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List of Abbreviations

AASB	Australian Accounting Standards Board
ACCA	Association of Chartered Certified Accountants
ACT	Association of Corporate Treasurers
ACTEO	Association pour la participation des entreprises françaises à l'harmonisation comptable internationale
AFEP	Association Française des Entreprises Privées
AFRAC	Austrian Financial Reporting and Auditing Committee
AIB	Allied Irish Banks
APB	Accounting Practice Board
APC	Accounting Practices Committee
ASB	Accounting Standards Board Limited
ASBJ	Accounting Standards Board of Japan
BBA	British Bankers' Association
BDO	Binder Dijker Otte
BG	British Gas
CASB	Canadian Accounting Standards Board
CCDG	Council on Corporate Disclosure & Governance
CEBS	Committee of European Banking Supervisors
CFA	Chartered Financial Analyst
CICBV	Canadian Institute of Chartered Business Valuers
CIPFA	Chartered Institute of Public Finance and Accountancy
CLs	comment letters
CNC	Conseil National de la Comptabilité
CPA	Certified Public Accountants
DASB	Dutch Accounting Standards Board

DP	discussion paper
DRSC	Deutsches Rechnungslegungs Standards Committee
DTT	Deloitte Touche Tohmatsu
E&Y	Ernst & Young
e.g.	exempli gratia
EC	European Commission
ED	exposure draft
ed.	editor
EFRAG	European Financial Reporting Advisory Group
FASB	Financial Accounting Standards Board
FEE	Fédération des Experts Comptables Européens
FICPA	Florida Institute of Certified Public Accountants
FSR	Foreningen af Statsautoriserede Revisorer
FVM	Fair Value Measurement
GNAIE	Group of North American Insurance Enterprises
HSBC Holdings plc.	Hong Kong and Shanghai Banking Corporation Holdings Public Limited Company
i.e.	id est
IAA	International Actuarial Association
IAS	International Accounting Standard(s)
IASB	International Accounting Standards Board
IBF	Irish Bankers' Federation
ICAEW	Institute of Chartered Accountants in England & Wales
ICAI	Institute of Chartered Accountants in Ireland
ICAS	Institute of Chartered Accountants of Scotland
ICPAK	Institute of Certified Public Accountants of Kenya
IDW	Institut der Wirtschaftsprüfer
IFRS	International Financial Reporting Standard(s)

IFRSRC of KASB	International Financial Reporting Standards Review Committee of the Korea Accounting Standards Board
IOSCO	International Organization of Securities Commissions
ISDA	International Swaps and Derivatives Association
IVSC	International Valuation Standards Committee
JICPA	Japanese Institute of Certified Public Accountants
KPMG	Klynveld Peat Marwick Goerdeler
LIAJ	Life Insurance Association of Japan
LIBA	London Investment Banking Association
LSCA Ltd.	London Society of Chartered Accountants Limited
MASB	Malaysian Accounting Standards Board
MEDEF Mgmt.	Mouvement des Entreprises de France Management
NAIC	National Association of Insurance Commissioners
NASB	National Accounting Standards Board of Russia
No	Number
NRS	Norsk RegnskapsStiftelse
NSW	New South Wales
p.	page
para.	paragraph(s)
pp.	pages
PWC LLP	PricewaterhouseCoopers Limited Liability Partnership
q.	question
qs.	questions
RICS	Royal Institute of Chartered Surveyors

SAICA	South African Institute of Chartered Accountants
SEAG	Swedish Enterprise Accounting Group
SFRSC	Swedish Financial Reporting Standards Council
SIC	Standing Interpretation Committee
Swiss GAAP FER	Swiss Generally Accepted Accounting Principles Fachempfehlungen zur Rechnungslegung
UNICE	Union of Industrial and Employers' Confederation of Europe
US GAAP	United States Generally Accepted Accounting Principles

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1 Introduction

1.1 Objective of the Thesis

In November 2005, the International Accounting Standards Board (IASB) publishes the discussion paper (DP) “Measurement Bases for Financial Accounting – Measurement on Initial Recognition”¹ prepared by the Canadian Accounting Standards Board (CASB) and including a catalogue of 19 questions for comment (see appendix). Consequently, 86 respondents submit their comment letters (CLs) to the IASB. These respondents comprise institutions as well as individuals, standard setters and accounting professionals, as well as organisations from the financial and industrial sector.

The project is undertaken by the IASB due to current measurement standards and practices, which are inconsistent and out of date. The developments in recent years are no longer reflected in existing International Accounting Standards (IAS).² Under International Financial Reporting Standards (IFRS)³ it is current practice to initially measure assets and liabilities at historical cost. Fair value is applied merely in specific cases, e.g. under IFRS 3 “Business Combinations” and IAS 39 “Financial Instruments: Recognition and Measurement with the addition of the provisions on the use of the fair value option”. The DP proposes to initially apply fair value and only where fair value cannot be reliably estimated on initial recognition substitutes for fair value shall be applied.⁴ Thus, consistency in accounting shall be achieved.

¹ Henceforth, the abbreviation DP refers to the discussion paper “Measurement Bases for Financial Accounting – Measurement on Initial Recognition” prepared by the CASB.

² See *IASB* (2005a), p. 7.

³ The term “International Financial Reporting Standards” refers to the International Financial Reporting Standards (IFRS), the International Accounting Standards (IAS), the Standing Interpretations Committee-Interpretations (SIC) and the International Financial Reporting Interpretations Committee-Interpretations (IFRIC).

⁴ See *IASB* (2005a), para. 119-178.

1.2 Structure of the Thesis

This thesis can be subdivided into two main issues:

- the preliminary analysis and graphical presentation of the 86 CLs (see figures 1 and 2), where q. 19, which merely asked for further comments, was left out, and
- the extraction of the main arguments out of the CLs.

The preliminary analysis and graphical presentation incorporates certain constraints: The majority of the commenting respondents do not explicitly answer to one, more, or all of the 19 posed questions. Hence, this part of the thesis bears a strong subjective perception where the CLs do not provide clear answers to specific questions. Therefore, the broader categorisation of the response options into “agrees”, “mostly agrees but with restrictions”, “mostly disagrees but with restrictions”, and “disagrees” should help in minimizing any subjective influences and enable the extraction of the main arguments.

Chapter 1 of this thesis provides an overview of the objectives and the structure of the content. In chapter 2 of the thesis, the scope of the discussion regarding other ongoing projects of the IASB and the Financial Accounting Standards Board (FASB) is discussed, as well as constraints on the discussion with respect to initial measurement in opposition to subsequent re-measurement, consequently the treatment of profit and loss presentation and recognition, and capital maintenance.

Further, the DP’s role in determining the objectives of financial reporting is analysed in chapter 3 of this thesis. An essential part of the discussion also treated in this chapter is whether the sum of the values of an entity’s assets and liabilities should reflect an entity’s value as a whole ignoring any synergies, or whether the value of an entity as a whole and hence any synergies are acknowledged. Further, the possibility of a cost/benefit constraint of the CASB’s proposal is analysed in chapter 3. With respect to the trade-off of relevance and reliability, the discussion on the applicability

of the CASB's proposition that "when more than one alternative measurement basis achieves an acceptable level of reliability, the most relevant of these measurement bases should be selected"⁵ is outlined. The foundation for the discussion on the trade-off is especially q. 12 of the DP's catalogue of questions (see appendix). The respondents' answers to q. 19 provide most arguments for the composition of chapters 2 and 3. Moreover, the DP and the commenting respondents discuss estimation uncertainty, which may cause difficulties in determining one single price (see also the DP's q. 13).

The main focus regarding the analysis of the alternative measurement bases suggested by the DP in chapter 4 of this thesis lies on historical cost and fair value. Regarding the definition of historical cost, the aspect mostly discussed by the respondents involves assets that take time to construct. With respect to fair value, the following points are highly emphasised: The question whether the notion describes an entry or an exit value or both, whether it incorporates the market value measurement objective or not, and hence whether the single term "fair value" needs to be split up into different terms and definitions. In this regard the DP's qs. 1 and 2 provide the basis for a discussion among the respondents.

Furthermore, chapter 4 of this thesis discusses the CASB's statement that transaction costs shall only be recognised on initial recognition, if they are recoverable in the market place.⁶ The recoverability through immediate sale and future use are discussed in this chapter. In this regard, it is further differentiated between historical cost and fair value as the preferred measurement basis on initial recognition. Q. 11 of the DP's catalogue aims at this discussion.

In chapter 5, the DP's introduction of two fundamental sources of differences between measurement bases is outlined:

- market versus entity-specific measurement objectives, and

⁵ IASB (2005a), para. 89.

⁶ See IASB (2005a), para. 86.

- value-affecting sources of differences.

Here q. 3 of the DP's list of questions provides the foundation for an introductory discussion. In this chapter of the thesis, the DP's conclusion that fair value either reflects market value, if there is an active market, or an estimate of what the market price would be,⁷ is analysed. In the latter case, estimation uncertainty causes difficulties in determining one single price. This is outlined in chapter 3. Hence, the clearer differentiation between fair value as a market price and an estimated price is also an issue. Moreover, the question whether fair value measurement is even entirely separable from entity-specific objectives and inputs is discussed. In this regard, especially the DP's qs. 4 and 15 encourage the discussion. Further, the CASB concludes that the market measurement objective has essential properties, which make it superior to entity-specific measurement objectives.⁸ Thereby, the practical relevance of the theoretical assumption that markets are perfectly efficient and highly active and that there always exists a market for a certain asset plays an essential role in the discussion. Here, especially the qs. 5 and 6 of the DP's catalogue of questions launched a discussion among the respondents.

Regarding the value-affecting sources of differences, the DP raises the issue of the a priori expectation, which states that on any given measurement date there is only one fair value (see q. 7a of the list of questions).⁹ Then, reasons for turning this assumption down are discussed in the thesis: the issue of unit of account regarding assets and of credit risk regarding liabilities (see the DP's qs. 8 and 9), the existence of multiple markets and the choice of the most advantageous market (see the DP's q. 10).

In chapter 6 of this thesis, finally the CASB's core proposal that fair value shall be the most relevant measurement basis on initial recognition, given

⁷ See *IASB (2005a)*, para. 102; see also *IASB (2005b)*, para. 111.

⁸ See *IASB (2005a)*, para. 60.

⁹ See *IASB (2005a)*, para. 62.

it is reliably measurable,¹⁰ is discussed. The most frequently discussed issues surrounding the CASB's proposal involve:

- the assumption of perfect markets,
- the recognition of a gain or loss on initial recognition,
- an entity's intention whether to use or to sell an asset, and the purpose of an investment – financial or non-financial, and
- the objectives of financial reporting: what information the readers of financial statements expect to get.

At this point, qs. 14 and 16 of the DP's catalogue provide a fundamental basis for the discussion. In addition, a catalogue of substitutes having to be applied as consistent as possible with fair value (see the DP's q. 17) is analysed and a measurement hierarchy (see the DP's q. 18) introduced.

2 Scope of the Discussion “Measurement on Initial Recognition”

2.1 Other Current Projects of the IASB and the FASB

Many of the 86 respondents criticise that it is not clear how the discussion launched at this point in time fits into the IASB's current agenda. They claim the DP to be premature given related projects, e.g. the project on Fair Value Measurement (FVM) and other ongoing projects such as the convergence project including especially the Conceptual Framework, but also Revenue Recognition and Performance Reporting.¹¹

¹⁰ See *IASB* (2005a), para. 102.

¹¹ See *ACT* (2006), section “General Comments” para. 3; similar *BBA* (2006), pp. 1, 2; *Bundesverband deutscher Banken e.V.* (2006), pp. 1, 7; *CNC* (2006), covering letter introduction, appendix qs. 6, 19; *DRSC* (2006), p. 1; *DTT International* (2006), p. 1; see also *FSR* (2006), pp. 1, 12; *GNAIE* (2006), p. 1; *Goldman Sachs International* (2006), section “Discussion Paper's Objectives”; *Grant Thornton International* (2006), pp. 6-7; *Group of 100* (2006), p. 1; *HSBC Holdings plc.* (2006), p. 4; *IBF* (2006), section “Comparison of measurement bases”; *IDW* (2006), p. 1; *IOSCO* (2006), “General Comments” section 1; *ISDA* (2006), p. 1; *LSCA* (2006), p. 1; *MASB* (2006), p. 1; *Mazars & Guérard* (2006), p. 3; *PWC LLP* (2006), p. 1; *SAICA / APB of South Africa / APC of SAICA* (2006), pp. 2, 3; *Zentraler Kreditausschuss* (2006), pp. 1, 8.

Many issues, especially the objectives of financial statements, would be better pursued by the IASB's and the FASB's joint project on the Conceptual Framework first, rather than treating them parallel in both projects. Any change should be part of the review of the Conceptual Framework.¹² Therefore, the discussion on initial measurement would better await the outcome of the FASB's conclusion on fair value.¹³ However, the DP anticipates the outcome of the project on the Conceptual Framework, implicitly presuming that fair value is the most relevant measurement basis on initial recognition.¹⁴ Issues might have to be adopted by the CASB, if the IASB and the FASB come to another conclusion in their project on the Conceptual Framework.¹⁵ Otherwise, issues raised by the CASB will have to be considered when revising the IASB Framework.¹⁶ In addition, inconsistencies as well as overlaps with the project on FVM but also current IFRS are identifiable on several issues, e.g. the definitions of fair value and historical cost (see chapter 4.1.1 and 4.5.1 below), the definition of market (see chapter 5.2.1 below) or the levels of the proposed measurement hierarchy (see chapter 6.4 below).¹⁷ In many aspects, issues should better be addressed in accordance with the IASB in order to reach convergence.¹⁸ Many conclusions reached by the CASB can thus be only tentative.¹⁹

The appropriate order of discussion would be to finalize the Conceptual Framework project first and thereby determine the objectives and qualita-

¹² See ACCA (2006), section "Major overall comments"; similar *Basel Committee on Banking Supervision* (2006), p. 1; *BBA* (2006), pp. 1, 2; *BDO Global Coordination B.V.* (2006), p. 1; *CEBS* (2006), p. 3; *CNC* (2006), covering letter introduction, appendix q. 6; *CPA Australia* (2006), p. 10; *E&Y* (2006), p. 1; *IBF* (2006), section "Conceptual Framework"; *ICAEW* (2006), para. 34-35; *LIBA* (2006), p. 2; *NRS* (2006), p. 1; *Hundred Group of Finance Directors* (2006), covering letter section "Development of the Conceptual Framework".

¹³ See *Basel Committee on Banking Supervision* (2006), p. 1; similar *Swiss GAAP FER* (2006), p. 2.

¹⁴ See *FSR* (2006), p. 12.

¹⁵ See *CCDG* (2006), introduction para. 2; similar *NSW Treasury* (2006), p. 10.

¹⁶ See *European Banking Industry* (2006), enclosure p. 1; see also *IOSCO* (2006), "General Comments" section 1.

¹⁷ See ACCA (2006), section "Major overall comments"; see also *BBA* (2006), p. 2; *DTT International* (2006), p. 2; *Grant Thornton International* (2006), pp. 6-7; *LIBA* (2006), p. 2; *NASB* (2006), para. 4.

¹⁸ See *CPA Australia* (2006), pp. 1, 10.

¹⁹ See *AIB* (2006), p. 1 (paginated); similar *NSW Treasury* (2006), p. 10.

tive characteristics of financial reporting, which have direct implications for the discussion on measurement issues – initial and subsequent.²⁰ Thenceforth, other projects such as Business Combinations, FVM and Revenue Recognition could be launched.²¹ The Hundred Group of Finance Directors says: “Anything else would be like setting out on a journey without a map ...”²². Therefore, the IASB needs to rethink what the next step to undertake should be now.²³

The project on FVM intends among other issues to reach greater consistency with the definition and application of fair value under United States Generally Accepted Accounting Principles (US GAAP).²⁴ Therefore, PricewaterhouseCoopers Limited Liability Partnership (PWC LLP) suggests that the IASB first finishes its research on this issue before any further proposals are published.²⁵ Hence, any proposal for measurement on initial recognition should be first viewed in the light of achieving convergence with US GAAP.²⁶ Some of the conclusions drawn by the CASB, e.g. the neutrality of fair value towards entry or exit values (see chapter 4.5.1 below), do not fulfil the IASB’s general objective to reach convergence with US GAAP.²⁷ Thus, the main issue should be to close the gaps between IFRS and US GAAP in order to establish a foundation for harmonizing both sets of standards, rather than introducing entirely new accounting concepts.²⁸

²⁰ See *Basel Committee on Banking Supervision* (2006), p. 3; similar *Bundesverband deutscher Banken e.V.* (2006), p. 2; *KPMG IFRG Ltd.* (2006), p. 1; *Swiss GAAP FER* (2006), p. 1; *Zentraler Kreditausschuss* (2006), p. 2.

