services.

Q9. **Unit of account**

The paper proposes to define the unit of account of the asset or liability to be measured on initial recognition as follows:

(a) Individual item or portfolio is generally the unit of account in which the reporting entity has acquired the asset or incurred the liability[23];

(b) Level of aggregation for non-contractual assets is the lowest level of aggregation at which an identifiable asset is ready to contribute to the generation of future cash flows through its sale or use[24].

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[23] See the main paper, paragraphs 149-154, or the condensed paper, paragraphs 67-70.

[24] See the main paper, paragraphs 157-161, or the condensed paper, paragraphs 71-73.

17. Though more respondents agree with these proposals than those who disagree (17 respondents versus 9), many respondents note some concerns with respect to the unit of account issues without expressing agreement or disagreement with these proposals (15 respondents). Respondents made the following comments:

(a) First need to assess what the objectives of financial reporting are before decisions can be made about what and when changes in assets and liabilities are, should represent, or be recognized (11 respondents). What should the statement of financial performance and financial position portray? How and when should gains and losses on purchasing, construction and other performance factors be crystallized? And will it meet user needs?;

(b) Need to clearly describe the link between unit of account and market measurement objectives. Following the decision usefulness objective, the unit of account should be the lowest possible level of unbundled unit in the specific deal, unless each item is linked and can only be understood as one transaction;

(c) Concerns that the consequences of the proposal are unclear and focus on financial instruments. Issue is linked to recognition of day one gains or losses and needs to be further considered;

(d) Need to assess the proposal as part of a coherent, principle-based and working measurement theory, which is crucial to achieve comparable and enforceable standards;

(e) Recognize exceptions (3 respondents), such as self-constructed asset or those transferred within corporate group;

(f) Need to assess in conjunction with re-measurement (7 respondents). Consider guidance in IAS 39;

(g) Need a consistent approach on the use of block adjustments, both premiums and discounts, for all entities that use IFRS (2 respondents);

Individual item or portfolio

(h) Is an entity-specific assessment as it depends on the entity's intended usage - to bundle or unbundle the items (5 respondents);

(i) Depends whether the value of a portfolio equals the sum of the values of each item contained in the portfolio if they are to be valued separately (2 respondents). Assumptions are key. The business combinations project has demonstrated how the fair value of individual assets and liabilities may not add up to the price paid;

(j) For homogeneous items, the objective of measurement is to measure each asset and liability, therefore, to the extent possible, the unit of account should be each asset and liability;

(k) Need to consider how a market participant would price and manage the risk;

(l) Depends on the measurement base that will be used. If the item is recorded at historical cost, use the unit the item is acquired in. If fair value is used, report the unit that provides the highest value;

(m) Question how proposal is applicable on subsequent measurement;

Lowest level of aggregation to which non-contractual assets contributes to future cash flows

(n) Vacuous or imprecise proposal;

(o) Should be at a lower level than cash generating unit (4 respondents), otherwise contrary to the objective of financial statements. For example, a basket purchase of a plant and equipment should record the items separately - one level lower. A respondent recommends the unit of account in which each input is acquired in a market to which the entity has ready access. When there is a choice of such markets, the reference market should be that in which inputs can be most economically acquired (most advantageous market);

(p) Levels of aggregation could be different for various bases, for example, assess net realizable value of pieces of a plant, but for value in use expected future cash flows are assessed for the whole plant;

(q) For dissimilar items, the unit of account should facilitate subsequent measurement. For example, account for each performance obligation in a contract. This principle would apply to non-contractual assets, as well;

(r) Need to consider how aggregated assets need to be componentised in order to depreciate the components over different useful lives, and the implications for assets that are in the process of construction;

(s) Concerns as it will result in the recognition of gains and losses on non-contractual assets due to synergistic effects of aggregating inputs. Such information is vague and ambiguous - not decision useful;

(t) Use historical cost to measure constructed assets and other assets (2 respondents), given difficulty in obtaining a market measure for such assets. Then the unit of account does not matter;

(u) Need to provide more detailed guidance on what is meant by “contribution” to capital to make assessment operational;

(v) Need to develop guidance on how to handle the replacement of component parts of tangible assets (2 respondents); and

(w) Need to consider portfolio aggregation (2 respondents) and diversification as part of operating activities of a business.

Q10. **Best market source**

The paper proposes that, in many cases, the best market source on initial recognition is the market in which the asset or liability being measured was acquired or issued. However, some significant situations are noted in which a different source may be appropriate, and research is proposed into possible multiple markets[25].

18. Though more respondents agree with this proposal than those who disagree (19 respondents versus 3), many other respondents only share their concerns with the proposal without expressing agreement or disagreement with it (15 respondents). Respondents made the following comments:

    (a) As the paper suggests, more research is required (9 respondents), including assessing all the implications from the proposals. Some have difficulty with the analysis of possible exit prices for demand deposit liabilities (example in paragraph 173 of main paper on determining the appropriate market) and the pertinence of the information to investors;

    (b) Does not reflect practice or the real world (4 respondents), including the extent to which markets are disaggregated for identical items. When there are multiple values to consider, the most relevant one is the transacted price;

    (c) Further thought is needed on this issue as much of the analysis is based on the assumption of one fair value, which observable evidence shows in not valid (3 respondents);

    (d) Question why the paper rejects making a rebuttable presumption that fair value on initial recognition is the actual transaction value. Use of the market in which items are acquired will result in recording items at their historical cost;

    (e) Does not consider how the fair value of an asset can change depending on management's intentions;

    (f) Should not assume that the market value of all liabilities on initial recognition should be equivalent to the fair value of the assets received as the fair value of assets includes compensation for incurring those liabilities (recognition of the value added by the seller);

    (g) Respondent believes market participants are indifferent to how a particular set of liabilities are incurred. Thus, disagree that measuring obligations at a "reliably estimable exit market value" to overcome this market conundrum is a re-measurement issue. Recommend that the general rule should be to measure the market value of performance obligations on initial recognition using exit market values;

    (h) Should not use the exit market, the market in which items are normally sold, when determining which market to price items acquired in a bundle or group. Result in inconsistent measurement of these items (2 respondents). Another respondent recommends referring to the acquisition market for assets used in production of

[25] See the main paper, paragraphs 162-182, or the condensed paper, paragraphs 75-82.

goods and services, and the exit market in which the entity expects to sell an asset or liability for items which the entity intends to sell;

(i) Inconsistent with the principle that the market value of an asset or a liability is measured in the most advantageous market available to the entity. Results in measuring liabilities indirectly at the market value of assets received in exchange for incurring them, rather than considering the most advantageous market for extinguishing them, such as a business-to-business market instead of a retail market in which the liability is incurred. Recommend considering the most advantageous market concept proposed in the FASB Fair Value Measurement Statement (2 respondents). Yet, other respondents support not using this FASB concept. Where the most advantageous market price is not the price obtained by management, a loss would likely be recognized which implies judgement on management's stewardship. It will also create substantial administrative costs for minimal benefit;;

(j) Need to separately consider liabilities that are not created through exchanges to which the entity can control how it extinguishes the liability, such as taxes, long term environmental liabilities and legal claims (4 respondents). Recommend that such liabilities be initially measured based on the legal or contractual settlement required, or when the entity has a choice, based on the method which gives the lowest net cost of settlement. Recommendation may apply to some exchange incurred liabilities, such as long term employee benefits;

