



Lloyds Chambers  
1 Portsoken Street  
London  
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May 19th 2006

Director, Accounting Standards  
Canadian Accounting Standards Board  
ed.accounting@cica.ca

Dear Sir,

**Measurement Bases for Financial Accounting**

By way of background, Hermes is a pension fund manager based in London, managing money and providing stewardship services to three of the five largest UK pension schemes among our 200 clients. We have £65 billion under management and a further £10 billion under advice (as at end March 2006). We are well-known for our involvement and expertise in matters of long-term ownership and take a close interest in such matters in all markets in which our clients have investments.

We welcome the opportunity to respond to the discussion paper produced by staff of the Canadian Accounting Standards Board. This raises important issues of international significance and is an extremely helpful contribution to an ongoing debate.

Rather than answering each detailed question, we intend to make some general comments and then highlight our views on particular matters raised.

We find the use of the term 'fair value' problematic. It does not seem to us to have the definitional quality and clarity of the other terms which the CASB rightly lists as the possible alternative measurement bases. If it did have that quality and clarity, there would be no need for the CASB's lengthy analysis of appropriate estimates of fair value and substitutes for fair value. What is more, we feel that the use of the term 'fair value' obscures the nature of the debate on measurement, because it provides little information in itself and yet seems to close off all debate. No one, after all, would argue that *unfair* values should be used in accounts; 'fair value' is thus a rather loaded term.

Our strong preference would therefore be that the term 'fair value' is dropped entirely from the consideration given to measurement bases. We welcome the clarity which the CASB has brought to the understanding of the term 'fair value' as either a market price or a modelled market price, and we would therefore strongly recommend that these two alternatives be substituted for the term 'fair value' in the list of potential measurement bases.

Further to this comment, we are also uncomfortable with the proposed use of modelled market values as a valuation methodology which takes precedence over every method other than an observable market price. It seems to us a real error to prefer modelled values, which might arise in markets that may not exist in reality, to genuine prices which have actually been paid in arm's length transactions. We therefore do not favour the proposed measurement hierarchy. The use of real market prices where there is a real market does seem to us appropriate; that would seem to us to favour prices paid in real arm's length transactions over theoretical modelled market prices.

We make limited responses to some of the specific questions in the attachment.

Yours faithfully,

A handwritten signature in black ink, appearing to be 'P. Lee', with a long horizontal flourish extending to the right.

PAUL LEE  
Director  
Hermes Investment Management Ltd

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**Hermes response to detailed questions (please note comments in covering letter)**

**Q1. Do you agree that the list of identified possible measurement bases sets out the bases that should be considered? If not, please indicate and explain any changes that you would make.**

As discussed in our covering letter, we do not feel that the inclusion of the term 'fair value' is helpful. It does not seem to us to have the definitional quality and clarity of the other terms in the list of identified possible measurement bases. Indeed, we feel that the use of the term 'fair value' obscures the nature of the debate on measurement, because it provides little information in itself and yet seems to close off all debate. Our strong preference would therefore be that the term 'fair value' is dropped entirely from the list. We welcome the clarity which the CASB has brought to the understanding of the term 'fair value' as either a market price or a modelled market price, and we would therefore strongly recommend that these two alternatives be substituted for the term 'fair value' in the list of potential measurement bases.

**Q4 (c). Do you with the fair value measurement objective as proposed, and its derivation from the market value measurement objective?**

We would welcome a wholesale abandonment of the term 'fair value' and the use of the term 'market price' where this is in fact what is meant.

**Q14. Do you agree that fair value is the most relevant measure of assets and liabilities on initial recognition of assets and liabilities?**

As discussed in our covering letter, we would have significant hesitation before substituting a valuation which includes any degree of estimation for the genuine reality of the value transferred for an asset or liability in an arm's length transaction.

**Q15. Do you agree that fair value is not capable of reliable estimation in some common situations?**

We believe that in the majority of cases in the real world there will be very real difficulties in generating a modelled market value which provides useful information. There are many imperfections in markets which genuinely exist and operate actively; the estimations in a modelled market transaction would introduce significantly more such imperfections.

**Q18. Do you agree with the proposed hierarchy for the measurement of assets and liabilities on initial recognition? If not, please explain your reasons for disagreeing and what alternatives you might propose.**

As discussed in our covering letter, no, we do not agree with the proposed hierarchy. We believe that market prices are appropriate valuation methods for assets and liabilities which are genuinely traded on markets. We do not believe that it is appropriate to substitute a theoretical modelled market price for a price paid for an asset in an arm's length transaction. We believe that the use of a historical cost is likely to provide more useful information than a modelled market value, but we would also welcome more prominence in the hierarchy being given to replacement or reproduction costs and deprival values.