²¹ See *Bundesverband deutscher Banken e.V.* (2006), p. 2; similar *Zentraler Kreditausschuss* (2006), p. 2.

²² *Hundred Group of Finance Directors* (2006), covering letter section “Development of the Conceptual Framework”.

²³ See *Mazars & Guérard* (2006), p. 3.

²⁴ See *IASB* (2006e), p. 1; see also *IASB* (2006c), para. 2, 55; *PWC LLP* (2006), p. 2.

²⁵ See *PWC LLP* (2006), p. 2.

²⁶ See *Bundesverband deutscher Banken e.V.* (2006), pp. 2, 7; see also *UBS AG* (2006), p. 3; similar *Goldman Sachs International* (2006), section “Discussion Paper’s Objective”.

²⁷ See *Goldman Sachs International* (2006), section “Discussion Paper’s Objective”.

²⁸ See *Bundesverband deutscher Banken e.V.* (2006), pp. 2, 7; see also *Zentraler Kreditausschuss* (2006), pp. 2, 8.

2.2 Selective Constraints on the Discussion

When and what should initially be recognised is a precondition for how measurement takes place on initial recognition.²⁹ Many issues might thenceforth become obsolete, according to Deloitte Touche Tohmatsu (DTT) International.³⁰ However, the CASB decides to exclude the timing of initial recognition from the scope of the discussion.³¹ The DP is based on initial measurement at the date of acquisition of an asset rather than its first reporting date, which will rarely coincide.³² Initial measurement, however cannot be discussed in isolation from initial recognition.³³ Moreover, it is unclear how the issue of depreciation fits into the discussion since this issue does not arise before the first balance sheet date.³⁴

Furthermore, the discussion takes place on a general level and does not take into account different types of assets and liabilities.³⁵ The initial question would be to challenge, why different assets and liabilities are currently measured differently under various measurement bases with respect to their nature and purpose.³⁶ Examples are regular operations versus business combinations. Further, financial instruments are measured at fair value. However, intangible assets and unique equipment are measured differently from fair value.³⁷

On the other hand, the discussion is highly geared towards financial businesses and does not take into account different types of businesses and

²⁹ See *DTT International* (2006), p. 1; similar *Hong Kong Institute of CPA* (2006), p. 1; *LIBA* (2006), p. 2; *SAICA / APB of South Africa / APC of SAICA* (2006), p. 2.

³⁰ See *DTT International* (2006), p. 1.

³¹ See *IASB* (2005a), para. 5.

³² See *IAA* (2006), p. 2; see also *ICAEW* (2006), para. 8.

³³ See *ACT* (2006), section "General Comments" para. 2; see also *AFRAC* (2006), p. 4; *AIB* (2006), p. 1 (paginated); *PWC LLP* (2006), pp. 1, 3; *Shell International Ltd.* (2006), p. 1.

³⁴ See *ICAEW* (2006), para. 8.

³⁵ See *Grant Thornton International* (2006), p. 1; similar *Imamura, Takeshi* (2006), q. 18; *NASB* (2006), para. 5.

³⁶ See *E&Y* (2006), p. 2; see also *NASB* (2006), para. 5.

³⁷ See *NASB* (2006), para. 5.

issues specific to particular business sectors.³⁸ Fair value measurement may be appropriate for certain businesses, e.g. the insurance business. However this should be discussed in light of the particular industry.³⁹ Further, fair value measurement might be misleading in certain modern industries, as for example during the Internet bubble.⁴⁰ The DP disregards especially industrial sectors. However, conclusions drawn from the finance sector cannot just be simply transferred to other sectors, as especially the discussion on market imperfections proves (see chapter 5.2.2 below).

2.3 Temporal Constraints on the Discussion

The CASB chooses to restrict the discussion to measurement on initial recognition in isolation from subsequent re-measurement,⁴¹ although conclusions reached in the former stage might be overruled in the latter.⁴² There is not a clean division between initial and subsequent re-measurement.⁴³ Initial measurement has far-reaching implications for re-measurement.⁴⁴ However, conclusions reached on initial measurement are not necessarily extendable to subsequent re-measurement.⁴⁵

Measurement on initial recognition cannot be treated in isolation from re-measurement, since the both are linked together and interrelated and it is not practicable to treat initial measurement in isolation from subsequent

³⁸ See *IAA* (2006), p. 2; similar *ICAEW* (2006), para. 38; *NAIC* (2006), p. 1; *Nestlé* (2006), p. 2.

³⁹ See *ICAEW* (2006), para. 38.

⁴⁰ See *NASB* (2006), para. 6.

⁴¹ See *IASB* (2005a), para. 7.

⁴² See *ACTEO / AFEP / MEDEF* (2006), covering letter p. 3; see also *AFRAC* (2006), p. 4; *DRSC* (2006), p. 2; *E&Y* (2006), p. 6; *ICAS* (2006), p. 1; *LIBA* (2006), p. 1; *UNICE* (2006), section 1.

⁴³ See *ASBJ* (2006), p. 2; similar *Markit Valuations* (2006), p. 2; *NASB* (2006), para. 1.

⁴⁴ See *Bundesverband deutscher Banken e.V.* (2006), p. 2; see also *CIPFA* (2006), p. 1; *ICAS* (2006), p. 1; *LIBA* (2006), p. 1; *Zentraler Kreditausschuss* (2006), p. 3.

⁴⁵ See *DRSC* (2006), p. 2; similar *UBS AG* (2006), p. 2.

re-measurement. Thus, both should be discussed together.⁴⁶ Only considering both, will lead to a sound conclusion.⁴⁷ How assets or liabilities are measured on an ongoing basis influences the decision how elements should be measured on initial recognition. Measuring initially at market value might accompany the commitment to also do so on subsequent re-measurement.⁴⁸ A measurement basis chosen on initial measurement should also be applied on subsequent re-measurement in order to be consistent.⁴⁹ For example, a financial instrument might initially be measured at fair value, and thus result in a recognised gain. However, measuring subsequently at amortised cost, this gain would immediately have to be reversed on day 2.⁵⁰ Moreover, in the banking industry valuations are made on a daily basis and the distinction between initial and subsequent re-measurement will sometimes not be clear.⁵¹ In this regard, it needs to be clarified when initial measurement ends and subsequent re-measurement begins.⁵² Considering both stages together might lead to different conclusions.⁵³

Leaving aside subsequent re-measurement consequently also leads to leaving the debate on profit and loss recognition aside. Hence, having to

⁴⁶ See *Basel Committee on Banking Supervision* (2006), p. 4; see also *BDO Global Coordination B.V.* (2006), p. 1; *BG Group* (2006), covering letter; *British American Tobacco* (2006), p. 1; *Bundesverband deutscher Banken e.V.* (2006), p. 7; *CEBS* (2006), p. 3; *CPA Australia* (2006), pp. 1, 10; *European Banking Industry* (2006), enclosure p. 2; *F. Hoffmann-La Roche Ltd.* (2006), covering letter pp. 1, 2 (paginated); *FEE* (2006), p. 1; *FSR* (2006), p. 11; *HSBC Holdings plc.* (2006), p. 1; *Hundred Group of Finance Directors* (2006), covering letter section "Scope", appendix q. 19; *IAA* (2006), pp. 2, 13; *IBF* (2006), section "Initial measurement in isolation"; *IDW* (2006), p. 1; *industrie-holding* (2006), pp.1-2; *ISDA* (2006), p. 2; *KPMG IFRG Ltd.* (2006), p. 2; *LIAJ* (2006), p. 1; *LIBA* (2006), p. 1; *NASB* (2006), para. 1; *NSW Treasury* (2006), pp. 1, 10; *PWC LLP* (2006), pp. 1, 3; *SFRSC* (2006), p. 3; *Swiss GAAP FER* (2006), p. 1; *Zentraler Kreditausschuss* (2006), p. 8.

⁴⁷ See *ACT* (2006), section "General Comments" para. 2; see also *Hong Kong Institute of CPA* (2006), p. 1.

⁴⁸ See *LSCA* (2006), p. 2; similar *CNC* (2006), covering letter section 3.

⁴⁹ See *Consiglio Nazionale dei Dottori Commercialisti / Consiglio Nazionale dei Ragionieri* (2006), introduction; similar *IFRSRC of KASB* (2006), pp. 11-12.

⁵⁰ See *ISDA* (2006), p. 2.

⁵¹ See *LIBA* (2006), p. 1.

⁵² See *ISDA* (2006), p. 2.

⁵³ See *AASB* (2006), pp. 2, 7; see also *BBA* (2006), p. 1; *British American Tobacco* (2006), p. 1; *EFRAG* (2006), pp. 2, 4; *Goldman Sachs International* (2006), section "Initial and Subsequent Measurement"; *Group of 100* (2006), p. 1; *LSCA* (2006), pp. 1, 3.

cope with profit recognition is avoided. Even though the measurement of income and expenses has significant implications on the discussion, income effects are excluded from the discussion.⁵⁴ However, merely an accumulated costs model can eliminate all day 1 profits.⁵⁵ Only the combined view on initial as well as subsequent measurement determines the timing and amount of changes that will result in income and expense.⁵⁶ In order to draw firm conclusions on the relevance of a measurement basis, its implications on the measurement of profit also need to be considered.⁵⁷ The DP has a main focus on the allocation of gains and losses to different periods.⁵⁸ Measurement should be discussed with respect to post-recognition issues also, e.g. effects on earnings and presentation of the performance measurement.⁵⁹ The CASB regards financial accounting solely as an issue about assets and liabilities rather than also income and expense.⁶⁰ The revenue and expense view is inappropriately locked out.⁶¹ For more details see the discussion on synergies in chapter 3.1 below.

Further, both initial and subsequent measurements are bound to the concepts of capital maintenance since any income recognised reflects a significant part of capital, i.e. retained earnings.⁶² The capital maintenance implications of a particular measurement basis need to be considered also.⁶³ The concept of capital adopted and its implications on the concepts of capital maintenance influence the measurement of the entity's profit in the current period and the nature of future economic benefits. For

⁵⁴ See *ACTEO / AFEP / MEDEF* (2006), covering letter p. 3, appendix p. 4; similar *CNC* (2006), covering letter section 3; *E&Y* (2006), p. 6; *ICAEW* (2006), para. 5, 15, 36; see also *LSCA* (2006), p. 3.

⁵⁵ See *ACTEO / AFEP / MEDEF* (2006), appendix p. 4.

⁵⁶ See *British American Tobacco* (2006), p. 1; see also *UBS AG* (2006), p. 2.

⁵⁷ See *AASB* (2006), p. 6.

⁵⁸ See *EFRAG* (2006), p. 4.

⁵⁹ See *BDO Global Coordination B.V.* (2006), p. 1; see also *British American Tobacco* (2006), p. 4; *CIPFA* (2006), p. 1; *Hundred Group of Finance Directors* (2006), covering letter section "Scope"; *KPMG IFRG Ltd.* (2006), p. 1; *LSCA* (2006), p. 3; *Mazars & Guérard* (2006), p. 3; *Shell International Ltd.* (2006), p. 1.

⁶⁰ See *E&Y* (2006), p. 6.

⁶¹ See *JICPA* (2006), p. 2; see also *Verhille, Roland* (2006), p. 5.

⁶² See *Basel Committee on Banking Supervision* (2006), p. 4.

⁶³ See *AASB* (2006), p. 6; see also *EFRAG* (2006), p. 20.

example, the physical capital maintenance, i.e. the operating capability under which an entity's productive capacity matters, requires the current cost measurement basis.⁶⁴ The financial concept, i.e. the number of monetary units invested under which the capital comprises the net assets or equity of the entity, does not prescribe the use of a particular measurement basis.⁶⁵ For more detail on financial capital see chapter 6.1.6 below.

Thus, the DP should take capital maintenance also into account. However, the CASB decides to leave it outside its scope.⁶⁶ It is essential to have a consistent concept of capital maintenance before deciding on the most relevant measurement basis on initial recognition.⁶⁷

2.4 Applicability in Practice

Several respondents perceive that the DP lacks practicability and takes place in a theoretical vacuum.⁶⁸ They claim it to be very academic and that it assumes the existence of perfect and efficient markets, which is not realistic (for further detail see chapter 5.2.2 below).⁶⁹ The DP does not sufficiently consider practical situations.⁷⁰ It seems to assume that the conclusions drawn from an ideological perspective are more important than practical issues.⁷¹ However, financial reporting has to be practical.⁷² It is "... a practical mechanism for communication between preparers and users of financial statements. ... It does not have a *raison d'être* outside of serving that purpose, and it needs to be considered in terms of its fulfilling that purpose, not against more general, philosophical criteria (i.e. no 'art

⁶⁴ See AASB (2006), p. 6.

⁶⁵ See IASB (2002), para. 102, 106.

⁶⁶ See *Consiglio Nazionale dei Dottori Commercialisti / Consiglio Nazionale dei Ragionieri* (2006), qs. 14, 19; see also AASB (2006), pp. 6-7; ACCA (2006), q. 18.

⁶⁷ See IDW (2006), p. 1; similar *F. Hoffmann-La Roche Ltd.* (2006), covering letter p. 2 (paginated).

⁶⁸ See *industrie-holding* (2006), p. 1; similar ICAI (2006), p. 2; *F. Hoffmann-La Roche Ltd.* (2006), covering letter p. 1 (paginated).

⁶⁹ See SAICA / APB of South Africa / APC of SAICA (2006), p. 3.

⁷⁰ See AIB (2006), p. 1 (paginated).

⁷¹ See JICPA (2006), p. 2.

⁷² See FEE (2006), p. 2; see also ICAI (2006), p. 2; *industrie-holding* (2006), p. 2.

for art's sake')."⁷³ Generally, a more balanced and deeper analysis would be more useful.⁷⁴

The needs and demands of all preparers and users of financial statements need to be considered before any conclusion can be drawn.⁷⁵ Pilot tests with real companies can assist in identifying practical difficulties, but also especially the overall costs of implementing the proposed measurement approach (see also chapter 3.2 below on the cost/benefit constraint).⁷⁶ Actual financial statements recently prepared under IFRS should be taken into consideration in order to identify what issues pose the greatest difficulties between preparers and users.⁷⁷ However, the DP lacks practical and illustrative examples.⁷⁸ For further detail on the objectives of financial statements see also chapter 3.1 below.

Eventually, it is unclear whether there is even a demand for changing current accounting practice and introducing a new measurement approach.⁷⁹ The DP assumes that there is a request for a fundamental change of financial reporting.⁸⁰ Other respondents do not follow this opinion. On the contrary, analysts often ask for more information on markets and competitive positions, performance, innovation, new prospects, and businesses' strategic opportunities. There seems whatsoever not to be a demand for such a drastic change to current accounting practice from any part.⁸¹ The DP should explain why the existing model

⁷³ *F. Hoffmann-La Roche Ltd. (2006)*, covering letter pp. 1-2 (paginated); *industrie-holding (2006)*, pp. 1-2.

⁷⁴ See *IOSCO (2006)*, "General Comments" section 2; see also *SFRSC (2006)*, pp. 5-6.

⁷⁵ See *industrie-holding (2006)*, p. 2; see also *SAICA / APB of South Africa / APC of SAICA (2006)*, p. 10.

⁷⁶ See *FEE (2006)*, p. 2; see also *ICAI (2006)*, p. 1; *SEAG (2006)*, p. 2.

⁷⁷ See *PWC LLP (2006)*, p. 2.