(k) For demand deposit floors, use of a minimum value or other accounting constraint is inconsistent with market approach. Raises the inconsistency between using an exchange (as proposed in the fair value definition) versus a settlement approach for determining the fair value of liabilities. Settlement approach is more relevant to lender or insurance policy holders (2 respondents);

(l) Ignores the existence of arbitrage between markets for identical items;

(m) If fair value is the measurement base, the appropriate market is the one in which an asset could be realized at the highest value or a liability settled or transferred at its lowest value;

(n) Argue that the proposal is considering different assumptions used in measuring the item, not different markets;

(o) Need to consider an approach for constructed assets. For example, when a building is constructed on a purchased piece of property;

(p) Based on an entity-specific view - not a market view;

(q) Highlights difficulties with the proposed approach. Not an issue if an item is measured at historical cost on initial recognition (3 respondents); and

(r) Issue should be dealt with in the scope of the Revenue Recognition project as it has direct impact on income. Therefore, it is premature to conclude.

Q11. ***Transaction costs***
The paper proposes that transaction costs, costs that are not recoverable in the marketplace on the measurement date, are not part of the fair value of an asset or liability on initial recognition.[26]

19. More respondents disagree with this proposal than those who agree (26 respondents versus 19). Some respondents only share their concerns with the proposal without expressing agreement or disagreement with it (11 respondents). Respondents made the following comments:

(a) Important issue because inefficiencies in the market, such as information risk, can result in significant transaction costs (4 respondents);

(b) Assess in relation to subsequent measurement (5 respondents), i.e. include transaction costs if assets or liabilities are to be carried subsequently at cost;

(c) Recommend using "irrevocable transaction cost" to describe the revised definition of transaction costs as users understand the term to include all transaction costs;

(d) Further analysis is required of the whole issue and as part of a separate paper (2 respondents) as:
- IFRS treatment is inconsistent when similar assets and liabilities are transacted for individually or are components of a business combination;
- Significant change in practice;
- Assess whether costs are priced in the market;

(e) Assumes markets are perfect (3 respondents), yet existence of transaction costs proves that markets are not efficient as proposed in the paper. This proposal is contradictory to other proposals (2 respondents);

(f) Need to provide more robust discussion to substantiate the proposal (3 respondents);

Include transaction costs
(g) Recommend that the recoverability of costs should be assessed in relation to whether they would be recovered through the entity's business operations, using either an in-use or stand-alone basis, depending on the nature of the asset (20 respondents). Transaction costs are part of determining the total return on assets. Splitting the costs is irrelevant to the business and not workable. Several respondents support the current practice of accounting for such costs;

(h) Willingness of entities to incur transaction costs proves that assets have a higher value in use (3 respondents). Consideration of these costs is part of the rational

[26] See the main paper, paragraphs 193-200, or the condensed paper, paragraphs 86-87.

economic decision process management follows to price and purchase assets (3 respondents);

(i) Assess whether the costs meet the definition of an asset in their own right. If they do not, then they should be expensed (4 respondents);

(j) Include transaction costs following the market and entity-specific measurement objectives;

(k) Interpret the fair value definition to include transaction costs;

(l) Often difficult to separate transaction costs from fair value on initial recognition as costs are embedded within the market price (2 respondents);

(m) Transaction costs are incurred to counter, or are due to, market inefficiencies (3 respondents) and should not be separated from the purchase price, as incurring them is likely to impact the agreed upon price;

(n) Relevant to include as other market participants will incur such costs (4 respondents);

(o) Obtain a proper matching of revenue and expenses (4 respondents);

(p) Consistent with guidance in existing IFRS (4 respondents), excluding impairment. Consider why IAS 39 does not distinguish between transaction costs that are recoverable and those that are not (2 respondents);

Exclude transaction costs

(q) Transaction costs are not relevant to assessing the fair value of an asset or liability at the valuation date;

(r) Agree for financial or held for trading items (4 respondents);

(s) Consider implementation problems (2 respondents), especially for non-financial items; and

(t) Concerned with the treatment of expensing such costs on initial recognition.

Q12. **Select the most relevant measurement basis**

The paper proposes that, when more than one measurement basis achieves an acceptable level of reliability, the most relevant of these bases should be selected[27].

20. More respondents agree with this proposal than those who disagree (26 respondents versus 13) and some respondents only share their concerns with the proposal without expressing agreement or disagreement with it (5 respondents). Respondents made the following comments:

[27] See the main paper, paragraph 202, or the condensed paper, paragraph 89.

(a) Need to consider the objectives of financial reporting and the relationship between the balance sheet and income statement, focusing on providing information that is relevant to users (2 respondents), before deciding which measurement base should be used;

(b) Significantly different views as to what reliability actually means and how it interacts with the relevance test;

(c) Concerns about ranking relevance over reliability:
- Insufficient support (4 respondents), for example, the paper assumes that users, if given a choice, will always sacrifice reliability in favour of relevance;
- Consider other applicable qualitative characteristics as well as relevance (3 respondents) to achieve accountability to shareholders and meet financial statement objectives;
- View reliability as a constraint when it has equal status with relevance in the framework;
- Reasoning to support relevance is couched in terms of reliability[28];Does not provide a valid basis for choosing one measurement rather than another;

Several respondents support the equal standing of relevance and reliability as currently described in the existing conceptual framework. A respondent believes that in most instances any trade off for more relevance at the sacrifice of reliability will not be worth it;

(d) Focus on maximizing both relevance and reliability (3 respondents) as they are inter-related measures. To achieve the objective of financial reporting is to provide the maximum of usefulness which "is a combination of both characteristics where the marginal change in either is just equal. … A clear ranking of alternative measures can only be drawn if two measures exhibit similar reliability but differ in relevance, or vice versa. Any other trade off requires consideration of the relative change in reliability and relevance." [Austrian Financial Reporting and Auditing Committee - CL 11] For example, a highly uncertain estimate might be less relevant than historical cost in practice;

(e) Challenge the use of an "acceptable reliability threshold" (3 respondents) as it is contrary to the approaches taken in current IASB projects and requires interpretation. Need to explain how and to what extent this approach deviates from the existing framework;

(f) Believe there is no reason to place greater importance on relevance than reliability if an acceptable level of reliability cannot be achieved. The Accounting Standards Board *Statement of Principles* states: "When the most relevant information is not the most reliable,…it will usually be appropriate to use the information that is the most relevant of whichever information is reliable". (*Chapter 3.34, paragraph 202).* Recognize that the proposed ranking is consistent with other IASB standards' decisions, including ED8 on Operating Segments;

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28 Also see Agenda Paper, What does or should fair value purport to represent?, paragraph 44.