⁷⁸ See *Shell International Ltd. (2006)*, covering letter para. 4, appendix q. 19.

⁷⁹ See *British American Tobacco (2006)*, p. 1; see also *Bundesverband deutscher Banken e.V. (2006)*, p. 2; *European Banking Industry (2006)*, covering letter p. 2; *Hundred Group of Finance Directors (2006)*, section "Meeting the needs of users?"; *F. Hoffmann-La Roche Ltd. (2006)*, covering letter p. 2 (paginated); *industrie-holding (2006)*, p. 2.

⁸⁰ See *IASB (2005a)*, p. 7.

⁸¹ See *F. Hoffmann-La Roche Ltd. (2006)*, covering letter p. 2 (paginated); see also *industrie-holding (2006)*, p. 2.

has to be modified at all.⁸² The Hundred Group of Finance Directors notes that the CASB “is trying to find a solution to a problem that does not exist.”⁸³

Consistency in accounting practice has to be achieved.⁸⁴ Inconsistencies may enable the structuring of transactions by the preparers in order to achieve certain results.⁸⁵ Currently, choosing between cost and another measurement basis, mixing market and entity-specific data in one measurement basis (“mixed-attribute model”) and again applying other valuation bases in testing for impairment is allowed under several standards.⁸⁶ Additionally, different information might be required in calculating depreciation or disposal values.⁸⁷

However, the Institute of Chartered Accountants in England & Wales (ICAEW) argues that consistency has already been sufficiently achieved with the application of fair value where historical cost is unavailable, i.e. in business combinations and for financial instruments.⁸⁸ The use of fair value in business combinations can be regarded as an approximation for historical cost since there are no individual payments available for separable assets. Nevertheless, the current application of fair value in business combinations may not be seen as justification for a wider use of fair value on initial recognition.⁸⁹ Consistency also has to be retained, as far as amounts used in establishing the cash flow and profit and loss statement of a going concern entity would be based on another assumed use than fair value, since the latter feigns the disposal of an asset (see also chapter 3.2 below).⁹⁰

⁸² See *European Banking Industry* (2006), covering letter p. 2.

⁸³ *Hundred Group of Finance Directors* (2006), section “Meeting the needs of users?”.

⁸⁴ See *ICAEW* (2006), para. 37; see also *PWC LLP* (2006), p. 3.

⁸⁵ See *AFRAC* (2006), p. 3.

⁸⁶ See *PWC LLP* (2006), p. 3; similar *CFA Institute* (2006), p. 3.

⁸⁷ See *RICS Valuation Faculty* (2006), p. 9.

⁸⁸ See *ICAEW* (2006), para. 37.

⁸⁹ See *ICAEW* (2006), para. 28-29.

⁹⁰ See *IVSC* (2006), appendix q. 19.

3 Criteria for Evaluation and Basic Assumptions

3.1 Objectives of Financial Reporting

The CASB mentions:

- decision usefulness, i.e. the aptitude to predict an entity's ability to generate cash flows, and
- stewardship, i.e. the accountability of management to the owners,

as the two objectives of accounting.⁹¹ However, the DP does apparently not consider both equally important. It is biased towards the requirement of decision usefulness and does not focus to the same extent on stewardship. However, several respondents reject this view.⁹² If stewardship were also considered an important objective, entity-specific measurement bases would play a more important role.⁹³ According to the Foreningen af Statsautoriserede Revisorer (FSR), historical cost is a better basis regarding the objective of stewardship.⁹⁴ Investors enter a "stewardship 'contract'"⁹⁵ with management. Further on, investors assess management's performance by looking at financial statements. Changing the required measurement bases would also change the terms of the contract, and thus imply a change on what management's role is.⁹⁶ The stewardship perspective results in figures relevant to the reporting entity instead of just hypothetical marketplace participants.⁹⁷ Further, a clear explanation on how stewardship relates to decision usefulness is missing.⁹⁸

There are different theoretical approaches for reaching the objective of decision-usefulness: A balance sheet is based on individually valuing each

⁹¹ See *IASB (2005a)*, para. 10-11; see also *IASB (2005b)*, para. 123.

⁹² See *ASB (2006)*, section A para. 4; see also *ACT (2006)*, section "General Comments" para. 1; *CNC (2006)*, appendix q. 3; *DRSC (2006)*, p. 1; *EFRAG (2006)*, p. 5; *F. Hoffmann-La Roche Ltd. (2006)*, covering letter p. 1 (paginated); *ICAS (2006)*, p. 2; *IDW (2006)*, pp. 5-6; *industrie-holding (2006)*, pp. 1, 5; *Shell International Ltd. (2006)*, p. 9; *Syngemat International AG (2006)*, p. 4.

⁹³ See *SFRSC (2006)*, p. 10.

⁹⁴ See *FSR (2006)*, p. 4.

⁹⁵ *Syngemat International AG (2006)*, p. 4; *industrie-holding (2006)*, p. 5.

⁹⁶ See *Syngemat International AG (2006)*, p. 4; see also *industrie-holding (2006)*, p. 5.

⁹⁷ See *ASB (2006)*, section A para. 5.

⁹⁸ See *SFRSC (2006)*, p. 2.

item's cash flow (item-by-item-approach). Users and readers of financial statements are not interested in cash flows generated by individual items but by the entity as a whole.⁹⁹ However, adding these individual items up does not equal the cash flow of the whole entity.¹⁰⁰ Synergies are not taken into account. Thus, the entity's value as a whole cannot be depicted by individual valuation. Further, self-generated goodwill is not recognised, although it influences the entity's cash flows generated in the future, too. The users' ability to assess an entity's generation of future cash flows may not be enhanced by fair value measuring. Disregarding synergies may represent a true and fair view of an entity's individual assets and liabilities. However, acknowledging synergies assists better in assessing an entity's ability to generate cash flows. Fair value encompasses a higher predictive value and is thus more relevant to users of financial statements.¹⁰¹ The computation of income needs to be considered in order to evaluate the entity's value as a whole.¹⁰²

Reporting changes in fair value as income will not incorporate predictive value because the changes are non-repetitive. Needed information on future cash flows may not be derived from the fair value, i.e. the present value of future cash flows.¹⁰³ The accounting information of fair value is only of limited relevance. Fair value is not capable of providing information on future cash flows. However, it may assist users in assessing the reporting entity's ability to deal with risks.¹⁰⁴ The Deutsches Rechnungslegungs Standards Committee (DRSC) defends why measuring each item individually at fair value does not provide a better approximation of the entity's value as a whole: The future cash flows are discounted with a rate of return, which may change while the fair values of the items, e.g. the entity's cash, may remain the same. Moreover, the self-generated goodwill of an entity's value may lessen while the fair values of its assets may

⁹⁹ See *DRSC* (2006), p. 2; see also *IDW* (2006), pp. 5-6.

¹⁰⁰ See *DRSC* (2006), p. 2; see also *IDW* (2006), p. 5; *FEE* (2006), p. 1.

¹⁰¹ See *DRSC* (2006), p. 2; see also *IDW* (2006), p. 5.

¹⁰² See *ASBJ* (2006), p. 2.

¹⁰³ See *DRSC* (2006), p. 6.

¹⁰⁴ See *IDW* (2006), p. 5.

increase.¹⁰⁵ The main difference between the two approaches is the recognition of gains and losses during the period through which an entity holds the assets or liabilities.¹⁰⁶

Moreover, with respect to the objective of decision-usefulness of financial reporting, the cash flow statement and the income statement are more useful than the balance sheet, according to the ICAEW.¹⁰⁷ Solely looking at the balance sheet cannot assist in assessing internally generated goodwill, and hence, the ability of an entity to generate future cash flows,¹⁰⁸ since information on profit and loss is also relevant.¹⁰⁹ However, the income effects of the change to measurement on initial recognition as proposed by the DP and whether these can assist users in assessing future cash flows are along with subsequent re-measurement excluded from the scope of the discussion (see chapter 2.3 above).¹¹⁰

The objectives of financial reporting as well as who the relevant addressees are and what their needs are would need to be discussed in more detail in advance, before launching a discussion on measurement on initial recognition. Several respondents criticise that the CASB does not sufficiently address what view of an entity's financial position and performance the financial statement should portray.¹¹¹ This is however an indispensable precondition for many of the conclusions drawn by the CASB, e.g. what the most relevant measurement basis on initial recognition is (see chapter

¹⁰⁵ See *DRSC* (2006), pp. 7-8.

¹⁰⁶ See *E&Y* (2006), p. 6.

¹⁰⁷ See *ICAEW* (2006), para. 24.

¹⁰⁸ See *JICPA* (2006), p. 2; see also *Mazars & Guérard* (2006), p. 2.

¹⁰⁹ See *British American Tobacco* (2006), p. 1; see also *JICPA* (2006), p. 2; *Mazars & Guérard* (2006), p. 2.

¹¹⁰ See *DRSC* (2006), p. 14; see also *ICAEW* (2006), para. 24; *NRS* (2006), p. 1.

¹¹¹ See *ACTEO / AFEP / MEDEF* (2006), covering letter p. 2; see also *AIB* (2006), p. 1 (paginated); *ASB* (2006), section A para. 2, section B q. 9; *Basel Committee on Banking Supervision* (2006), p. 3; *CNC* (2006), covering letter introduction, section 2.5; *DASB* (2006), p. 6; *DRSC* (2006), p. 1; *EFRAG* (2006), pp. 2, 6; *European Banking Industry* (2006), covering letter p. 1; *FEE* (2006), p. 2; *industrie-holding* (2006), p. 1; *FSR* (2006), p. 2; *LSCA* (2006), pp. 1, 2; *NRS* (2006), p. 1; *RICS Valuation Faculty* (2006), p. 9; *SFRSC* (2006), p. 2; *Shell International Ltd.* (2006), pp. 1, 2; *UNICE* (2006), section 1.

6.1 below).¹¹² Further, a concept of performance measurement needs to be developed before deciding on measurement on initial recognition.¹¹³ Whatsoever, the CASB does not indicate what users' needs are and how they influence the choice of a measurement basis.¹¹⁴ The IASB Framework, on the contrary, determines the users of financial statements to be mainly financial analysts, investors and creditors.¹¹⁵

The Swedish Financial Reporting Standards Council (SFRSC) stresses that purposes of the objective of financial reporting other than simply estimating future cash flows should be considered.¹¹⁶ The ability to generate future cash flows will be relevant to parties of business combinations and acquisitions. Individual investors are rather interested in the entity's future earnings and performance. Thus, Takeshi Imamura suggests to differentiate the measurement bases for business combinations and acquisitions from those for financial reporting.¹¹⁷

The Group of 100 points out that comparability and understandability are also qualitative characteristics, which need to be considered in meeting the objectives of financial statements.¹¹⁸ For a closer discussion on comparability see chapter 5.5 below.

3.2 Cost/Benefit Constraints

Several respondents argue that applying fair value rather than historical cost on initial recognition would increase the cost of preparing financial statements considerably.¹¹⁹ Disclosure Solutions Limited (Ltd.) accurately

¹¹² See *BBA* (2006), p. 1; see also *European Banking Industry* (2006), covering letter p. 1.

¹¹³ See *IDW* (2006), p. 6; similar *CIPFA* (2006), p. 11; *F. Hoffmann-La Roche Ltd.* (2006), covering letter p. 2 (paginated).

¹¹⁴ See *E&Y* (2006), p. 2.

¹¹⁵ See *IASB* (2002), para. 9-10; see also *industrie-holding* (2006), p. 1.

¹¹⁶ See *SFRSC* (2006), p. 12.

¹¹⁷ See *Imamura, Takeshi* (2006), section "General – Underlying Assumption of the Paper" q. 6.

¹¹⁸ See *Group of 100* (2006), p. 7.

¹¹⁹ See *ACCA* (2006), section "Major overall comments"; see also *F. Hoffmann-La Roche Ltd.* (2006), covering letter p. 3 (paginated); *FEE* (2006), p. 8; *Hundred Group of*

points out that “it will be a vast waste of resources if every time an asset is purchased effort is put into working out fair values.”¹²⁰ In most circumstances, except where observable market prices are already available, preparers of financial statements will experience higher costs.¹²¹ Having to derive market values from active markets due to the lack of observable market prices would impose significant costs and complexity in preparing financial statements.¹²² These costs are not outweighed by any additional benefit.¹²³ The CASB does not sufficiently consider the cost-benefit issues in its discussion.¹²⁴ However, this needs to be ensured before any change to current measurement practice can be applied.¹²⁵ Grant Thornton International points out that such a drastic change in measurement needs to be convincingly justified by benefits exceeding the possibly increased costs and complexity.¹²⁶ The costs to the preparer need to be minimized compared to the resulting usefulness and a balance between cost and benefit has to be obtained.¹²⁷

Historical cost has to be considered in accounting already, e.g. for monitoring payments. Having to determine fair value accessorially would incur additional costs and effort.¹²⁸ Further, cash flow statements are prepared based on cash and cash equivalents paid and received, on which also historical cost relies. Thus, fair value measurement would require an entirely different system of bookkeeping supplementary to the

Finance Directors (2006), covering letter section “Workable in practice?”; *IDW* (2006), p. 16.

¹²⁰ *Disclosure Solutions Ltd.* (2006), section “Why fair value is unsuitable for initial recognition”.

¹²¹ See *Grant Thornton International* (2006), p. 6.

¹²² See *Grant Thornton International* (2006), p. 2; similar *BG Group* (2006), p. 4; *British American Tobacco* (2006), p. 3.

¹²³ See *FEE* (2006), p. 8; see also *IDW* (2006), p. 16; similar *BBA* (2006), pp. 1, 2; *British American Tobacco* (2006), p. 3; *CIPFA* (2006), pp. 1-2; *Hundred Group of Finance Directors* (2006), covering letter section “Workable in practice?”; *ICAEW* (2006), para. 37; *LSCA* (2006), pp. 3, 4; *Mazars & Guérard* (2006), p. 1; *Mazars & Guérard* (2006), p. 9; *NSW Treasury* (2006), p. 2; *SEAG* (2006), pp. 2, 7.

¹²⁴ See *ACCA* (2006), q. 14; see also *BDO Global Coordination B.V.* (2006), p. 2; *EFRAG* (2006), p. 20.

¹²⁵ See *DASB* (2006), p. 2.

¹²⁶ See *Grant Thornton International* (2006), p. 6.

¹²⁷ See *ASB* (2006), section B q. 14; see also *NSW Treasury* (2006), pp. 1-2; similar *PWC LLP* (2006), p. 1.

¹²⁸ See *FEE* (2006), p. 8; see also *IDW* (2006), p. 16.

one already used for cash flow statements.¹²⁹ Disclosure Solutions Ltd. describes historical cost as “a cheap measure to obtain”¹³⁰.

Moreover, the Hundred Group of Finance Directors points out that most transactions are settled within a short period of time.¹³¹ Thus, assets and liabilities may be recognised and again derecognised within the same accounting period.¹³² Adjustments would have to be performed and resources would be wasted on the determination of fair value for items that never even appear on the balance sheet.¹³³ Even if settlement has not taken place by the balance sheet date, any valuation gain or loss rather confuses users than assists them.¹³⁴ Shell International Ltd. points out that the preparation of financial statements takes some time and market-based values might have changed significantly by the reporting date. Therefore, entity-specific measures may be more relevant and reliable.¹³⁵

As a consequence to numerous accounting scandals such as Enron or Parmalat increased emphasis is put on the credibility of financial statements.¹³⁶ However, under full fair value accounting amounts may suffer drastic changes during periods of high volatility.¹³⁷ Introducing a measurement approach of estimated fair value will lead to increased control and auditing complexity.¹³⁸ Regarding increased obligations and requirements imposed by the Sarbanes-Oxley Act¹³⁹, an entity might be required to incur additional costs for establishing internal controls in order to ensure that these new requirements for financial reporting are being complied with.

¹²⁹ See *DRSC* (2006), p. 12.

¹³⁰ *Disclosure Solutions Ltd.* (2006), section “Historical cost”.

¹³¹ See *Hundred Group of Finance Directors* (2006), covering letter section “Measurement hierarchy”.

¹³² See *BDO Global Coordination B.V.* (2006), p. 1.

¹³³ See *Hundred Group of Finance Directors* (2006), covering letter section “Measurement hierarchy”; see also *ICAEW* (2006), para. 11.

¹³⁴ See *Hundred Group of Finance Directors* (2006), covering letter section “Measurement hierarchy”.

¹³⁵ See *Shell International Ltd.* (2006), p. 5.

¹³⁶ See *F. Hoffmann-La Roche Ltd.* (2006), covering letter p. 3 (paginated); see also *industrie-holding* (2006), p. 4; *SEAG* (2006), pp. 1-2.

¹³⁷ See *industrie-holding* (2006), p. 4; see also *F. Hoffmann-La Roche Ltd.* (2006), covering letter p. 3 (paginated).

¹³⁸ See *SEAG* (2006), pp. 1-2.

¹³⁹ Sarbanes-Oxley Act of 2002, H.R. 3763.

Companies that cannot prove to have identified all differences between transaction prices and fair value might be claimed to have weak internal controls.¹⁴⁰

3.3 Trade-Off Relevance – Reliability

The DP proposes:

“When more than one alternative measurement basis achieves an acceptable level of reliability, the most relevant of these measurement bases should be selected.”¹⁴¹

Hence, it is argued that a measurement basis can only be relevant, if it can be measured with an acceptable level of reliability. There are several respondents agreeing with the proposal and that relevance should be prioritised over reliability.¹⁴² It would be inadequate to report irrelevant measures solely because they are reliable.¹⁴³

The DP seems to assume that readers of financial statements would sacrifice reliable information for a higher degree of relevance without providing sufficient justification.¹⁴⁴ It fails to convince why the doubts over reliability are overruled by the advantages of relevance.¹⁴⁵ If an acceptable level of reliability cannot be met, relevance is not necessarily more important than reliability.¹⁴⁶ In many cases it is not true that relevance is more important than reliability.¹⁴⁷ Financial statements absented reliability are also impaired in relevance.¹⁴⁸ Moreover, users might get a negative

¹⁴⁰ See *ICAEW* (2006), para. 12.

¹⁴¹ *IASB* (2005a), para. 89.

¹⁴² See *AASB* (2006), p. 13; see also *ACCA* (2006), q. 12; *ACTEO / AFEP / MEDEF* (2006), covering letter p. 2, appendix p. 5; *CCDG* (2006), q. 12; *Consiglio Nazionale dei Dottori Commercialisti / Consiglio Nazionale dei Ragionieri* (2006), q. 12; *CPA Australia* (2006), p. 7; *FEE* (2006), p. 7; *FICPA* (2006), p. 5; *Hundred Group of Finance Directors* (2006), appendix q. 12; *IAA* (2006), p. 9; *ICAI* (2006), p. 7; *industrial holding* (2006), p. 14; *IVSC* (2006), appendix q. 12; *Monash University* (2006), p. 5; *NAIC* (2006), p. 8; *NSW Treasury* (2006), p. 7; *RICS Valuation Faculty* (2006), p. 7; *Syngentat International AG* (2006), p. 14; *UNICE* (2006), section 3.

¹⁴³ See *Grant Thornton International* (2006), pp. 2, 9.

¹⁴⁴ See *Mazars & Guérard* (2006), p. 2; see also *Shell International Ltd.* (2006), p. 7.

¹⁴⁵ See *IOSCO* (2006), “General Comments” section 2.

¹⁴⁶ See *ASB* (2006), section B q. 12.

¹⁴⁷ See *SAICA / APB of South Africa / APC of SAICA* (2006), p. 10.

¹⁴⁸ See *Mazars & Guérard* (2006), p. 2.

impression that the importance placed on accurate, dependable measurements is diminished.¹⁴⁹ Thus, relevance is not a valid basis for selecting one measurement basis over another.¹⁵⁰

Further, some of the respondents criticise that the DP does not equally stress relevance and reliability as it is done by the IASB Framework, which puts even emphasis on both.¹⁵¹ The DP fails to achieve a balance between reliability and relevance, i.e. decision usefulness and the stewardship objective (see chapter 3.1 above).¹⁵² The IASB and the FASB seem to propose that measures that are not reliable can still be relevant.¹⁵³ Hence, the issue is much more complicated than just a simple trade-off.¹⁵⁴ Relevance and reliability are two inter-related concepts.¹⁵⁵ The Austrian Financial Reporting and Auditing Committee (AFRAC) considers achieving a balance by defining a minimum level of reliability and optimising relevance difficult.¹⁵⁶ The Institut der Wirtschaftsprüfer (IDW) however finds this theoretically possible.¹⁵⁷

Numerous respondents argue that the term “an acceptable level of reliability” is vague and leaves the question open, when exactly such a threshold will be reached.¹⁵⁸ It needs to be defined more precisely otherwise scope of interpretation is left open.¹⁵⁹ Either defining an

¹⁴⁹ See *Basel Committee on Banking Supervision* (2006), p. 4.

¹⁵⁰ See *Mazars & Guérard* (2006), p. 8; see also *ICAEW* (2006), para. 64.

¹⁵¹ See *IASB* (2002), para. 45; see also *DASB* (2006), p. 1; *DRSC* (2006), pp. 7, 11; *EFRAG* (2006), p. 15; *FEE* (2006), p. 7; *FSR* (2006), pp. 2, 9.

¹⁵² See *FSR* (2006), pp. 2, 9.

¹⁵³ See *EFRAG* (2006), p. 16.

¹⁵⁴ See *CEBS* (2006), p. 4; see also *Shell International Ltd.* (2006), p. 7.

¹⁵⁵ See *Grant Thornton International* (2006), p. 9; similar *AFRAC* (2006), p. 12.

¹⁵⁶ See *AFRAC* (2006), pp. 12-13.

¹⁵⁷ See *IDW* (2006), p. 13.

¹⁵⁸ See *ACTEO / AFEP / MEDEF* (2006), covering letter p. 2; see also *AFRAC* (2006), pp. 12-13; *CIPFA* (2006), p. 12; *CNC* (2006), appendix q. 12; *EFRAG* (2006), p. 16; *F. Hoffmann-La Roche Ltd.* (2006), appendix q. 13; *FSR* (2006), p. 9; *GNAIE* (2006), p. 10; *Grant Thornton International* (2006), p. 9; *Group of 100* (2006), p. 7; *industrie-holding* (2006), p. 14; *IOSCO* (2006), “General Comments” section 4; *Nestlé* (2006), p. 4; *SFRSC* (2006), pp. 4, 12; *Shell International Ltd.* (2006), p. 7; *Syngemat International AG* (2006), p. 14; *UNICE* (2006), section 3.

¹⁵⁹ See *ASB* (2006), section B q. 13; see also *CIPFA* (2006), p. 3; *industrie-holding* (2006), p. 14; *SFRSC* (2006), pp. 12-13; *Syngemat International AG* (2006), p. 14.

absolute or a relative threshold is proposed.¹⁶⁰ Thereby, the latter taking into account the relation to available measurement bases might be considered superior.¹⁶¹ The determination of this concept in practice may significantly destabilise accounting consistency.¹⁶² The International Financial Reporting Standards Review Committee of the Korea Accounting Standards Board (IFRSRC of KASB) points out "...that there are only a handful of jurisdictions in the world – namely, the developed countries – that currently have such highly developed accounting and financial infrastructure."¹⁶³ Thus, this will result in a number of different acceptable levels of reliability around the world.¹⁶⁴ The concept of reliability should be made more operational.¹⁶⁵ According to the European Financial Reporting Advisory Group (EFRAG), the proposal implies the presumption that information obtained "through the eyes of management"¹⁶⁶ is less reliable since it is based on a neutral view towards the reporting entity without sufficient justification for this presumption.¹⁶⁷

The IDW argues that fair value has a high degree of reliability only where active markets exist. However, in reality this is often not the case and fair value has to be derived using valuation techniques based on non-market-based parameters, and thus failing to provide an acceptable level of reliability.¹⁶⁸ The DP acknowledges that an estimate of fair value lacking a market price may be open to major measurement uncertainties.¹⁶⁹ However, it is not clear how sufficient reliability is then achieved.¹⁷⁰

¹⁶⁰ See *IFRSRC of KASB* (2006), p. 8.

¹⁶¹ See *EFRAG* (2006), p. 16.

¹⁶² See *IFRSRC of KASB* (2006), p. 9.

¹⁶³ *IFRSRC of KASB* (2006), p. 8.

¹⁶⁴ See *IFRSRC of KASB* (2006), p. 8.

¹⁶⁵ See *DASB* (2006), p. 7; similar *CIPFA* (2006), p. 3.

¹⁶⁶ *EFRAG* (2006), p. 15.

¹⁶⁷ See *EFRAG* (2006), pp. 15-16.

¹⁶⁸ See *IDW* (2006), p. 14.

¹⁶⁹ See *IASB* (2005a), para. 104.

¹⁷⁰ See *SFRSC* (2006), p. 13.

3.4 Sources of Measurement Uncertainty – Estimation Uncertainty and Economic Indeterminacy

The DP identifies the following sources of measurement uncertainty:

- Estimation uncertainty, i.e. the judgement about an uncertain existing condition or future outcome involved in an estimate.
- Economic indeterminacy involving arbitrary allocations when the costs must be allocated among two or more assets or liabilities.¹⁷¹

Although the DP identifies these reasons for measurement uncertainty, no suggestion on how to take these uncertainties into account is provided.¹⁷²

Some respondents question whether the two factors are the only reasons for measurement uncertainty, even though these critics do also not provide further suggestions.¹⁷³

Grant Thornton International states that a wide range of measurement uncertainty indicates that the measurement may not be reliable.¹⁷⁴

However, the International Actuarial Association (IAA) opposes that in businesses having to accept uncertain risks such as the insurance business the multitude necessary “to provide ‘relevant and reliable information’ can be quite large and even if available may not be ‘relevant’.”¹⁷⁵

Anyway, it would be false to ignore the item concerned, since “there might be lower and upper limits that are reliably determinable.”¹⁷⁶ The Group of North American Insurance Enterprises (GNAIE) states that in opposition to the DP’s proposal that actual outcomes are not necessarily reliable for measurement estimation,¹⁷⁷ they should be an indicator for reliability of estimates. Otherwise the available information may not be adequate for reliable estimation. Thus, whether the measurement basis represents what it purports to portray has to be questioned.¹⁷⁸

¹⁷¹ See *IASB (2005a)*, para. 90, 91, 95.

¹⁷² See *SFRSC (2006)*, p. 4.

¹⁷³ See *CNC (2006)*, q. 13; see also *Martinez, Chris (2006)*, p. 5.

¹⁷⁴ See *Grant Thornton International (2006)*, pp. 9-10.

¹⁷⁵ *IAA (2006)*, p. 10.

¹⁷⁶ *IAA (2006)*, p. 10.

¹⁷⁷ See *IASB (2005b)*, para. 206.

¹⁷⁸ See *GNAIE (2006)*, p. 11.

The DP describes estimation uncertainty as “limitations on the reliability of a measurement basis”¹⁷⁹. In this regard, Petri Vehmanen suggests considering it as a lack of instruments for measurement in certain situations where other means than measurement have to be applied.¹⁸⁰

PWC LLP purports the disclosure of measurement uncertainty because information on earnings and gains and losses is indispensable for market confidence.¹⁸¹ The AFRAC proposes that, since estimation uncertainty is disclosed, information on economic indeterminacy should also be depicted in the notes.¹⁸² Disclosing the formula with respect to the cost of an item allocated among two or more assets or liabilities regarding economic indeterminacy will diminish the limitation on measurement significantly.¹⁸³ On the other hand, it has to be borne in mind that a lack of reliability cannot be mitigated through disclosure. Assuming that measurement uncertainties can only be overcome by disclosing additional information is not convincing.¹⁸⁴ The range of possible outcomes cannot be proven due to estimation uncertainty.¹⁸⁵ Hence, it can hardly be eliminated through disclosure. Further, it is difficult to identify which information on measurement uncertainty users of financial statements are interested to get. It will be difficult for readers to understand the information and draw conclusions about timing and uncertainty of future cash flows.¹⁸⁶

Furthermore, the CASB states the example of two entities A and B: A intends to acquire a subsidiary from B. A presumes synergies which leads it to value the subsidiary at an acquisition price of 1.5 million. B on the contrary has fewer expectations and would not be able to exploit the same

¹⁷⁹ IASB (2005a), para. 90.

¹⁸⁰ See Vehmanen, Petri (2006), p. 10.

¹⁸¹ See PWC LLP (2006), p. 3.

¹⁸² See AFRAC (2006), p. 13.

¹⁸³ See DRSC (2006), p. 11; see also IDW (2006), p. 15.

¹⁸⁴ See ACTEO / AFEP / MEDEF (2006), covering letter p. 2; see also Bundesverband deutscher Banken e.V. (2006), p. 6; Grant Thornton International (2006), p. 9; Mazars & Guérard (2006), p. 2; UNICE (2006), section 3; Zentraler Kreditausschuss (2006), p. 6.

¹⁸⁵ See DRSC (2006), p. 11.

¹⁸⁶ See IDW (2006), pp. 7, 15.

synergies. It values the subsidiary with a price of 0.5 million. If A acquires the subsidiary for 1.35 million, it is questioned whether this should be the fair value of the subsidiary.¹⁸⁷ However, the CASB does not provide a resolution for this example. The asset can either be measured indirectly, i.e. at the consideration paid of 1.35, or directly, while in the latter case identification and estimation problems will arise since most inputs have multiple attributes, e.g. prices and terms that need to be identified. Under current practice, assets are tested for impairment and a potential lower value, assuming that the entity has made a bad deal, will be written down to the recoverable amount. Direct measurement results in a net profit or loss recognised on initial recognition, which results in more problems than testing for impairment.¹⁸⁸ The CASB should discuss in more detail the concept of depreciation and impairment compared to fair value measurement.¹⁸⁹

4 Alternative Measurement Bases

4.1 Historical Cost

4.1.1 Definition

The DP proposes the following definition of historical cost:

“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.”¹⁹⁰

The IDW suggests avoiding the term “fair value” within this definition since this refers already to another measurement basis.¹⁹¹ Historical cost shall be generally based on the cash or cash equivalents paid wherever assets

¹⁸⁷ See *IASB (2005a)*, para. 110.

¹⁸⁸ See *SFRSC (2006)*, pp. 4, 5.

¹⁸⁹ See *CPA Australia (2006)*, p. 8.

¹⁹⁰ *IASB (2005a)*, para. 34.

¹⁹¹ See *IDW (2006)*, p. 4.

are acquired and only in special situations when assets are not acquired for cash the fair value of the consideration given is of secondary importance.¹⁹² Fair value should be addressed in special situations not generally always.¹⁹³ The Hundred Group of Finance Directors, on the contrary, agrees that fair value is the basis for historical cost.¹⁹⁴

Concerning the term “fair value of the consideration given”, some standard setters find that historical cost equals the accumulation of costs including allocations of costs.¹⁹⁵ If historical cost shall be estimated correctly, cost allocations need to be part of the consideration given.¹⁹⁶ Especially, considering assets that take time to construct several respondents view the partial acquisitions, i.e. the accumulated costs incurred to build the asset, to be the fair value of the consideration given.¹⁹⁷ Hence, in this case it is suggested to add the words “at the amount of cash or cash equivalents paid” to the definition and focus on the accumulated costs.¹⁹⁸ Roland Verhille points out that readers are rather concerned about the money invested in the business than any value of the asset or liability.¹⁹⁹ Petri Vehmanen, on the contrary, argues that an asset is measured at the exchange value at the time of exchange rather than the current amount of money.²⁰⁰ Thus, the reference to an amount being paid might not be necessary.

A number of opinions contradicting the DP exist among the responding authors regarding the term “at the time of their acquisition” in relation to assets that take time to construct. The CASB proposes that the fair value

¹⁹² See *Hundred Group of Finance Directors* (2006), appendix q. 2; see also *ICAEW* (2006), para. 41; *Shell International Ltd.* (2006), p. 2-3.

¹⁹³ See *ICAEW* (2006), para. 41.