(g) Provide guidance on the use an "acceptable reliability threshold" (7 respondents) by:
- Defining the specific criteria each measurement basis needs to meet to reach the threshold;
- Explaining that acceptable level of reliability can be reached if and only if the asset or liability purports to portray the future cash-in and cash-out expected to arise, not a representation of future cash flows based on assumptions estranged to entity's business model or operations [ACTEO, AFEP & MEDEF – CL 31];
- Preventing reliable or a relative level being interpreted differently among jurisdictions—for instance, it is our observation that what one would deem as an "acceptable level of reliability" in a developed country would be quite different from an "acceptable level of reliability" determined in a developing country. [International Financial Reporting Standards Review Committee, Korea - CL26];

(h) Paper's proposal will result in similar items being recognised using different measurement bases, thus, will reduce comparability and understandability of financial information;

(i) Consider assessment in IAS 39 which further explores this issue;

(j) In practice trade-off decisions between reliability and relevance are much more complex. Other issues need to be taken into account, such as:
- Other recognition criteria;
- Post-recognition issues;
- Performance measurement, presentation and disclosure matters;

(k) Evaluate the information content and relevance of aggregations of different measurement bases within financial reports;

(l) Disclosure is not an acceptable way to deal with lack of reliability in a measurement; and

(m) Difficult to evaluate a proposal in isolation of the broader discussion on measurement;

Q13. **Reliability limitations**
The paper proposes two sources of limitations on measurement reliability:
(a) Estimation uncertainty involves a judgment about an uncertain existing condition or future outcome; and
(b) Economic indeterminacy arises when it is not possible to define a phenomenon in sufficiently concrete terms to enable it to be validly quantified, at least without making significant limiting assumptions.[29]

21. Respondents strongly agree with the proposal (31 respondents versus one who disagrees) and a few only share their concerns with the proposal without expressing agreement or disagreement with it (5 respondents). Respondents made the following comments and suggestions:

    (a) Define, understand and make the "acceptable reliability threshold" operational (13 respondents) (refer to comments made in Q12). Guidance is needed so the exercise of professional judgement is not arbitrary. The degree of measurement precision associated with the required or desired level of confidence or risk should also be established;

    (b) Concerns as financial statements cannot provide relevant information if the reliability threshold is set too low. Respondent believes this concern is another substantial flaw in the paper;

    (c) Clarify the distinction between an accounting estimate and the technical term "estimate," as an accounting estimate is not certain and is not necessarily developed using a statistical or other technical approach;

    (d) Need to analyze these concepts in further depth (2 respondents);

    (e) Not convinced why the discussion paper narrows the concept of reliability to "faithful representation" which contradicts the Framework;

    (f) Two reliability limitations proposed also apply to relevance and need to be discussed;

    (g) Existence of market inefficiencies, such as multiple market prices and non-active markets, makes it harder to achieve a reliable measurement of market value in many cases (3 respondents). Another respondent is unsure whether all uncertainties relating to measurement at market value can be classified into the two proposed categories;

    Estimation uncertainty

    (h) Clarify statements like "accounting measurement cannot avoid some degree of estimation uncertainty" as it implies that it is a minor issue when it can be quite large. Need to determine lower and upper limits that are reliably determinable so that relevant information is not ignored even if it has a larger degree of estimation uncertainty;

[29] See the main paper, paragraphs 204-216, or the condensed paper, paragraphs 90-100.

(i) Impossible to prove the range of possible outcomes and the respective probabilities given practical difficulties (2 respondents);

(j) Estimation uncertainty cannot be alleviated by disclosures like economic indeterminacy – this is a substantial difference between the two limitations;

(k) More clearly distinguish volatility from estimation uncertainty by referring to "uncertainty of the value over time" versus "volatility of the value over time**";**

Economic indeterminacy

(l) Recommend that the concept be clarified as it is vague by (2 respondents):
- Explaining what it covers;
- Providing examples;

(m) Disclosing the allocation formula will provide useful information and will mitigate this limitation; and

(n) Estimates subject to "economic indeterminacy" are not more immune to measurement bias than those subject to "estimation uncertainty" as those estimates are as susceptible to measurement bias as estimates requiring allocations, e.g. consider uncertainties involving estimates of future cash flows to be received from a loan receivable.

Q14. **Fair value is the most relevant measure**
The paper proposes that fair value is the most relevant measure of assets and liabilities on initial recognition, and therefore should be used when it can be estimated with acceptable reliability[30].

22. More respondents disagree with this proposal than those who agree (43% of total respondents disagree or 36 respondents, versus 17 who agree). Respondents made the following comments:

(a) Need to consider the objectives of financial reporting and the relationship between the balance sheet and income statement, focusing on providing information that is relevant to users (9 respondents), before selecting the most relevant measurement base;

(b) Debate should be focused on, or should now consider, re-measurement (8 respondents), and only then consider initial measurement. For an asset or liability re-measured at fair value, the measurement base used at initial recognition is irrelevant. Though, one respondent notes that initial measurement is important as it "calibrates" the model;

[30] See the main paper, chapter 7 and paragraphs 410-415, or the condensed paper, chapter 7 and paragraphs 179-180.

(c) Accept the use of fair value if efficient markets exist and it can be reliably estimated (8 respondents);

(d) Insufficient support for the proposal (23 respondents) – the paper "fails to convince". Certain respondents believe the paper is advocating full fair value accounting;

(e) Satisfying a sufficient reliability threshold is a critical condition to assessing a fair value estimate. A few respondents said that fair values cannot be determined reliably;

(f) Raise the following concerns about fair value measurements (many respondents express one or more of these concerns):
- Perfect and complete markets are rare;
- Consider real world practicalities;
- Vast majority of assets and liabilities have no observable market price;
- Whether a market *exit* value provides the most appropriate portrayal of the entity's financial position;
- Consider information asymmetry;
- Measurement models are imperfect and have limited verifiability and objectivity;
- Subjective and subject to manipulation;
- Use of hypothetical markets;
- Reliability of the estimates, especially in jurisdictions with developing markets;
- Recognize gains and losses which may never realize;
- Less objective financial statements;
- Increase in volatility in earnings;
- How it improves decision usefulness;
- How users will use the values to make resource allocation decisions;
- Not necessarily relevant in <u>all</u> situations;
- Not considered in management's decision making process;

(g) Distinguish between types of assets and liabilities, i.e. those held for trading versus those held for use (several respondents);

(h) Develop more consistent and high quality guidance for non-quoted items;

(i) Explain or justify why fair value is appropriate in specific existing standards;

Recommendations as to which is the most relevant measure

(j) Historical cost is the most relevant measure on initial recognition as it is objective, understandable, neutral, verifiable, inexpensive to obtain, creates meaningful performance to demonstrate management's stewardship of resources and is better for predicting cash flows (many respondents). Respondents recommend:

- For quite a lot of transactions, the transaction price is the best evidence of fair value as it represents the amount paid (6 respondents);
- Historical cost and fair value are the same on initial recognition in most exchange transactions in most economies (5 respondents). Therefore, it can be assumed to be the same unless there is clear evidence to the contrary;
- There are circumstances in which fair value can provide a pragmatically acceptable proxy for historical cost, e.g. where there is no separable consideration (2 respondents);
- Use historical cost unless it differs from fair value, as all costs directly attributable to acquisition of assets should be included on initial measurement, including transaction costs;

(k) Current cost is worthy of consideration as a measurement base to be used on initial recognition for assets acquired in business combinations, received by way of donation or grant. Expect current cost would not give a materially different initial carrying amount than historical cost, except in limited cases, yet would be more helpful on re-measurement;

(l) Value in use is more appropriate in some cases where the fair value is irrelevant, such as when an entity has no intention to sell an asset;

(m) Deprival value, determined using reliable market based information, will equate to a market value rather than fair value. Another respondent recommends deprival value as it measures the capacity of the entity to continue to provide goods and services in its current line of business. Depreciation based on deprival values provides the necessary inputs to assess the entity's ability to recover its costs, generate returns and future cash flows;

(n) Current cash equivalents (net market values) should be used if the measurement objective is to assess the entity's financial flexibility. Values for assets would usually be based on the asset's highest and best use determined by the market, unless it is specialized equipment for which there are no available buyers, then need to use its scrap value;

(o) Determination of the most relevant measure should be based on or consider:

- Purpose of the information;
- Nature of the item (e.g. asset for resale or for use in operations, financial versus non-financial) (4 respondents);
- Other qualitative characteristics, including usefulness and predictive value;
- How gains and losses arise and what those gains and losses tell users of the financial statements about the financial performance of the entity;

- What works in practice (2 respondents);
- Cost benefit implications, such as the additional record keeping costs due to possible changes to accounting systems to track items at fair value for the balance sheet and at their cash or cash equivalents for the cash flow statement (6 respondents);
- Presentation and disclosure effects;

(p) Need a clear understanding of what exactly fair value is;

(q) Consider the use of private empirical data which is neither entity-specific nor market based, yet relevant and verifiable; and

(r) Need to explore such measurement issues with users of financial statements (4 respondents). Create an Investor Task Force, like FASB, to obtain user feedback on whether such accounting treatments and disclosures are decision useful.

Q15. **When fair value cannot be reliably estimated**
The paper proposes that fair value is not capable of reliable estimation in some common situations on initial recognition and that:
(a) A single transaction exchange price should not be accepted to be equal to fair value unless there is persuasive evidence that it is; and
(b) A measurement model or technique cannot be considered to achieve a reliable estimation of the fair value of an asset or liability when the estimate depends significantly on entity-specific expectations that cannot be demonstrated to be consistent with market expectations[31].

23. Respondents strongly agree that fair value is not capable of reliable estimation in many common situations on initial recognition.

24. More respondents agree with the proposals (a) and (b) than those that disagree (25 respondents versus 9), though some qualify their support. A few respondents share their concerns with the proposals without expressing agreement or disagreement with them (4 respondents). Respondents made the following comments/suggestions:

(a) Provide additional guidance on the definition of “market”;

(b) Proposals are contradictory to the pure finance theory or underlying concepts of market efficiency (3 respondents);

(c) Support these proposals as in many situations a reliable fair value could not be estimated without substantial cost, time and effort (3 respondents). The costs of developing models would exceed the benefits in all cases;

(d) Need further guidance on determining what makes an estimate reliable;

Single transaction

[31] See the main paper, paragraphs 232-277, or the condensed paper, paragraphs 104 and 106-118.

(e) Propose the opposite, a presumptive requirement – that a recent transaction exchange price provides strong evidence of market value or current value unless there is clear evidence to the contrary (14 respondents). To reject this evidence unless there is persuasive evidence is too strong, not practical and too costly. A respondent believes that a bargain, or paying more then fair value, would be persuasive market evidence that the price or amount does not reflect fair value. Recommendation is supported by the business combinations proposals;

(f) Propose to adopt a business judgment assumption - similar to the going concern assumption - that management does its best given the circumstances to negotiate a price for common transactions. Management would report the price negotiated as a fair value. This assumption would minimize the complexities of measuring fair value at initial recognition;

(g) Historical cost should be considered a legitimate market price for constructed assets;

(h) Agree that few infrequent observable transactions do not constitute a market, thus, a transaction price may not or should not be assumed to be a fair value (3 respondents);

(i) IASB Framework does not specify verifiability as an essential aspect of reliability (or faithful representation). Verification provides assurance that the information is reliable. However, lack of such assurance does not necessarily mean the information is not reliable;

Models or techniques

(j) Consider practical difficulties in estimating fair value for most assets and liabilities for which no highly-perfect market exists;

(k) Hard to envision a practical situation where only non-entity specific information could be used where no market exists for the item;

(l) No fair value model does not rely on entity-specific inputs. Disclosure of entity-specific assumptions is critical to enable users to make their own judgements. Another respondent believes that it is reasonable to assume that the “best estimate” of a knowledgeable market player might be the best approximation of “fair value”. Thus, it will neither be possible nor necessary to demonstrate that the estimation based on entity-specific expectations is “consistent with market expectations” as the entity is a market player;

(m) In practice, the distinction between types of input are hard to identify as an entity influences market expectations;

(n) Evidence of entity-specific performance and expectations can often be supported by reference to that asset in the hands of an averagely competent operator in the market. Therefore, such information can be used to obtain a reliable estimate of fair value from a market perspective (2 respondents);

(o) Consider the use of empirical private data as a reliable information source in absence of efficient market data; and

(p) Allow for other methods of valuation in unique circumstances.

Q16. **Comparison of measurement bases**
The paper analyses and concludes, with respect to the comparative relevance and reliability of historical cost, current cost - reproduction cost and replacement cost, net realizable value, value in use, and deprival value, on initial recognition that:

(a) ***Historical cost*** *can be accepted as a relevant and reliable substitute for fair value on initial recognition when fair value is not reliably estimable, if it is reasonable to assume that the historical cost amount is recoverable (if an asset) or represents the amount owning (if a liability);*

(b) ***Current cost*** *be used in preference to historical cost as a substitute for fair value when it is capable of reliable estimation, and it is reasonable to assume that it is recoverable (if an asset) or reasonably represents the amount owing (if a liability). When the above conditions for the use of current cost, or current consideration amount, are not met, it is proposed that historical cost is an acceptable substitute when it is capable of reliable measurement and it is reasonable to assume that the historical cost amount is recoverable (if an asset) or reasonably represents the amount owing (if a liability);*

(c) ***Net realizable value*** *is a less relevant measurement basis than fair value, thus, there is no role for net realizable value, as traditionally defined;*

(d) ***Value in use****, defined as an entity-specific objective, is not an appropriate substitute for fair value on initial recognition. However, a present value-based estimate of future net cash flows to be received or paid in respect of an asset or liability may be an acceptable estimate of fair value, if the future cash flows and discount rate(s) can be reliably estimated and the estimate is determined on a basis as consistent as possible with the fair value measurement objective. When such an estimate is significantly dependent on entity-specific expectations that cannot be justified to be the same as market expectations, it should be considered to be a hybrid measurement basis substitute for fair value; and*

(e) ***Deprival value*** *is used when the fair value of an asset cannot be reliably estimated. The "deprival value" decision rule be restated to be the lower of current cost and recoverable amount, with recoverable amount being the higher of realizable value and the present value of the future net cash inflows to be generated by the asset.*

Current cost would be replacement cost, or failing its reliable measurement, reproduction cost. If current cost is not capable of reliable measurement, historical cost would be considered an appropriate substitute on initial recognition if it is *capable of reliable measurement. Each of these measurement bases would be applied as consistently as possible with the fair value measurement objective.*[32]