¹⁹⁴ See *Hundred Group of Finance Directors* (2006), appendix q. 2.

¹⁹⁵ See *IASB* (2005a), para. 36.

¹⁹⁶ See *ACTEO / AFEP / MEDEF* (2006), appendix p.1.

¹⁹⁷ See *CNC* (2006), appendix q. 2; see also *Consiglio Nazionale dei Dottori Commercialisti / Consiglio Nazionale dei Ragionieri* (2006), q. 2; *DASB* (2006), p. 3; *FEE* (2006), p. 4; *IDW* (2006), p. 4; *SEAG* (2006), p. 4; similar *ACT* (2006), q. 2; *ACCA* (2006), q. 2.

¹⁹⁸ See *Mazars & Guérard* (2006), p. 4; see also *EFRAG* (2006), p. 7.

¹⁹⁹ See *Verhille, Roland* (2006), p. 5.

²⁰⁰ See *Vehmanen, Petri* (2006), p. 15.

of the consideration given should be the component parts, when an asset becomes operational and ready to contribute to the generation of future cash flows.²⁰¹ The definition should refer to an asset's acquisition but also to its construction.²⁰² Otherwise a different view on what constitutes the time of acquisition would have to be adopted.²⁰³ It cannot be the CASB's intention that the date of initial measurement is every time when each part becomes ready to contribute to future cash flows. Thus, it needs to be clarified if the amount at initial measurement would be the fair value of all single transactions to construct the final asset or of the ready asset at the time of completion. The DP seems to propose that an incomplete asset should be measured at fair value less the estimate of any discount the market would deduct from the incomplete asset. On the other hand however, re-measurement at each balance sheet date was not dealt with in the DP. The problematic of limiting the scope solely to initial recognition in isolation from subsequent re-measurement becomes apparent here.²⁰⁴ Although, the DP sets its scope to exclude the timing of initial recognition (see chapter 2.2 above), the definition includes the words "at the time of their acquisition". Shell International Ltd. also suggests clarifying what is to be taken as "the time of acquisition".²⁰⁵

Further, construction time that lasts for several years would lead to substantial amounts of recognised day 1 profits and losses, if the fair value approach were applied.²⁰⁶ It needs to be clarified how differences between historical cost and fair value regarding self-constructed assets are to be accounted for.²⁰⁷ UBS AG²⁰⁸ questions the decision-usefulness of reporting the completed asset's fair value rather than the accumulated costs.²⁰⁹

²⁰¹ See *IASB (2005a)*, para. 32.

²⁰² See *CPA Australia (2006)*, p. 3; see also *FEE (2006)*, p. 4.

²⁰³ See *EFRAG (2006)*, p. 7.

²⁰⁴ See *SEAG (2006)*, p. 4.

²⁰⁵ See *Shell International Ltd. (2006)*, p. 3.

²⁰⁶ See *SFRSC (2006)*, p. 6; similar *Syngentat International AG (2006)*, p. 3.

²⁰⁷ See *IFRSRC of KASB (2006)*, p. 12.

²⁰⁸ UBS originally stood for Union Bank of Switzerland. However, the Union Bank of Switzerland was merged with Swiss Bank Corporation in 1998, and thenceforth, UBS ceased to be considered a representational acronym.

²⁰⁹ See *UBS AG (2006)*, p. 9.

Users may find it more valuable to solely view the fair value in the notes.²¹⁰

The CASB omits the words “or in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business”²¹¹ because it appears to describe an expected value measurement.²¹² Nevertheless, some believe that liabilities for which non-monetary consideration is received, e.g. income taxes or contingent liabilities should not be ignored and not be excluded from the definition of historical cost.²¹³ Referring to “the value at origination”²¹⁴ is suggested by the European Banking Industry since a liability might be incurred without reception of any consideration.²¹⁵ It needs to be made clear which identified measurement basis should be applied to liabilities that do not result from exchange transactions.²¹⁶ The discussion of these issues may not change the conclusions drawn on fair value. However, this is not apparent and needs to be discussed, too.²¹⁷

Furthermore, it is not clear whether the amount for items carried at amortized or depreciated costs would be the cost at the original date of acquisition or the net depreciated cost at the date of the exchange actually taking place.²¹⁸ The University of Wisconsin assumes the following example: Two real estate properties, for which there is no market price currently observable, shall be exchanged. The two properties were originally acquired at 7.3 million and 7.0 million. The carrying values are 5.8 and 5.5 million.²¹⁹ Assuming that the proposal is to recognise the properties at the carrying value, i.e. the net depreciated cost, the

²¹⁰ See *NASB* (2006), para. 8; see also *UBS AG* (2006), p. 9.

²¹¹ *IASB* (2002), para. 100(a).

²¹² See *IASB* (2005a), para. 35(c).

²¹³ See *European Banking Industry* (2006), enclosure p. 3; see also *GNAIE* (2006), p. 3; *NAIC* (2006), p. 2.

²¹⁴ *European Banking Industry* (2006), enclosure p. 3.

²¹⁵ See *European Banking Industry* (2006), enclosure p. 3.

²¹⁶ See *Grant Thornton International* (2006), p. 7.

²¹⁷ See *ASB* (2006), section A para. 3.

²¹⁸ See *NAIC* (2006), p. 2; similar *University of Wisconsin* (2006), q. 1.

²¹⁹ See *University of Wisconsin* (2006), q. 1.

University of Wisconsin suggests to choose “current carrying value”²²⁰ as a clearer term for the measurement basis historical cost.

4.1.2 Possible Measurement Basis on Initial Recognition

Some respondents consider historical cost as the most relevant measurement basis on initial recognition (see chapter 6.1.3 below). There are cases where the costs for individual items are not separately identifiable, e.g. business combinations or multiple-element transactions. In these situations only fair value shall be considered on initial recognition, according to some respondents.²²¹ Historical cost will then not be a possible measurement bases.

Further, Petri Vehmanen states that values stop being measurements as soon as they are first depreciated. Modifications are arbitrary allocations.²²² Thus, in cases an amortized asset is exchanged historical cost is not an option for measurement. Then, the National Accounting Standards Board of Russia (NASB) considers it a possibility to use fair value.²²³

4.2 Current Cost

4.2.1 Definition

The DP proposes the following definition of current cost:

“The most economic cost of an asset or of its equivalent productive capacity or service potential.”²²⁴

This definition further incorporates these two terms:

- Reproduction cost: “The most economic current cost of replacing an existing asset with an identical one.”²²⁵

²²⁰ *University of Wisconsin* (2006), q. 1.

²²¹ See *industrie-holding* (2006), p. 6; see also *Syngemat International AG* (2006), p. 5.

²²² See *Vehmanen, Petri* (2006), pp. 16, 18.

²²³ See *NASB* (2006), para. 2.

²²⁴ *IASB* (2005a), para. 38.

²²⁵ *IASB* (2005a), para. 38.

- Replacement cost: “The most economic current cost of replacing an existing asset with an asset of equivalent productive capacity or service potential.”²²⁶

The AFRAC suggests changing the terms “most economic cost” to “most advantageous cost”²²⁷ because there are already other definitions in this regard, which incorporate the latter words.²²⁸

Other respondents consider the definition to be too broad.²²⁹ They claim it not to be based on accounting literature.²³⁰ Given that reproduction would be the most economic means of replacing an asset, replacement cost could also incorporate reproduction cost.²³¹ Therefore, since the distinction between these two terms is unclear, it is suggested to combine them.²³² Otherwise, “reproduction cost” should be renamed “replacement cost” and “replacement cost” should be labelled “substitution cost” in order to avoid misunderstanding.²³³

4.2.2 Possible Measurement Basis on Initial Recognition

Some respondents do not consider current cost, reproduction and replacement cost as separate measurement bases.²³⁴ The terms may not be relevant on initial recognition, however on subsequent re-measurement.²³⁵

These measurement bases are not mutually exclusive since there may be cases when reproduction cost might equate replacement cost.²³⁶

²²⁶ IASB (2005a), para. 38.

²²⁷ AFRAC (2006), p. 6.

²²⁸ See AFRAC (2006), p. 6.

²²⁹ See *Grant Thornton International* (2006), p. 7; see also *SAICA / APB of South Africa / APC of SAICA* (2006), p. 4.

²³⁰ See *SAICA / APB of South Africa / APC of SAICA* (2006), p. 4.

²³¹ See *Grant Thornton International* (2006), p. 7; see also *ICPAK* (2006), covering letter.

²³² See *ICPAK* (2006), covering letter.

²³³ See *BG Group* (2006), p. 2.

²³⁴ See *AASB* (2006), p. 3; see also *NSW Treasury* (2006), p. 3.

²³⁵ See *Grant Thornton International* (2006), p. 12.

²³⁶ See *IVSC* (2006), appendix q. 1.

Therefore, reproduction should be regarded as a subset of replacement cost (see also chapter 4.2.1 above).²³⁷

4.3 Net Realizable Value

4.3.1 Definition

The DP's proposed definition for net realizable value is:

“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.”²³⁸

The Royal Institute of Chartered Surveyors (RICS) Valuation Faculty proposes to remove the term “net” from the definition based on the assumption that (net) realizable value is a substitute for fair value and costs of realisation are not part of fair value either.²³⁹

4.3.2 Possible Measurement Basis on Initial Recognition

This definition assumes that an amount of money is not actually paid. Therefore, the measurement basis is not currently observable. However, frequent trading may create generalizations, and thus enable predictions.²⁴⁰

Further, Disclosure Solutions Ltd. criticises that the two transaction costs – one borne for the asset's acquisition on the one hand and its future disposal on the other hand – create hypothetical day 1 losses.²⁴¹

²³⁷ See AASB (2006), p. 3.

²³⁸ IASB (2005a), para. 42.

²³⁹ See RICS Valuation Faculty (2006), p. 3.

²⁴⁰ See Vehmanen, Petri (2006), p. 17.

²⁴¹ See Disclosure Solutions Ltd. (2006), section “Net realisable value”.

4.4 Value in Use

4.4.1 Definition

The DP proposes this definition of value in use:

“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.”²⁴²

The CASB acknowledges that the definition does not state whose expectations should be met.²⁴³ These are assumed to be the reporting entity management’s best estimates of future cash flows.²⁴⁴ Value in use is an entity-specific measure.²⁴⁵ However, this preference for entity-specific expectations was not made entirely clear.²⁴⁶ This should certainly be somehow incorporated in the definition.²⁴⁷

The definition further includes the reference to an asset’s useful life. However, the CASB fails to explain if market or entity-specific aspects exactly define an asset’s useful life. Shell International Ltd. considers the useful life to be determined by the entity’s management.²⁴⁸

4.4.2 Possible Measurement Basis on Initial Recognition

There seems to be a contradiction since present value is described as a technique to estimate measurement rather than a measurement basis itself, but the same assumption is not stated for value in use, which incorporates the terms “the present value of”. Both present value and

²⁴² IASB (2005a), para. 44.

²⁴³ See IASB (2005a), para. 45.

²⁴⁴ See IASB (2005a), para. 45; see also ACTEO / AFEP / MEDEF (2006), appendix p. 4; IDW (2006), p. 4.

²⁴⁵ See IFRSRC of KASB (2006), p. 10.

²⁴⁶ See CNC (2006), appendix q. 2; see also EFRAG (2006), p. 7.

²⁴⁷ See AFRAC (2006), p. 6; see also IDW (2006), p. 4.

²⁴⁸ See Shell International Ltd. (2006), pp. 3, 9.

value in use are only forecasts. Their correctness will not be proven until the underlying events have taken place, according to Petri Vehmanen.²⁴⁹

4.5 Fair Value

4.5.1 Definition

The DP proposes the following definition of fair value:

“The amount for which an asset or liability could be exchanged between knowledgeable, willing parties in an arm’s length transaction.”²⁵⁰

This definition differs from the one used by the IASB: The term “exchanged” is replaced for “settled” with respect to liabilities.²⁵¹ This replacement is attempted to enhance a neutral reference to both an entry and exit value and to prevent that the term refers solely to an exit value.²⁵²

The proposed definition not taking side for either an entry or an exit market does not coincide with the FASB’s view in its project on FVM.²⁵³ There, fair value is in favour of an exit measure.²⁵⁴ Many respondents demand reaching convergence and agreeing on a consistent notion on this issue first and consequently basing the definition clearly on either entry or exit prices.²⁵⁵ The RICS Valuation Faculty supports the decision for fair value being either an entry or an exit measure in order to coincide with the proposal that there is only one fair value on a given measurement date (see chapter 5.6.1 below).²⁵⁶

²⁴⁹ See *Vehmanen, Petri* (2006), p. 17.

²⁵⁰ *IASB* (2005a), para. 46.

²⁵¹ See *IAS 32* (2004), para. 11.

²⁵² See *IASB* (2005a), para. 47.

²⁵³ See *ASBJ* (2006), p. 4; see also *CPA Australia* (2006), p. 3; *Group of 100* (2006), p. 2; *IAA* (2006), p. 3; *JICPA* (2006), p. 2; *Nestlé* (2006), p. 2; *NSW Treasury* (2006), p. 2.

²⁵⁴ See *FASB FVM Team* (2006), p. 4.

²⁵⁵ See *ASBJ* (2006), p. 4; see also *CPA Australia* (2006), p. 3; *DRSC* (2006), p. 5; *EFRAG* (2006), pp. 7-8; *Group of 100* (2006), p. 2; *IAA* (2006), pp. 2-3; *JICPA* (2006), p. 2; *MASB* (2006), p. 2; *NAIC* (2006), pp. 2-3; *NSW Treasury* (2006), p. 2; *NRS* (2006), p. 3; *UBS AG* (2006), pp. 5, 8; *Zentraler Kreditausschuss* (2006), p. 6.

²⁵⁶ See *RICS Valuation Faculty* (2006), p. 9.

The FASB acknowledges that for certain assets and liabilities multiple markets exist and that then fair value should be derived from a transaction in the most advantageous market (see also chapter 5.6.5 below).²⁵⁷ Since markets are not perfect in reality and multiple markets and information asymmetry exist (see chapter 5.2.2 below), there will always – even in financial markets that are highly liquid – be a difference between entry and exit prices and not just a single equilibrium price.²⁵⁸ A single equilibrium price will only be achieved over a certain period of time. Therefore, certainly not all exchange transactions will bring out an equilibrium price (see also chapter 5.3.3.1 below).²⁵⁹ Thus, the definition of fair value not clearly being based on either entry or exit prices does not take real-world market conditions into account.²⁶⁰

Other respondents demand a definition explicitly grounded on an exit market.²⁶¹ Grant Thornton International finds exit values more relevant in predicting future cash flows.²⁶² According to the EFRAG, an exit value may indeed be a good indicator of future cash flows, if the entity intends to dispose of its assets. However, most entities use assets to generate cash flows.²⁶³ The International Organization of Securities Commissions (IOSCO) questions how fair value can be considered an exit value while taking historical cost and current cost, which may not indicate exit prices as substitutes for fair value.²⁶⁴ The Chartered Institute of Public Finance and Accountancy (CIPFA) purports to refer solely to entry values since especially for specialized and non-income generating assets exit values are not decision-useful.²⁶⁵

²⁵⁷ See *FASB FVM Team* (2006), p. 2; see also *NAIC* (2006), p. 2.

²⁵⁸ See *DRSC* (2006), pp. 3, 5, 6; see also *Martinez, Chris* (2006), pp. 2-3.

²⁵⁹ See *Martinez, Chris* (2006), pp. 2-3.

²⁶⁰ See *IDW* (2006), p. 4.

²⁶¹ See *Grant Thornton International* (2006), p. 8; see also *Monash University* (2006), p. 2; *NSW Treasury* (2006), p. 3; *Mazars & Guérard* (2006), p. 4.

²⁶² See *Grant Thornton International* (2006), p. 8.

²⁶³ See *EFRAG* (2006), p. 17.

²⁶⁴ See *IOSCO* (2006), “General Comments” section 6.

²⁶⁵ See *CIPFA* (2006), pp. 2, 13.