25. Many respondents raise concerns with the comparison and share different views, though a similar number of respondents disagree, agree or only provide comments without expressing agreement or disagreement with it (16 respondents disagree, 11 agree and 15 provided comments). Their concerns and views are outlined below:

(a) Approach and presentation of the measurement base comparison is biased (21 respondents) as the market measurement objective is assumed to be superior. For example, as a result, the strengths of fair value and weaknesses of historical cost are overstated, and the weaknesses of fair value and strengths of historical cost are understated. If one looks beyond this and takes into account that usually there will not be an efficient market for the asset or liability involved, the arguments used are not very convincing (5 respondents);

(b) Comparison should have (many respondents):
- Been drafted using a neutral tone and language;
- Evaluated the pros and cons of the various measurement bases;
- Evaluated the affect of the sources of differences on the various measurement bases;
- Illustrated how each measurement basis is likely to best serve decision usefulness and predictive value, and how and why it could be impeded from doing so;
- Provided empirical evidence from users, investors and preparers to support the proposals;
- Considered re-measurement;

(c) A single measurement objective is not sufficient to achieve the objective of financial reporting. Recommend measurement objectives need to be chosen according to the purpose of the investment, i.e. historical cost for non-financial investments and fair value for financial investments;

26. *Fair Value*
(a) Market value of an asset based on a hypothetical market would not be more reliable than an entity-specific measurement, when a market does not exist for the asset;

32 See the main paper, paragraphs 281-409, or the condensed paper, paragraphs 120-178.

(b) May not offer greater relevance than some of the other measurement bases, when the underlying assumption of fair value - that fair value will reflect the single highest value for that asset or liability, commensurate with the attendant level of risk - is only operational for commodity-type items where there is an established market and constant and active trading;

(c) Paper judges other measurement bases to be of lesser ranking than fair value since they do not include the concept of recoverability, yet, the respondent believes there is little mention made of recoverability in the fair value discussion;

(d) Proper evaluation of the implications of the sources of differences, being market versus entity-specific measurement objectives and differences in value-affecting properties, would have led away from placing reliance on fair value when there is a known historical cost;

(e) Not neutral if significant day one profits or losses are reported (2 respondents);

(f) Not a relevant measure for liabilities not incurred in an exchange or that are not normally exchanged (e.g., income taxes), as fair value implies an exchange transaction;

(g) Not a separate basis of valuation but a generic term which, subject to reliability, incorporates all other proposed terms, except historical cost;

27. *Historical cost*

(a) Disagree with the case made again historical cost as:

- Rational management would only pay the amount it expects, at least, to receive in future cash flows for the asset (5 respondents) - this is the asset's fair value at initial recognition or a good surrogate for fair value. Therefore, historical cost can be recovered and is relevant, compared to fair value;
- Expect fair value and historical cost to be similar in normal situations or in efficient markets (6 respondents). The paper should have analysed when the amounts are different to understand the reasons for the differences, before proposing any conclusions (2 respondents);
- Agreed-upon price in a real transaction (2 respondents), viewed through the eyes of management, is highly reliable and more decision-useful;
- Provides funding information for owners to evaluate and hold management accountable, compared to other measurement bases.
- No need for an additional market test;
- Supported by extensive practical experience;
- Different entity-specific measure compared to other entity-specific measures (5 respondents) as it excludes management's intentions, assumption and arguments. Arguments used to dismiss entity-specific measures do not apply to historical cost. The paper does not recognize this and does not use the term consistently (2 respondents);
- Matching of historical costs does *not* result in a less informative matching of costs and revenues in later periods (3 respondents). The market value approach does not better satisfy the matching objective;

- Provides a better indication of future net income of the entity – has more predictive value than fair value;
- Does not lack reliability because pre-recognition costs are not capitalized in accordance with IFRS (3 respondents);
- Recoverability of an asset measured at cost is not more difficult to determine than when it is measured on another basis (2 respondents). Assessing historical cost against a recoverable amount will provide much better information to financial statement users when such costs are no longer expected to be recovered and not simply combined with other period expenses. Recoverability implies re-measurement;
- Practical necessity;

(b) Discuss the objective of measuring assets at historical cost to enable assessments of the entity's performance in generating returns on the nominal amount of capital invested in the entity's assets;

(c) Agree allocations create economic indeterminacy but they should be based on a justified and acceptable rationale. Allocations are considered part of the art of modelling;

(d) Rank historical cost over current cost as it is no more rational then current cost – reflects rational business actions;

(e) Consider whether historical cost is a valid substitute for the fair value of tangible current and non-current assets;

28. *Current cost*

(a) Over simplified the arguments (3 respondents). Yet, another respondent believes that the meaning and relevance of current cost base is not convincing, even in times of significant inflation;

(b) Only relevant if the entity will replace the asset or at least its function and capacity (2 respondents);

(c) Material limitations on the reliability of these measurement bases. On the other hand, a different respondent believes the paper overemphasized the difficulties of reliably estimating replacement cost. For many valuable assets used by entities, there are few alternative uses for the assets and the role of the asset in the entity's operation is usually clear and its value determinable;

(d) Paper argues that "historical cost purports to measure what was paid for an asset or received for a liability, while current cost purports to measure the most economic amount that rationally could have been paid or received on initial recognition". Question why current cost has more information value than historical cost, and why using the current cost measurement basis results in more relevant information than the alternative bases available. The rationale for these assessments needs to be demonstrated;

(e) Use is not welcomed based on past experience. Current cost was used during inflationary period of the 1970's and 1980's in the United Kingdom but was dropped because it was difficult for both preparers and users to understand and was often seen as either unreliable, irrelevant or both (2 respondents);

(f) IFRS allows replacement cost as proxy for fair value when no-market based measure is available. For example, in IAS 16 and IFRS 3;

29. *Net realizable value*

(a) Not convinced as the relevance of the measure is impacted by entity-specific factors;

(b) No role for this measure except where assets are acquired exclusively for resale in business combinations or multiple-element package transactions;

(c) Irrelevant on initial recognition (2 respondents);

30. *Value in use*

(a) Close substitute in theory to fair value since it takes into account future cash flows to be derived from the asset but is usually developed through entity specific expectations, thus, reliability and objectivity is subject to debate;

(b) Present value techniques may allow the technique to be used to estimate fair value, provided stringent conditions are imposed to ensure representational faithfulness of the measure;

(c) Superior to fair value (2 respondents) as it is based on management's expectation, but is not capable of reliable estimation on re-measurement;

(d) Not a relevant initial measurement basis for an asset if the cash flows can only be identified at a level higher then the asset - the cash generating unit level;

(e) Irrelevant on initial recognition (2 respondents);

31. *Deprival value*

(a) Includes an implicit hierarchy of applicability of information which is substantially underpinned by market-based information, when reliable information is available and relevant. From this perspective, deprival value, rather than fair value, equates to the market view of value in use. Thus, where the entity's costs differ from the cost other market participants would bear, fair value systematically underestimates 'market value in use' by an amount corresponding to transaction costs. Respondent views deprival value as a more relevant measure when viewed from a market perspective;

(b) Is not relevant (5 respondents) and should be only considered on re-measurement, yet in theory it is the best method as it covers the most logical approach that a manager would adopt in a given situation;

(c) Need to explain why the deprival value measurement would not improve the decision usefulness of financial statements, compared to mere disclosure. Such information is utilized by investors in assessing management performance, therefore, there could be advantages in having fully congruent internal and external measurements;

(d) Decrease comparability as both net realizable value and value in use are entity-specific values which are subject to insider information and information asymmetry;

(e) Lack of consideration paid to this basis. Need to consider applying this measurement basis. For example, are assets that cannot be measured at market value subject to impairment tests on initial recognition, as implied by this basis?;

(f) If historical cost is determinable, deprival value should only be applied on re-measurement; and

(g) Complex and time consuming to calculate (2 respondents) and thus, unsuitable. Need to asses whether the benefits outweigh the costs of using this measure.

Q17. **Substitutes for fair value**
The paper proposes that when other measurement bases are used as substitutes for fair value on initial recognition, they should be applied on basis as consistent as possible with the fair value measurement objective.[33]

32. More respondents disagree with the proposal then those that agree (20 respondents versus 10). Many respondents share their concerns with the proposal without expressing agreement or disagreement with them (12 respondents). Respondents made the following comments and suggestions:

Use of substitutes

(a) Disagree with the use of substitute measurement bases when fair value is not reliably measurable as:
- Disagree with the fair value measurement objective or that it is superior (5 respondents) without sufficient evidence of its superiority. Thus, the paper is considered biased (3 respondents);
- The proposed substitute measures lack relevance or will not be the most relevant (10 respondents);
- There must be a reason to use substitutes (7 respondents), such as the absence of active markets. Thus, it would be difficult, or inappropriate to apply the fair value measurement objective when using other measurement bases;
- Significant reliability concerns with the substitutes;
- Time consuming and expensive to use substitutes;
- Paper places too much emphasis on the consistent application of the fair value measurement objective (3 respondents). A respondent acknowledges that a mixed measurement model might help to resolve this problem;

[33] See the main paper, paragraph 417, or the condensed paper, paragraph 186.

(b) Need to question how frequently and in what circumstances it will be impossible to make a reliable estimate of fair value. If this difficulty is too widespread then fair value is not a viable measurement basis;

(c) Disagree with using substitute measures for fair value as the only circumstances in which fair value cannot be reliably estimated (on initial recognition or subsequently) are when assets and liabilities fail the reliability criterion for recognition using *any* measurement basis. Respondent views "substitutes" as fair value estimates;

(d) Reservation about describing a measure that is found in an inactive market as fair value;

(e) Recommend that historical cost should be used instead (2 respondents), except for assets held for trading, as it is a superior and an easier option then fair value;

(f) Support decision not to call substitute measurement bases "fair value" but prefer the use of labels that highlight their differences in methodology. Labelling substitute measurements as fair value measurements will cause confusion (2 respondents);

(g) Disagree, as any of these bases *may represent* fair value in particular circumstances;

(h) Historical cost should not be positioned as a substitute for fair value as respondent believes that historical cost is a more appropriate measure on initial recognition unless it clearly differs from fair value;

(i) Support current practice to disclose the measurement bases, which enables any user to make his/her own conclusions;

(j) Clarify how substitutes are to be applied, i.e., if acquisitions are required to be measured at fair value of the acquiree, it could well be historical cost;

(k) Clarify and strengthen the understanding of what constitutes a market, to understand the full meaning of "consistent as possible with fair value measurement objective";

Use of models

(l) Process of market resolution[34] is of course not applied in a valuation model or technique undertaken by management. Respondent is doubtful that the objective of estimating fair value that incorporates assumptions market participants would use would truly be achieved in most circumstances;

[34] As proposed in the main paper, paragraph 102.

(m) Market value objective might be considered understandable, but valuation models and techniques are often complex and may require specialised knowledge both to apply and to interpret;

(n) Reliability limitations (2 respondents) are often significant and different techniques often yield very different results. Models are of course highly sensitive to certain inputs. Respondent believes that a wide range of estimation uncertainty in a fair value estimate is at least a strong indicator of lack of reliability;

(o) Use of valuation models and techniques adds cost and complexity for preparers and auditors (2 respondents); and

(p) Consider the use of private empirical data which is neither entity-specific nor market based, yet relevant and verifiable.

Q18. **Proposed measurement hierarchy**
This paper proposes that the fair value of an asset or liability can be estimated with an acceptable level of reliability on initial recognition when either of the following conditions is met:

Level 1: There is an observable market price for assets or liabilities that are identical or similar to the asset or liability to be measured on or near the time of initial recognition, and reliable adjustment consistent with market expectations can be made for (i) any differences between the market-traded assets or liabilities and the asset or liability being measured and (ii) any time difference.

Level 2: Failing an observable market price meeting the conditions of Level 1, there is an accepted model or technique for estimating the market price of the asset or liability to be measured on initial recognition, and all significant inputs reflect observable market prices or reliably measurable phenomena that can be expected to be the basis of market participants' determinations within the model or technique.

Substitutes for Fair Value – Levels 3 and 4

Level 3: Estimates of current cost: Failing the ability to estimate fair value with acceptable reliability (that is, to meet the conditions of Levels 1 or 2):

(a) an asset should be measured on initial recognition at its current cost, provided that this amount can be reliably estimated and can be reasonably expected to be recoverable; and

(b) a liability should be measured on initial recognition at its current consideration amount, provided that this amount can be reliably estimated and can be reasonably expected to represent the amount owed.

The paper proposes that historical cost might often be acceptable in lieu of current cost on initial recognition.

Level 4: Models or techniques that depend significantly on entity-specific expectations: If the conditions of Levels 1, 2 or 3 cannot be met, an asset or liability should be measured on initial recognition on the basis of an accepted model or technique.

> *To the extent that reliable market-based data are unavailable, the measurement model or technique should use reliably estimable entity-specific data that are not demonstrably inconsistent with observable market expectations.*[35]

33. More respondents disagree with the proposed hierarchy then those that agree (26 respondents versus 10). Many other respondents share their concerns with the proposed hierarchy without expressing agreement or disagreement with it (13 respondents). Respondents made the following comments and suggestions:

    (a) Need to consider the objectives of financial reporting and the relationship between the balance sheet and income statement, focusing on providing information that is relevant to users (2 respondents), before discussing a measurement hierarchy;

    (b) Need to consider the re-measurement aspects of the puzzle before assessing the proposed measurement hierarchy;

    (c) Not convinced by the superiority of the market measurement objective (5 respondents), thus, not provided any comments on this proposal. The paper did not provide sufficient support to demonstrate the superior relevance of market measurement objective. Certain respondents view the proposals as biased;

    (d) Current system, to usually measure assets and liabilities at historical cost on initial recognition, is a system that is working well and does not need to be changed (2 respondents);

    (e) Entity-specific measurement objectives could result in more relevant measurements for non-financial assets and liabilities (4 respondents). A respondent noted the hierarchy provides useful guidance for measuring financial instruments;

    (f) Historical cost should be applied first before the hierarchy on initial recognition (10 respondents). In addition, historical cost:
    - Should be a rebuttable presumption (3 respondents) that it is the best estimate of fair value;
    - Be based on the cost from an arm's length transaction;
    - Be used to measure non-financial assets;
    - Be used unless it is different to fair value;
    - Is most reliable basis;
    - Is preferable to a fair value substitute based on a theoretical model;
    - Is less subjective;
    - Supports the existing IFRS position;

    A respondent believes the other bases should only be used to assess recoverability on re-measurement;

    (g) Conflicts with the Fair Value Measurement hierarchy developed by the FASB and recommend:

[35] See chapter 8 of the main paper or the condensed paper.