The change from fair value being the amount at which a liability could be “settled” to one at which it could be “exchanged”, i.e. transferred, might make the treatment of specific assets and liabilities more uniform.²⁶⁶ The Institute of Certified Public Accountants of Kenya (ICPAK), on the contrary, believes that this replacement is redundant since the former expression is a variant of the latter and that the term “exchanged” should be retained.²⁶⁷ The Conseil National de la Comptabilité (CNC), which opposes the interpretation of fair value as market value, disagrees with this replacement because “exchanged” – compared to “settled” – incorporates a preference for market value.²⁶⁸

In addition, in the insurance business the principle of ultimate settlement, even following a prior transfer, is considered critical. Any transfer or exchange needs to be accepted by the transferee. In any regulated industry, such as the insurance business, the transferee also has to be regulated in order to enforce that the obligation will be settled vis-à-vis the beneficiary. Thus, any transfer notion needs to be influenced by a settlement obligation in regulated industries.²⁶⁹

In addition, the reference to a market value measurement objective is not included in the definition by the CASB because other definitions also do not mention it. Nonetheless, fair value is presumed by the CASB to incorporate the market value measurement objective.²⁷⁰ The DP states: “There would seem to be acceptance among accounting standard setters that the objective of fair value measurement is to represent the market value of an asset or liability at the measurement date.”²⁷¹ The Certified Public Accountants (CPA) Australia agree with this statement.²⁷² However,

²⁶⁶ See *British American Tobacco* (2006), p. 2.

²⁶⁷ See *ICPAK* (2006), covering letter.

²⁶⁸ See *CNC* (2006), appendix qs. 2, 8.

²⁶⁹ See *NAIC* (2006), p. 3.

²⁷⁰ See *IASB* (2005a), para. 48.

²⁷¹ *IASB* (2005b), para. 92.

²⁷² See *CPA Australia* (2006), p. 3.

most standard-setters have not taken sides yet, according to the EFRAG.²⁷³

The SFRSC purports that the demand for inclusion of the market value measurement objective is not important enough to give rise to change the well-known definition of fair value.²⁷⁴ The sole presumption that the market value measurement objective is embodied in the definition however is considered to be insufficient by other respondents. The market value or its approximation should either be included in the definition,²⁷⁵ or at the utmost, the market value measurement objective should be mentioned in the label of this measurement basis in order to reach clarity.²⁷⁶ Some think the term fair value should solely be based on the market.²⁷⁷ Hence, according to the Accounting Standards Board Ltd. (ASB) it shall be re-labelled “market value”.²⁷⁸ Then the definition and the terms would need to be refined. The definition needs to express more clearly whether it is a market-based or an entity-specific measure.²⁷⁹

An observable market price is considered necessary in the measurement of fair value. Therefore, the University of Wisconsin suggests a more specific term such as “fair market value”.²⁸⁰ This term would be more appropriate and not confuse users of financial statements unnecessarily.²⁸¹ The CNC, on the contrary, states that the given fair value definition does not necessarily imply the existence of a market, also a single transaction might fulfil this definition.²⁸² The DP should explain the characteristics constituting a market in more detail. According to the Appraisal Institute, fair value contains many elements of the market value, but is not as specific since it omits especially the characteristics of proper

²⁷³ See *EFRAG* (2006), pp. 8, 10.

²⁷⁴ See *SFRSC* (2006), p. 8.

²⁷⁵ See *AFRAC* (2006), p. 6; see also *Markit Valuations* (2006), pp. 4, 5.

²⁷⁶ See *SFRSC* (2006), p. 8.

²⁷⁷ See *Monash University* (2006), p. 2.

²⁷⁸ See *ASB* (2006), section B q. 2.

²⁷⁹ See *DRSC* (2006), p. 5; see also *EFRAG* (2006), pp. 7-8; *Group of 100* (2006), p. 2; *NRS* (2006), p. 3.

²⁸⁰ See *University of Wisconsin* (2006), q. 1.

²⁸¹ See *CICBV* (2006), p. 1.

²⁸² See *CNC* (2006), covering letter section 4.1.1, appendix q. 2.

marketing time and time of exposure to the market as well as payment terms.²⁸³ The International Valuation Standards Committee's (IVSC) definition of a market includes the terms "after proper marketing" referring to an appropriate exposure time.²⁸⁴ Without an adequate time of exposure to the market not all assets are optimally sold.²⁸⁵ The IASB definition adopted by the CASB refers to an "arms length" and not a "market transaction". Therefore, it should be independent from the existence of an active market or available market prices.²⁸⁶ Fair value is the average of actual prices traded in a perfect market or the determination of what the average price would be, if there were a perfect market. It is not linked at all to actual market conditions, according to the London Society of Chartered Accountants (LSCA).²⁸⁷

A fair value may also be a calculated one and may not only involve market value.²⁸⁸ There may be important differences between a fair value derived from a market price in an active market and a calculated one.²⁸⁹ Equating fair value to market value would result in assets, which have no fair value because no market exists for them.²⁹⁰ The Australian Accounting Standards Board (AASB) agrees with the exclusion of the market value measurement objective because for various assets and liabilities active markets do not exist.²⁹¹ A clearer differentiation between the two concepts would be needed.²⁹²

Hermes Investment Management (Mgmt.) Ltd. suggests abandoning the broad term fair value and using "market price" where this is also meant.²⁹³ Market prices are not necessarily a reliable indicator of an asset's value to

²⁸³ See *Appraisal Institute* (2006), pp. 1-2.

²⁸⁴ See *IVSC* (2006), annex para. 3.2.7.

²⁸⁵ See *Appraisal Institute* (2006), pp. 1-2.

²⁸⁶ See *ACCA* (2006), q. 2.

²⁸⁷ See *LSCA* (2006), p. 2.

²⁸⁸ See *DRSC* (2006), pp. 5, 13; see also *Imamura, Takeshi* (2006), q. 2.

²⁸⁹ See *DRSC* (2006), p. 5.

²⁹⁰ See *BG Group* (2006), p. 2.

²⁹¹ See *AASB* (2006), p. 5.

²⁹² See *BG Group* (2006), p. 2; see also *IVSC* (2006), appendix q. 2; *RICS Valuation Faculty* (2006), p. 4.

²⁹³ See *Hermes Investment Mgmt. Ltd.* (2006), q. 4c.

any other owner, except in a perfectly competitive market where supply and demand are completely elastic.²⁹⁴ Considering the CASB's use of fair value, "fair price" might be a more appropriate label to use, according to the ASB. However, market value would be the more precise term to use given the CASB's analysis. The ASB points out that fair value is commonly used in share transfers and business combinations.²⁹⁵

The IVSC points out that "... the price that could be obtained in the general market, ignoring any additional price that may be paid by a purchaser with a special interest ..." ²⁹⁶ is a generally accepted definition of market value. Fair value reflects the synergistic element arising from the release of additional value to a specific buyer and seller. Market value is independent of any special interest or motives of the parties involved.²⁹⁷ Especially in business combinations or the transfer of blocks of shares the two values may differ significantly. Considering transactions between individuals and businesses in general, fair value will not always coincide with market value.²⁹⁸

Given that fair value can either be a market price or a modelled market price, the two versions should be considered separately.²⁹⁹ Takeshi Imamura suggests subdividing the definition into "market value" and "estimated market value".³⁰⁰ On the other hand, since accountants are already familiar with the term fair value, Goldman Sachs International purports not to replace this term.³⁰¹

The IVSC assumes the CASB's reason for holding on to the term "fair value" to be that confusion might arise because the term "market value" is already applied in various tax legislations. However, it needs to be accom-

²⁹⁴ See *ASB (2006)*, section A para. 16.

²⁹⁵ See *ASB (2006)*, section B q. 2.

²⁹⁶ *IVSC (2006)*, appendix q. 2.

²⁹⁷ See *IVSC (2006)*, appendix q. 2; see also *RICS Valuation Faculty (2006)*, p. 4.

²⁹⁸ See *IVSC (2006)*, appendix q. 2.

²⁹⁹ See *Hermes Investment Mgmt. Ltd. (2006)*, covering letter, q. 1.

³⁰⁰ See *Imamura, Takeshi (2006)*, q. 2.

³⁰¹ See *Goldman Sachs International (2006)*, section "Market Value objective".

plished that not even common law legislations would use precedents drawn from regulations for one purpose to support interpretations for another purpose. Therefore, the term may be accepted for reflecting elements of synergistic or special value, e.g. in business combinations.³⁰² Hermes Investment Mgmt. Ltd. argues that the use of the term “fair value” already obscured the nature of the discussion since no one would defend the usage of unfair values.³⁰³ CIPFA suggests using a more neutral terminology.³⁰⁴

4.5.2 Possible Measurement Basis on Initial Recognition

The definition of fair value is considered not to incorporate the same level of quality and clarity as the other measurement bases by Hermes Investment Mgmt. Ltd.³⁰⁵ E&Y goes as far as saying since fair value is not superior to the other measurement bases listed in the DP it should not be considered as measurement concept.³⁰⁶

If the term fair value were split up, and hence, also reflected other versions of it (see the discussion in chapter 4.5.1 above), these different versions would need to be included on the list of possible measurement bases also.³⁰⁷ Instead of subsuming market value or value in use under the term fair value, all bases should be described separately.³⁰⁸

³⁰² See *IVSC* (2006), appendix q. 4c.

³⁰³ See *Hermes Investment Mgmt. Ltd.* (2006), covering letter, q. 1.

³⁰⁴ See *CIPFA* (2006), p. 7.

³⁰⁵ See *Hermes Investment Mgmt. Ltd.* (2006), covering letter, q. 1.

³⁰⁶ See *E&Y* (2006), pp. 4-5.

³⁰⁷ See *EFRAG* (2006), p. 7; see also *AFRAC* (2006), p. 5; see also *Group of 100* (2006), p. 1.

³⁰⁸ See *BG Group* (2006), p. 2.

4.6 Deprival Value

4.6.1 Definition

The DP proposes the following definition for deprival value:

“The loss that an entity would suffer if it were deprived of an asset. The upper boundary is its replacement cost. The lower boundary is recoverable amount (which is the higher of its net realizable value and value in use).”³⁰⁹

The concept of deprival value stems from economic literature but has not yet been introduced to IASB accounting literature.³¹⁰ However, it underlies the concepts in IAS 36 “Impairment of Assets”, although it is not explicitly addressed by IFRS.³¹¹

Assuming that reproduction cost is not incorporated in replacement cost (see chapter 4.2.1 above), the deprival value should refer to current cost rather than just replacement cost. Regarding the current definition of deprival value, reproduction cost seems to be excluded from the definition.³¹²

4.6.2 Possible Measurement Basis on Initial Recognition

Deprival value is only a combination of other measurement bases, namely a decision rule between replacement cost, net realizable value, and value in use.³¹³ Thus, the IAA assumes that the latter measurement bases already adequately address deprival value.³¹⁴

³⁰⁹ IASB (2005a), para. 49.

³¹⁰ See *European Banking Industry* (2006), enclosure p. 4.

³¹¹ See *EFRAG* (2006), p. 7.

³¹² See *AASB* (2006), pp. 3-4.

³¹³ See *JICPA* (2006), p. 2; see also *NSW Treasury* (2006), p. 3.

³¹⁴ See *IAA* (2006), p. 2.

The CNC points out that deprival value referring to the “loss that an entity would suffer if it were deprived of an asset” is relevant on subsequent re-measurement rather than on initial measurement. Difficulties might arise in the long run in estimating the effects, such as loss of customers or image.³¹⁵ A number of respondents propose that deprival value is not relevant in any circumstances on initial recognition and may only be relevant on re-measurement.³¹⁶ It should hence be excluded from the proposed list of possible measurement bases.³¹⁷

4.7 Transaction Costs

The DP introduces the following definition:

“Transaction costs are defined as incremental costs that are directly attributable to the acquisition, issue or disposal of an asset or liability and, for the purposes of measuring the fair value of the asset or liability, are not recoverable in the marketplace on the measurement date.”³¹⁸

This definition differs from the current IASB definition in para. 9 of IAS 39 in two regards:

- Firstly, the applicability is expanded from financial assets and liabilities to simply assets and liabilities, i.e. financial and non-financial.
- Secondly, recoverability is introduced.

Contradicting views among the respondents oppose the introduction of recoverability: Under current accounting standards, transaction costs are included in the fair value of an asset, if they contribute to its functional performance or its readiness for use, which does not need to be

³¹⁵ See *CNC* (2006), appendix q. 2.

³¹⁶ See *ACCA* (2006), q. 16; see also *CNC* (2006), appendix q. 2; *FICPA* (2006), pp. 1, 7; *IAA* (2006), pp. 2, 12; *IDW* (2006), p. 3; *JICPA* (2006), pp. 2, 5; *NSW Treasury* (2006), p. 3.

³¹⁷ See *FICPA* (2006), p. 1; see also *IAA* (2006), pp. 2, 12; *IDW* (2006), p. 3; *JICPA* (2006), p. 2; *NSW Treasury* (2006), p. 3.

³¹⁸ *IASB* (2005a), para. 86.

changed.³¹⁹ Therefore the issue is to identify, if the costs contribute to an asset's functional performance.³²⁰ Further, the requirement of recoverability does not coincide with the definition of recoverability in IAS 36: "The recoverable amount of an asset or a cash-generating unit is the higher of its fair value less costs to sell and its value in use."³²¹ If the term were used in the same sense, it would lead to different results of transaction costs being recoverable.³²² IAS 39 does also not distinguish between transaction costs that are recoverable and such that are not.³²³ Under IAS 39 most financial instruments are measured at fair value including any costs directly attributable to an asset.³²⁴ Further, transaction costs are currently not treated equally regarding individual assets or liabilities compared to business combinations.³²⁵

The AFRAC purports recognizing transaction costs as part of the asset, if they are unavoidable.³²⁶ Transaction costs that can be passed on to a buyer are not part of fair value.³²⁷ Especially considering non-financial assets, it looks not logical to consider installation costs incurred to put a machine into its final position and condition to be irrecoverable, whereas on the other hand custom duties are viewed recoverable in a price achievable in a subsequent sale.³²⁸

The Association of Chartered Certified Accountants (ACCA) emphasises that contracting parties will agree upon who has to bear transaction costs before entering a contract.³²⁹ The IVSC on the other hand states that in the price agreed upon in the contract transaction costs would not be taken

³¹⁹ See *Disclosure Solutions Ltd.* (2006), section "Why fair value is unsuitable for initial recognition"; see also *industrie-holding* (2006), p. 14; *Syngemat International AG* (2006), p. 14; *UBS AG* (2006), p. 3.

³²⁰ See *industrie-holding* (2006), p. 14; see also *Syngemat International AG* (2006), p. 14.

³²¹ *IAS 36* (2004), para. 6.

³²² See *JICPA* (2006), p. 3.

³²³ See *NSW Treasury* (2006), p. 7.

³²⁴ See *IAS 39* (2004), para. 9; see also *CNC* (2006), appendix q. 11.

³²⁵ See *PWC LLP* (2006), p. 5.

³²⁶ See *AFRAC* (2006), p. 12.

³²⁷ See *ICAI* (2006), p. 6.

³²⁸ See *F. Hoffmann-La Roche Ltd.* (2006), appendix q. 11; see also *Nestlé* (2006), p. 3.

³²⁹ See *ACCA* (2006), q. 11.

into account. Nonetheless, whether to expense or capitalize transaction costs is an accounting not a measurement issue.³³⁰

Applying the recoverability test may lead to problems and divergence in practice.³³¹ Recoverability seems to be more about pricing flexibility than measurement.³³² For example, a buyer may be able to recover his transaction costs from his contracting party. However, the latter may not be able to recover them from the third party he negotiated with.³³³

The London Investment Banking Association (LIBA) purports that transaction costs, which are incorporated in and are part of fair value and are recoverable should be included in fair value. For example, costs of obtaining legal views on the purchase of a listed instrument enhance the asset's value and should therefore be included. However, commissions paid to a broker do not add any value to the asset concerned and are thus not included.³³⁴ On the other hand, if commissions are not charged to execute a transaction they may be included in the broker's profit margin, and thus may be recoverable. Either way, transaction costs should be treated consistently.³³⁵

The LIBA also considers the recoverability test critical. An entity would not incur costs, which it considers irrecoverable through the future use of the asset or liability, as reflected in entity-specific measurement objectives.³³⁶ The introduction of recoverability seems to intend to reflect the market value, which can immediately be realised. However, an entity may assume its investment including transaction costs to be recoverable over its useful life.³³⁷ The requirement that the revenues generated exceed the costs should differentiate between costs from selling an asset and costs from

³³⁰ See *IVSC* (2006), appendix q. 11.