- Adopting the FASB's hierarchy (6 respondents);
- Reconciling with the FASB's hierarchy (4 respondents) and resolving differences;
- IASB and FASB develop a converged hierarchy (2 respondents);

Respondents believe that such a fundamental concept should be consistent between IFRS and US GAAP;

(h) Hierarchy is an appropriate practical solution to the problem of not being able to reliably measure fair values in all situations. Another respondent states that as the hierarchy is "based on entry values, the transition between different levels of the hierarchy is likely to be less problematic, and is less likely to promote the use of information which would be irrelevant to decision making" [CIPFA – CL63];

(i) Fair value estimates determined using models with entity-specific information are often better estimates of actual amounts that would be received or paid to exit the risk position, especially for financial instruments;

(j) Further guidance is needed to apply the hierarchy in practice, such as criteria to determine which level to use;

(k) Difficult and costly to apply in practice (2 respondents);

(l) Paper should have considered transaction costs, value affecting properties (3 respondents) and the cost versus benefits of applying the hierarchy;

Level 1

(m) Has limited use as is only available for certain assets and liabilities in limited circumstances;

(n) Use different label, such as "market price fair value" to distinguish Level 1 from Level 2;

(o) Provide further guidance as to what constitutes an "observable market price" and the level of reliability required as there are different interpretations of these concepts;

Level 2

(p) Use a different label, such as "calculated fair values based on market inputs" to distinguish Level 2 from Level 1;

(q) Concerns that in practice, Level 2 may actually result (in some circumstances) in fair values which are inappropriate because a hypothetical market is assumed. In those circumstances, the respondent prefers a more reliable entity-specific measurement (Level 3 and 4 measurements);

(r) Recommended procedures and controls to determine Level 2 measurements would be onerous for companies and the added value attributable to the result is questionable;

(s) Disclosures should be required to provide users with necessary qualitative information to understand and assess fair value measurements estimated by models;

Level 3

(t) Support the decision not to call substitute measurement bases “fair value” as it would cause confusion but prefer the use of labels that highlight their differences in methodology (2 respondents). Many respondents disagree, refer to Question 17;

(u) Give more prominence in the hierarchy to historical cost, replacement or reproduction cost and deprival values (2 respondents);

(v) Not convinced that the measures in Level 3 have a sufficient nexus with objective of fair value, but believe they represent an improvement in financial reporting;

(w) Not convinced that current cost is capable of reliable estimation if a fair value cannot be determined using valuation techniques, or why historical cost might be accepted in lieu of current cost (2 respondents);

(x) Concern as to how a liability would be measured under Level 3 when its fair value cannot be estimated with acceptable reliability. It is unclear how it could be determined whether the current consideration amount can be reasonably expected to represent the amount owed. More detailed guidance is required;

(y) Actuaries are concerned as to the categorization of insurance liabilities as a Level 3 substitute based on their interpretation of what constitutes a market. Further clarification is needed to make the market concept and Level 3 operational;

Level 4

(z) Preferable to Level 3 where historical cost is not indicative of fair value, such as for a customer contract;

(aa) Support the need for a fourth level because of the unavailability of any other measures in some cases;

Alternatives

(bb) Recommend maximizing the consistency between stages in any application hierarchy, subject to considerations of the costs and benefits of the information, whatever the over-arching basis of valuation is determined to be;

(cc) Propose the hierarchy be cut off after level 1, whereby if estimates can be deemed to be reliable, then level 2 is appropriate whereas, if replacement cost or historic cost is deemed to be more appropriate and relevant, then these should be used;

(dd) Amend the proposed hierarchy to better address the use of private empirical data which is neither entity-specific nor market based, yet superior, relevant and verifiable;

(ee) A hierarchy is an effective means to convey the idea of valuation reliability and a valuator suggests the following hierarchy:
i) Directly observable prices for identical assets;
ii) Observable prices for similar assets that can be adjusted by the valuer to apply to the subject asset;
iii) Values derived from observable market data;
iv) Values based on more subjective inputs.

(ff) An appraiser recommends a different approach that combines the rationale for the hierarchy with principles that are:
- More consistent with Generally Accepted Valuation Principles (GAVP);
- Requires consideration of all three valuation approaches (sales comparison, cost and income); and
- Recognizes that market circumstances will dictate the evidence that is available, relevant and meaningful.

The approaches selected and applied are explained and justified in each valuation report in accordance with these standards.

Q19. **Other comments**

34. Respondents recommend further exploration or research of the following topics:

(a) How the proposals will improve the quality of financial reporting and how users will benefit from those improvements;

(b) Applicability of theoretical and empirical finance research in accounting;

(c) Criteria for choosing the most advantageous market where multiple markets exist;

(d) When and why market values are different to transaction prices;

(e) Entry versus exit debate;

(f) Market inefficiencies;

(g) Whether rational or irrational “price bubbles,” “underwriting cycles” and human behaviour should be considered in measurement for long term business, like insurance contracts;

(h) Situations where there is no market;

(i) How to determine the unit of account;

(j) Information content of line items and element aggregations when different measurement bases are aggregated; and

(k) Impact of the proposals on certain types of assets and liabilities, such as government grants and internally generated intangible assets.

35. A few respondents recommend conducting field or pilot tests to determine and assess the practicability of the proposals.

36. Other respondents do not believe the question of measurement on initial recognition merits any further research.

37. "The use of fair value on initial recognition needs to be evaluated on a case-by-case basis, taking into account the associated costs and complexity and the extent to which there are consistent, generally accepted and reliable models and techniques in specific circumstances." [Grant Thornton International – CL 04]

38. The benefits to users of the paper's proposals need to be evaluated against their costs. Respondents believe the proposals would be costly for no corresponding benefit to the users, especially for small- and medium-sized enterprises. For preparers, the proposals are considered to be time-consuming and expensive as it would be necessary to implement new control systems and procedures to identify transactions that have taken place at something other than fair value (perhaps simply because prices have changed between order date and recognition date) and to ensure that such transactions are properly accounted for.

39. Several respondents support the paper's proposal that the International Valuation Standards Committee, 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. The objective is to ensure that there is a sufficient underlying explanation in accounting standards to drive the development of appropriate valuation methodologies.

40. Consider the guidance in Generally Accepted Valuation Principles and other valuation standards as they are applicable over a wide range of disciplines.