³³¹ See *Nestlé* (2006), p. 3; see also *SFRSC* (2006), p. 12.

³³² See *Syngemat International AG* (2006), p. 7; see also *industrie-holding* (2006), p. 7; similar *ASB* (2006), section B q. 11; *EFRAG* (2006), p. 15.

³³³ See *industrie-holding* (2006), p. 7; see also *Syngemat International AG* (2006), p. 7.

³³⁴ See *LIBA* (2006), p. 3.

³³⁵ See *ISDA* (2006), p. 4.

³³⁶ See *LIBA* (2006), p. 3.

³³⁷ See *CNC* (2006), appendix q. 11.

using it.³³⁸ Many assets' transaction costs are not recovered immediately through the market but through the use of the asset, and therefore should enter into calculation of the fair value of the asset or liability.³³⁹ Hence, the recoverability test should be given a long-term view. For example, the interest expense incurred to construct an asset may not be recoverable in depressed market situations, however will need to be recovered in the long run given that the entity stays a going concern.³⁴⁰

Transaction costs are often incurred in order to counterbalance market inefficiencies. Thus, transaction costs should be included in fair value rather than being expensed, no matter if they are recoverable or not.³⁴¹ Transaction costs are part of the investment of which they are expected to bring future economic benefits.³⁴² They are likely to impact the price finally agreed upon.³⁴³ Marketplace participants are aware of transaction costs and will price them into the investment decision.³⁴⁴ Regarding financial instruments, transaction costs are an important part of determining their fair value and should be allowed to be an intrinsic part of the value.³⁴⁵

Moreover, investment decisions about assets are often made depending on the total costs. Thus, it seems useless to expense transaction costs on acquisition.³⁴⁶ Which part constitutes transaction costs does not add useful information to either the entity or users of financial statements.³⁴⁷ The exclusion of transaction costs might make fair value less decision-

³³⁸ See *FICPA* (2006), p. 5; see also *UNICE* (2006), section 4.

³³⁹ See *British American Tobacco* (2006), p. 3.

³⁴⁰ See *industrie-holding* (2006), pp. 7-8.

³⁴¹ See *ACTEO / AFEP / MEDEF* (2006), appendix p. 4; see also *AFRAC* (2006), p. 12; *UNICE* (2006), section 4.

³⁴² See *BG Group* (2006), p. 6; similar *DASB* (2006), p. 2; *Shell International Ltd.* (2006), p. 9.

³⁴³ See *FEE* (2006), p. 2; see also *UNICE* (2006), section 4.

³⁴⁴ See *CIPFA* (2006), p. 3; similar See *Shell International Ltd.* (2006), p. 9.

³⁴⁵ See *ISDA* (2006), p. 3.

³⁴⁶ See *ASB* (2006), section A para. 18, section B q. 11; see also *British American Tobacco* (2006), p. 3; *EFRAG* (2006), p. 15; *IDW* (2006), p. 13.

³⁴⁷ See *IDW* (2006), p. 13.

useful.³⁴⁸ As long as the total costs incurred are recoverable, transaction costs should be included in the purchase price.³⁴⁹

If fair value is applied on initial recognition, defining what part makes out transaction costs will not be relevant.³⁵⁰ For example, IAS 16 “Property, Plant and Equipment” permits to recognise also estimates of future costs of removing and disposing of items, although they are not directly attributable costs.³⁵¹ However, initially measuring at fair value including such costs would only become a negative part of fair value, which will not be justifiable. Thus, accounting for such costs is only possible measuring at historical cost.³⁵² The ASB supports that an asset intended for disposal should not be reported at an amount higher than net realizable value. Further, the ASB points out that in deciding whether to repair or dispose of an asset it is looked at its net realizable value.³⁵³

The AASB emphasises that, given that the initial measurement basis is historical cost, excluding transaction costs from historical cost will be difficult. Assuming that fair value is not reliable and historical cost has to be applied on initial recognition, an entity may not be able to distinguish which part constitutes transaction costs.³⁵⁴ Applying entity-specific measurement objectives on initial recognition, any cost related to the acquisition or construction of an asset shall be included.³⁵⁵ If an asset is subsequently measured at cost, including transaction costs given they are attributable to the acquisition at initial recognition is acceptable.³⁵⁶ Transaction costs should then be looked at in the light of being an asset on their own.³⁵⁷

³⁴⁸ See *CIPFA* (2006), p. 12.

³⁴⁹ See *UNICE* (2006), section 4.

³⁵⁰ See *ICAEW* (2006), para. 63.

³⁵¹ See *IAS 16* (2004), para. 13.

³⁵² See *ASBJ* (2006), p. 5.

³⁵³ See *ASB* (2006), section A para. 19.

³⁵⁴ See *AASB* (2006), p. 16.

³⁵⁵ See *industrie-holding* (2006), p. 14.

³⁵⁶ See *ASBJ* (2006), p. 5; see also *DASB* (2006), p. 6; *JICPA* (2006), p. 3; similar *ACCA* (2006), q. 2; *FEE* (2006), p. 7; *industrie-holding* (2006), p. 14; *SEAG* (2006), p. 3.

³⁵⁷ See *FEE* (2006), p. 7.

The acknowledgement of transaction costs highlights that markets are not as efficient as theoretically presumed (see chapter 5.2.2 below).³⁵⁸ Otherwise they would be part of fair value regardless of a potential recoverability test and not be expensed as soon as incurred.³⁵⁹ However, immediately expensing transaction costs, would lead to acquisitions being no longer neutral on earnings.³⁶⁰ Several respondents oppose such far-reaching and drastic changes to accounting treatment.³⁶¹ Expensing transaction costs at initial recognition, and thus recognizing a loss before the asset has even caused revenue will confuse users rather than provide them with superior information.³⁶² The proposal of expensing transaction costs as soon as they are incurred is based on the assumption of perfect, efficient and complete markets that rarely exist in reality where transaction costs can be quite significant and influence the price paid.³⁶³ In industries where it is ongoing practice to include transaction costs in the acquisition price it may be difficult if at all possible to identify what part makes out the transaction costs.³⁶⁴ This can be perceived especially with respect to non-financial assets.³⁶⁵ Only the value of the asset as a whole is observable.³⁶⁶ “The willingness of the entity to incur transaction costs in excess of the fair value proves that the value in use is higher.”³⁶⁷

The European Banking Industry purports that the treatment of transaction costs depends on the exit market, which is looked at when assessing whether the costs are expected to be balanced. If an asset is sold in the same market in which it was acquired, transaction costs should be expensed. If it is sold in a different market, all transaction costs enter into

³⁵⁸ See SAICA / APB of South Africa / APC of SAICA (2006), p. 9; similar AFRAC (2006), p. 12; DRSC (2006), p. 11.

³⁵⁹ See SAICA / APB of South Africa / APC of SAICA (2006), p. 9.

³⁶⁰ See Bundesverband deutscher Banken e.V. (2006), p. 5.

³⁶¹ See Bundesverband deutscher Banken e.V. (2006), p. 5; see also IFRSRC of KASB (2006), p. 8; Zentraler Kreditausschuss (2006), p. 5.

³⁶² See ICAI (2006), p. 7; see also SFRSC (2006), p. 7.

³⁶³ See Bundesverband deutscher Banken e.V. (2006), p. 5; see also CIPFA (2006), p. 3; Zentraler Kreditausschuss (2006), p. 5.

³⁶⁴ See ASB (2006), section A para. 18; see also *F. Hoffmann-La Roche Ltd.* (2006), appendix q. 11; *Martinez, Chris* (2006), p. 5.

³⁶⁵ See *F. Hoffmann-La Roche Ltd.* (2006), appendix q. 11.

³⁶⁶ See ASB (2006), section A, para. 18.

³⁶⁷ DRSC (2006), p. 11.

the determination of the acquisition price because the seller is compensated for his costs in the exit market, according to the European Banking Industry.³⁶⁸ The DP seems to assume that assets are sold on the same market they were bought on, which is rarely the case. The Fédération des Experts Comptables Européens (FEE) considers exit markets not to be relevant in assessing the recoverability test.³⁶⁹ Concerning measurement at historical cost, transaction costs are an entry measure including all payments to third parties that need to be undertaken to settle a transaction and obtain the asset.³⁷⁰ Other respondents, on the contrary, believe that transaction costs shall only play a role in deciding which market to address and determining fair value.³⁷¹

Accounting treatment of transaction costs should not just be discussed regarding initial measurement in isolation but linked to subsequent re-measurement also. Recoverability shall only play a role on subsequent re-measurement, according to some respondents.³⁷² Moreover, it needs to be defined first what view an entity's financial position and financial performance its financial statement purports to portray.³⁷³

4.8 Further Suggestions and Other Measurement Bases

It is pointed out by some respondents that the measurement bases are not all mutually exclusive. There are situations when reproduction and replacement cost or net realizable value and value in use may be equal.³⁷⁴ A new asset acquired in a deep liquid market could have the same

³⁶⁸ See *European Banking Industry* (2006), enclosure pp. 6-7.

³⁶⁹ See *FEE* (2006), p. 2.

³⁷⁰ See *ACCA* (2006), q. 11.

³⁷¹ See *ICAEW* (2006), para. 62; similar *CPA Australia* (2006), p. 7.

³⁷² See *Bundesverband deutscher Banken e.V.* (2006), p. 5; see also *CNC* (2006), appendix q. 11; *DASB* (2006), p. 6; *European Banking Industry* (2006), enclosure p. 7; *FSR* (2006), p. 9; *UBS AG* (2006), p. 3; *UBS AG* (2006), p. 3; *Zentraler Kreditausschuss* (2006), p. 5.

³⁷³ See *IDW* (2006), p. 13.

³⁷⁴ See *IVSC* (2006), appendix q. 1; similar *RICS Valuation Faculty* (2006), pp. 2-3.

reproduction cost, replacement cost, recoverable amount net realizable value, deprival value, and historical cost.³⁷⁵

Petri Vehmanen suggests a reclassification of measurement bases into:

- actual measurements, i.e. observable amounts of cash and cash equivalents,
- potential measurements, i.e. amounts not currently observable but collectable, and thus predictable, and
- forecasts, i.e. amounts that may not be predicted but only forecasted.³⁷⁶

Other respondents state that the discussion is obscured, if measurement bases that are not relevant on initial recognition are discussed. Thus, it should be focused on e.g. historical cost, value in use, and fair value.³⁷⁷ The DRSC considers net realizable value and current cost less relevant on initial recognition.³⁷⁸

Some respondents, on the contrary, demand that all existing measurement bases should be considered in order to arrive at a comprehensive discussion.³⁷⁹ Recoverable amount is the higher of net realizable value and value in use.³⁸⁰ It is a decision rule like deprival value. Hence, justification is needed why recoverable amount, but also appraisal value or entity-specific value are not considered possible measurement bases on initial recognition. Present value is the only term given such an explanation.³⁸¹ Further, the DRSC suggests considering face value and notional amount, i.e. the amount due on repayment, on the list of possible measurement bases also.³⁸²

³⁷⁵ See *Disclosure Solutions Ltd.* (2006), section “Historical cost”; see also *RICS Valuation Faculty* (2006), p. 3.

³⁷⁶ See *Vehmanen, Petri* (2006), pp. 14-15.

³⁷⁷ See *IDW* (2006), p. 3; see also *DRSC* (2006), p. 4.

³⁷⁸ See *DRSC* (2006), p. 4.

³⁷⁹ See *FEE* (2006), p. 4; see also *IFRSRC of KASB* (2006), p. 1.

³⁸⁰ See *RICS Valuation Faculty* (2006), p. 3.

³⁸¹ See *FEE* (2006), p. 4; see also *IFRSRC of KASB* (2006), p. 1.

³⁸² See *DRSC* (2006), p. 4.

In addition, the alternative measurement bases should not only be compared regarding initial recognition but also re-measurement (see chapter 2.2 and 2.3 above).³⁸³ A discussion on costs and benefits with respect to each measurement basis individually might provide additional value to any conclusions reached.³⁸⁴

5 Fundamental Sources of Differences between Measurement Bases

5.1 Overview

The DP has identified two fundamental sources of differences:

- market versus entity-specific measurement objectives and
- differences in defining the value-affecting properties of assets and liabilities.³⁸⁵

The market value measurement objective is based on market prices. Entity-specific objectives take management's perspectives and intentions into account. Hence, it is apparent that the two will lead to different values.³⁸⁶ The EFRAG states that it is an oversimplification to solely categorise data into market-based or entity-specific, since there might be measures that are neither one (for example mortality tables with respect to the insurance business).³⁸⁷

Value-affecting properties are the fundamental differences on a given date. An asset can have more than one market value depending upon any terms involved in a sale, e.g. the mode of transfer.³⁸⁸ Value-affecting

³⁸³ See *ASBJ* (2006), p. 7.

³⁸⁴ See *FEE* (2006), p. 2; similar *British American Tobacco* (2006), p. 1.

³⁸⁵ See *IASB* (2005a), para. 52.

³⁸⁶ See *University of Wisconsin* (2006), q. 3.

³⁸⁷ See *EFRAG* (2006), p. 11.

³⁸⁸ See *IVSC* (2006), appendix qs. 3b, 7a.

properties have to be defined before the process of valuation is performed.³⁸⁹

The CASB identifies entity-specific charges, i.e. transaction costs as another fundamental source of differences.³⁹⁰ Transaction costs are a decisive factor in determining fair value and deciding which market to address.³⁹¹ Nonetheless, some respondents state that because entity-specific charges are irrelevant to a market value assessment they are consequently not a fundamental source of difference.³⁹²

5.2 The Market Value Measurement Objective

5.2.1 The Market and the Market Value

The DP proposes the following definition of market:

“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.”³⁹³

The term “arm’s length” is not concrete enough in meaning independent parties, according to the New South Wales (NSW) Treasury.³⁹⁴ For more detail on the discussion of the term “arm’s length” see also chapter 4.5.1 above). The Appraisal Institute purports to remove the requirements of “knowledgeable parties” and “arm’s length transaction” from the market definition entirely since these need to be considered in the process of developing a value not in defining what makes out a market.³⁹⁵

³⁸⁹ See *RICS Valuation Faculty* (2006), p. 5.

³⁹⁰ See *IASB* (2005a), para. 63.

³⁹¹ See *ICAEW* (2006), para. 62; similar *CPA Australia* (2006), p. 7.

³⁹² See *IVSC* (2006), appendix q. 7b; see also *RICS Valuation Faculty* (2006), p. 6.

³⁹³ *IASB* (2005a), para. 55.

³⁹⁴ See *NSW Treasury* (2006), p. 4.

³⁹⁵ See *Appraisal Institute* (2006), p. 2.

Another criteria potential market participants are required to fulfil is “legal and financial ability to transact”, which has already been introduced in the FASB’s working draft on FVM.³⁹⁶ Unneeded divergence to the IASB and the FASB should be removed.³⁹⁷ The ability to participate in market transactions is especially important in businesses where the participants underlie legal regulation, e.g. the insurance business. Insurers cannot transfer liabilities out of insurance contracts but may only transfer risks related to insurance contracts through reinsurance whereat they have to remain liable vis-à-vis the beneficiary.³⁹⁸

The term “sufficiently extensive exchange transactions” can be claimed as being not precise enough. Markets where products are not homogenous, e.g. the real estate market, would consequently be excluded from the definition.³⁹⁹ The term “sufficiently” leaves scope of interpretation open. This impreciseness may lead to different decisions on what could be considered to be sufficient.⁴⁰⁰ This again could lead to too much subjectivity.⁴⁰¹ In practice, even limited transactions can bring out a fair value as long as the interacting parties are independent.⁴⁰² Other respondents believe that a market exists wherever commercial exchange of assets or services takes place.⁴⁰³

Sufficient exchange transactions and a sufficient number of market participants are needed in order to reach equilibrium.⁴⁰⁴ Only a large enough number of participants constitute a market. However, considering the actual range of countries and industries, there are economies that are weaker than others and which comprise only a restricted number of

³⁹⁶ See *FVM Team* (2003), pp. 2, 3, 7.