APPENDIX B

List of Organizations who submitted Comment Letters[36]

CL No.	Name of Organization	Industry Classification	Geographic Region
1	Roland Verhille (France)	Individual	Europe
2	Deloitte Touche Tohmatsu International	Accounting Firm	International
3	Steve Impey (UK)	Individual	Europe
4	Grant Thornton International	Accounting Firm	International
5	Union of Industrial and Employer's Confederations of Europe (UNICE)	Industry Representative	Europe
6	Monash University (Australia)	Academic	Asia-Pacific
7	Petri Vehmanen (Finland)	Academic	Europe
8	Institute of Chartered Accountants in England & Wales (ICAEW) (UK)	Accounting Professional	Europe
9	Florida Institute of CPA's (USA)	Accounting Professional	North America
10	Dutch Accounting Standards Board (Netherlands)	Standard Setter	Europe
11	Austrian Financial Reporting and Auditing Committee (AFRAC) (Austria)	Accounting Professional	Europe
12	Bundesverband deutscher Banken (Germany)	Financial Institution	Europe
13	Swiss GAAP FER Fachempfehlungen zur Rechnungslegung (Switzerland)	Standard Setter	Europe
14	International Organization of Securities Commissions (IOSCO)	Securities Regulator	International
15	Chris Martinez (Canada)	Individual	North America
16	KPMG (International)	Accounting Firm	International
17	Certified Public Accountants of Australia (Australia)	Accounting Professional	Asia-Pacific
18	Royal Institution of Chartered Surveyors (RICS) (UK)	Valuators	Europe
19	International Valuation Standards Committee (UK)	Valuators	Europe
20	Swedish Financial Accounting Standards Council (Sweden)	Standard Setter	Europe
21	University of Wisconsin-Milwaukee School of Business (USA)	Academic	North America
22	Ashraf Pervez, MBA, ACCA affiliate (Bangladesh)	Individual	Asia-Pacific
23	Syngenta International AG	Agriculture	International
24	Foreningen af Statsautoriserede Revisorer (FSR) (Denmark)	Accounting Professional	Europe
25	Institute of Chartered Accountants in Ireland (ICAI) (Ireland)	Accounting Professional	Europe

[36] List incorporates comment letters received as of 25 August, 2006.

CL No.	Name of Organization	Industry Classification	Geographic Region
26	International Financial Reporting Standards Review Committee (IFSRC) of Korean Accounting Standards Board (KASB) (Korea)	Standard Setter	Asia-Pacific
27	London Investment Banking Association (LIBA) (UK)	Financial Institution Representative	Europe
28	Zentraler Kreditausschuss (Germany)	Financial Institution	Europe
29	German Accounting Standards Committee (DRSC) (Germany)	Standard Setter	Europe
30	South African Institute of Chartered Accountants (SAICA) Accounting Practice Board (APB) of South Africa and the Accounting Practices Committee (APC) of SAICA (South Africa)	Accounting Professional	Africa
31	Association pour la participation des enterprises françaises à l'harmonisation comptabilité internationale (ACTEO) Association Française des Entreprises Privées (AFEP) and Mouvement des Entreprises de France (MEDEF) (France)	Industry Representative	Europe
32	International Swaps and Derivatives Association (ISDA)	Financial Services - Representative	International
33	Accounting Standards Board of Japan (ASBJ) (Japan)	Standard Setter	Asia-Pacific
34	AIB Bank (Ireland)	Financial Institution	Europe
35	Accounting Standards Board (ASB) (UK)	Standard Setter	Europe
36	Institut der Wirtschaftsprüfer (IDW) (Germany)	Accounting Professional	Europe
37	Fédération des Experts Comptables Européens (FEE)	Accounting Professional	Europe
38	Mr. Imamura CPA (Japan)	Individual	Asia-Pacific
39	Japanese Institute of Certified Public Accountants (JICPA) (Japan)	Accounting Professional	Asia-Pacific
40	NSW Treasury (Australia)	Public Sector	Asia-Pacific
41	F. Hoffmann La Roche (Switzerland)	Manufacturing	Europe
42	Norsk RegnskapsStiftelse – Norwegian Accounting Standards Board (Norway)	Standard Setter	Europe
43	UK 100 Group (UK)	Industry Representative	Europe
44	BG Group (UK)	Utility	Europe
45	Ernst & Young (International)	Accounting Firm	International
46	Life Insurance Association of Japan (Japan)	Insurance Representative	Asia-Pacific
47	International Actuarial Association (IAA)	Actuarial Association	International
48	Appraisal Institute (USA)	Valuators	North America

COMMENT LETTER SUMMARY
Discussion Paper: Measurement Bases for Financial Reporting
– Measurement on Initial Recognition

CL No.	Name of Organization	Industry Classification	Geographic Region
49	The Swedish Enterprise Accounting Group (SEAG) (Sweden)	Industry Representative	Europe
50	National Association of Insurance Commissioners (NAIC)	Financial Institution Regulator	North America
51	Markit (UK)	Valuators	Europe
52	UBS (Switzerland)	Financial Institution	Europe
53	Institute of Certified Public Accountants in Kenya (ICPAK) (Kenya)	Accounting Professional	Africa
54	Hermes (UK)	Financial Services	Europe
55	Mazars	Accounting Firm	Europe
56	Committee of European Banking Supervisors	Financial Institution Regulator	Europe
57	Disclosure Solutions Limited (UK)	Consultant	Europe
58	Institute of Chartered Accountants of Scotland (ICAS) (UK)	Accounting Professional	Europe
59	British American Tobacco	Manufacturing	Europe
60	London Society of Chartered Accountants (LSCA) (UK)	Accounting Professional	Europe
61	Irish Bankers' Federation (Ireland)	Financial Institution Representative	Europe
62	National Accounting Standards Board of Russia (Russia)	Standard Setter	Europe
63	CIPFA (UK)	Accounting Professional	Europe
64	BDO Global Coordination B.V.	Accounting Firm	International
65	Association of Corporate Treasurers (UK)	Industry Representative	Europe
66	Canadian Institute of Chartered Business Valuators (Financial Reporting Sub-Committee) (Canada)	Valuators	North America
67	Federation of Swiss Industrial Holding Companies (Switzerland)	Industry Representative	Europe
68	Hong Kong Institute of Certified Public Accountants (Hong Kong)	Accounting Professional	Asia-Pacific
69	PricewaterhouseCoopers (International)	Accounting Firm	International
70	Nestlé (Switzerland)	Manufacturing	International
71	Basel Committee on Banking Supervision (Switzerland)	Financial Institution Regulator	Europe
72	Malaysian Accounting Standards Board (MASB) (Malaysia)	Standard Setter	Asia-Pacific
73	Group of 100 (Australia)	Industry Representative	Asia-Pacific

CL No.	Name of Organization	Industry Classification	Geographic Region
74	Consiglio Nazionale del Dottori Commercialisti and the Consiglio Nazionale del Ragionieri (Italy)	Accounting Professional	Europe
75	Council on Corporate Disclosure and Governance (CCDG)	Standard Setter	International
76	European Banking Industry	Financial Institution Representative	Europe
77	British Bankers' Association (BBA) (UK)	Financial Institution Representative	Europe
78	Shell International Limited	Oil and Gas	International
79	Conseil National de la Comptabilité (CNC) (France)	Accounting Professional	Europe
80	Association of Chartered Certified Accountants (ACCA) (UK)	Accounting Professional	Europe
81	HSBC Holdings (UK)	Financial Institution	International
82	Goldman Sachs International	Financial Services	International
83	Australian Accounting Standards Board	Standard Setter	Asia-Pacific
84	European Financial Reporting Advisory Group (EFRAG)	Standard Setter	Europe