³⁹⁷ See *IFRSRC of KASB* (2006), p. 3.

³⁹⁸ See *GNAIE* (2006), p. 6; see also *NAIC* (2006), p. 4.

³⁹⁹ See *IVSC* (2006), appendix q. 4b.

⁴⁰⁰ See *CNC* (2006), appendix q. 4; see also *GNAIE* (2006), p. 6; *NRS* (2006), p. 3; *SFRSC* (2006), p. 9.

⁴⁰¹ See *NRS* (2006), p. 3.

⁴⁰² See *CNC* (2006), appendix q. 4; similar *Appraisal Institute* (2006), p. 2.

⁴⁰³ See *industrie-holding* (2006), p. 8; see also *Syngemat International AG* (2006), p. 7.

⁴⁰⁴ See *BG Group* (2006), p. 4; see also *Grant Thornton International* (2006), p. 9.

participants. Hence, the possible outcome does not achieve the same level among economies with diverging specifications.⁴⁰⁵

The advantages of the market measurement objective result from equilibrium prices being derived from active and open markets. However, this does not hold for the majority of assets and liabilities not traded on such markets (see chapter 5.2.2 below on market imperfections).⁴⁰⁶ The proposed assumption of perfectly complete markets is a precondition to defend the superiority of fair value measurement. However, such markets often do not exist.⁴⁰⁷ Hence, the proposed definition is theoretical and reflects an ideal situation.⁴⁰⁸ Where an active market does not exist it is rather idealistic to assume that supply equals demand on a given measurement date.⁴⁰⁹ The CASB's proposed definition however represents a perfect market.⁴¹⁰ The assumption that markets are perfectly efficient and highly active, which describes a hypothetical market nature is implicit in the market definition, but this does not hold in economic reality.⁴¹¹ The DP suggests addressing a hypothetical market in cases where an active market does not exist. However, this creates a wide gap between the hypothetical and a potentially active market.⁴¹² Shell International Ltd. proposes to apply a clearer term such as "active, well-informed liquid market" to the proposed definition.⁴¹³

The IVSC's definition of market includes the terms "estimated amount" referring to the most probable price reasonably obtainable by the seller and most advantageous for the buyer. This market value excludes any

⁴⁰⁵ See *BG Group* (2006), p. 4.

⁴⁰⁶ See *Grant Thornton International* (2006), p. 2.

⁴⁰⁷ See *IDW* (2006), p. 7.

⁴⁰⁸ See *Nestlé* (2006), p. 2; similar *CIPFA* (2006), p. 8.

⁴⁰⁹ See *Mazars & Guérard* (2006), p. 5.

⁴¹⁰ See *UBS AG* (2006), p. 6.

⁴¹¹ See *ACTEO / AFEP / MEDEF* (2006), appendix p. 2; see also *CIPFA* (2006), p. 3; *CPA Australia* (2006), p. 5; *F. Hoffmann-La Roche Ltd.* (2006), appendix q. 4b; *GNAIE* (2006), pp. 5-6; *ICAEW* (2006), para. 49; *IDW* (2006), p. 7; *Mazars & Guérard* (2006), p. 5; *Nestlé* (2006), p. 2; *RICS Valuation Faculty* (2006), p. 5; *SAICA / APB of South Africa / APC of SAICA* (2006), p. 6; *Shell International Ltd.* (2006), pp. 3-4.

⁴¹² See *F. Hoffmann-La Roche Ltd.* (2006), appendix q. 4b.

⁴¹³ See *Shell International Ltd.* (2006), pp. 3-4.

special considerations attached by anyone involved with the sale.⁴¹⁴ Any subjectivity has to be excluded from the concept of market value.⁴¹⁵ For more detail on the IVSC's definition of market and market value see chapter 4.5.1 above.

5.2.2 Market Imperfections and Inexistence – Theory and Practice

The CASB addresses two issues needed in order to understand what a market is:

- Firstly, the knowledge condition assuming access to publicly available information.
- Secondly, wide bid-ask price spreads taking into account possible information asymmetry and market inefficiencies.⁴¹⁶

Taking into account different norms and practices, the depth of information may vary between different markets.⁴¹⁷ In the real world of incomplete markets information asymmetry is not entirely removed. Thus, markets do not avail of all information. Markets are in reality not information-efficient, but solely information-efficient markets result in market prices that justify the market perspective.⁴¹⁸

According to the ASB, the CASB simply dismisses the issues about arbitrage, e.g. price bubbles, although even finance literature acknowledges and explains the existence of arbitrage.⁴¹⁹ However, it cannot be assumed that arbitrage is perfect since arbitrageurs are exposed to constraints, e.g. arbitrage risk in reality and the necessity of liquidity in order to participate in trading. The CASB does not sufficiently capture the effects of arbitrage on equilibrium.⁴²⁰

⁴¹⁴ See *IVSC* (2006), annex para. 3.2.1.

⁴¹⁵ See *IVSC* (2006), appendix q. 4b.

⁴¹⁶ See *IASB* (2005a), para. 105; see also *IASB* (2005b), para. 240-242.

⁴¹⁷ See *SFRSC* (2006), p. 9.

⁴¹⁸ See *DRSC* (2006), pp. 3, 7-8.

⁴¹⁹ See *ASB* (2006), section A para. 12.

⁴²⁰ See *GNAIE* (2006), p. 5.

The IDW goes as far as challenging that financial statements would not even be necessary in perfect and complete markets since there were no information asymmetry.⁴²¹ Moreover, it can be argued that if there were only perfect markets, there would not even be a need for the existence of companies, not to mention accounting information at all.⁴²²

Many respondents criticise that the DP presumes solely perfect, efficient, active and highly liquid markets, which in reality rarely exist. The DP is claimed not to take market inefficiencies into account.⁴²³ However, they exist in any market.⁴²⁴ Only a few completely efficient markets exist in practice⁴²⁵ and not even the most active markets are fully efficient.⁴²⁶ The majority of real world markets do not meet the definition of perfect markets.⁴²⁷ Entities operate on markets that are not perfectly efficient and far from the definition assumed by the CASB.⁴²⁸ Most assets and liabilities are not traded with any regularity on markets as defined by the DP.⁴²⁹ In practice, markets are sometimes efficient and sometimes inefficient, but they are rarely perfect.⁴³⁰ The ICAEW finds it illogic to base the assumptions solely on a small group of assets and liabilities.⁴³¹

⁴²¹ See *IDW* (2006), p. 2.

⁴²² See *AFRAC* (2006), p. 9; see also *DRSC* (2006), pp. 3, 6.

⁴²³ See *F. Hoffmann-La Roche Ltd.* (2006), covering letter p. 3 (paginated); see also *industrie-holding* (2006), p. 3.

⁴²⁴ See *Markit Valuations* (2006), covering letter section "Market measurement objective and market value".

⁴²⁵ See *EFRAG* (2006), p. 10; see also *ICAEW* (2006), para. 49; *Mazars & Guérard* (2006), p. 6.

⁴²⁶ See *ACTEO / AFEP / MEDEF* (2006), appendix p. 2.

⁴²⁷ See *ICAEW* (2006), para. 43; similar *IDW* (2006), p. 2; *F. Hoffmann-La Roche Ltd.* (2006), covering letter p. 3 (paginated), appendix q. 4b; *Group of 100* (2006), p. 1; *Mazars & Guérard* (2006), p. 1.

⁴²⁸ See *ACTEO / AFEP / MEDEF* (2006), covering letter p. 1; see also *AFRAC* (2006), p. 3; *AIB* (2006), p. 1 (paginated); *EFRAG* (2006), p. 9; *FEE* (2006), p. 5; *Group of 100* (2006), p. 3; *ICAEW* (2006), para. 49; *IDW* (2006), p. 12; *RICS Valuation Faculty* (2006), p. 5; *SFRSC* (2006), pp. 4, 10; *UNICE* (2006), section 2.

⁴²⁹ See *ASB* (2006), covering letter para 2; see also *Shell International Ltd. (2006)*, p. 2.

⁴³⁰ See *ASB* (2006), section B q. 4.

⁴³¹ See *ICAEW* (2006), para. 18.

Perfectly efficient markets and consequently observable market prices do not exist for most assets and liabilities.⁴³² Several respondents acknowledge the existence of such markets in sporadic cases:

- for some financial instruments traded on highly liquid markets,⁴³³
- for investment properties,⁴³⁴
- for assets held for sale, which are already measured at market value under current IFRS⁴³⁵, and
- for listed securities and certain commodities highly active markets may exist.⁴³⁶ However, what holds for some commodity markets is not simply transferable to other markets.⁴³⁷ On the contrary, the CPA Australia point out that stock markets and markets for e.g. intangible assets are not fully efficient.⁴³⁸ The RICS Valuation Faculty argues that markets frequently trading commodities such as stocks and shares are not perfectly efficient. Thus, there is no need to include the concept of equilibrium.⁴³⁹

Especially for non-financial instruments markets are highly inefficient and observable market prices are rarely available.⁴⁴⁰ For example, an entity manufacturing machinery can exploit synergies in using the machinery.⁴⁴¹ Some plants or equipment are specific to a company and do not have a market value.⁴⁴² Businesses manufacturing assets that are not aimed to be consumed or to be used to produce marketable assets are not in any

⁴³² See *BDO Global Coordination B.V.* (2006), p. 2; see also *Bundesverband deutscher Banken e.V.* (2006), pp. 3, 5-6; *E&Y* (2006), pp. 3, 5; *European Banking Industry* (2006), covering letter p. 2; *Hundred Group of Finance Directors* (2006), covering letter section "Why fair value?", appendix q. 4; *ICAEW* (2006), para. 13; *LSCA* (2006), p. 3; *Mazars & Guérard* (2006), p. 3; *Shell International Ltd.* (2006), p. 4; *Swiss GAAP FER* (2006), p. 2; *Zentraler Kreditausschuss* (2006), p. 2.

⁴³³ See *BDO Global Coordination B.V.* (2006), p. 2; see also *E&Y* (2006), pp. 4, 5; *FEE* (2006), p. 1; *Grant Thornton International* (2006), p. 10; *IDW* (2006), p. 7; *UBS AG* (2006), p. 6.

⁴³⁴ See *E&Y* (2006), p. 4.

⁴³⁵ See *Nestlé* (2006), p. 4.

⁴³⁶ See *Hundred Group of Finance Directors* (2006), covering letter section "Why fair value?"; see also *ICAEW* (2006), para. 21; similar *LSCA* (2006), p. 2.

⁴³⁷ See *industrie-holding* (2006), p. 3.

⁴³⁸ See *CPA Australia* (2006), p. 4.

⁴³⁹ See *RICS Valuation Faculty* (2006), p. 5.

⁴⁴⁰ See *DASB* (2006), pp. 2, 4; see also *Grant Thornton International* (2006), p. 9; similar *UBS AG* (2006), p. 6.

⁴⁴¹ See *FSR* (2006), p. 2.

⁴⁴² See *FEE* (2006), p. 1.

market at all. Measuring assets or liabilities at a market price, although an exchange transaction has not occurred will confuse users of financial statements rather than assist them.⁴⁴³ For liabilities resulting from insurance contracts there is no deep liquid secondary market at all.⁴⁴⁴

Further, the DP fails to take into account that emerging markets are highly volatile and lack depth and liquidity. They often do not meet the definition of an active market. The NASB states that local market prices will experience “short-term market swings”, which may not influence an entity’s operating performance. Thus, it would be illogic to re-measure a business’s operating assets.⁴⁴⁵

Moreover, the assumption of perfect markets is derived from finance theory.⁴⁴⁶ However, in reality perfect markets are the exception rather than the norm.⁴⁴⁷ Thus, the conclusions drawn from financial markets cannot simply be applied to markets trading industrial materials without further justification.⁴⁴⁸

Regarding the concept of equilibrium, an equilibrium price might only be achieved in the long run.⁴⁴⁹ Market forces will eliminate price differences on different markets only if they are efficient, otherwise there will be inconsistencies.⁴⁵⁰ The term “equilibrium price” assumes that markets are perfect and complete.⁴⁵¹ However, if a market is not perfect, quoted prices

⁴⁴³ See *Verhille, Roland* (2006), p. 3.

⁴⁴⁴ See *NAIC* (2006), p. 5; similar *LIAJ* (2006), p. 1.

⁴⁴⁵ See *NASB* (2006), para. 7.

⁴⁴⁶ See *ASB* (2006), section A para. 7-8, section B q. 4; see also *ACTEO / AFEP / MEDEF* (2006), covering letter p. 1, appendix p. 2; *E&Y* (2006), p. 3; *EFRAG* (2006), p. 9; *FEE* (2006), p. 5; *Group of 100* (2006), p. 3; *ICAEW* (2006), para. 49; *IDW* (2006), pp. 7, 12; *RICS Valuation Faculty* (2006), p. 5; *SFRSC* (2006), pp. 3, 9, 10; *UNICE* (2006), section 2.

⁴⁴⁷ See *ASB* (2006), section A para. 7-8, section B q. 4; see also *EFRAG* (2006), pp. 2, 9; *IBF* (2006), section “Capital Markets”; *SFRSC* (2006), p. 4.

⁴⁴⁸ See *E&Y* (2006), p. 2; see also *EFRAG* (2006), p. 9; *FEE* (2006), p. 5; *Group of 100* (2006), p. 3; *ICAEW* (2006), para. 49; *IDW* (2006), p. 12; *RICS Valuation Faculty* (2006), p. 5; *SFRSC* (2006), pp. 4, 10; *UNICE* (2006), section 2.

⁴⁴⁹ See *Martinez, Chris* (2006), pp. 2, 3.

⁴⁵⁰ See *EFRAG* (2006), p. 13; see also *industrie-holding* (2006), p. 12; *Syngemat International AG* (2006), p. 11.

⁴⁵¹ See *DRSC* (2006), p. 6; see also *FSR* (2006), p. 6.

need to be modified and can still not provide sufficient evidence what fair value may be, if market activities are infrequent.⁴⁵² Thus, the definition is based on the theoretical concept of equilibrium prices.⁴⁵³ Taking into account market inefficiencies would make the definition much more operational.⁴⁵⁴ Further, the equilibrium concept seems to assume that a market value consists of a single amount, which cannot be proven for all exchange transactions.⁴⁵⁵

The RICS Valuation Faculty believes that it is not necessary to mention the equilibrium concept, since a market is constituted when two or more parties are able to affect assets' prices through their bidding decisions.⁴⁵⁶ It is a theoretical concept and other respondents find that the practical acceptance of a price agreed upon by the contracting parties is much more important.⁴⁵⁷

5.3 The Fair Value Measurement Objective

5.3.1 Overview

The DP proposes that "... the fundamental objective of fair value is to reflect the market value of an item on the measurement date."⁴⁵⁸ "If there is no observable market price, the objective of fair value is to estimate what the market price would be if a market for that asset or liability existed on the measurement date."⁴⁵⁹

The RICS Valuation Faculty points out that market value and fair value need to be distinguished more clearly in order to avoid the impression that they are synonyms (see also chapter 4.5.1 above on the question whether the definition of fair value should incorporate the market value measure-

⁴⁵² See *FSR* (2006), p. 6; see also *UBS AG* (2006), p. 6.

⁴⁵³ See *industrie-holding* (2006), p. 5; see also *Syngemat International AG* (2006), p. 7.

⁴⁵⁴ See *UBS AG* (2006), p. 6.

⁴⁵⁵ See *Martinez, Chris* (2006), p. 2.

⁴⁵⁶ See *RICS Valuation Faculty* (2006), p. 5.

⁴⁵⁷ See *industrie-holding* (2006), p. 8; see also *Syngemat International AG* (2006), p. 7.

⁴⁵⁸ *IASB* (2005a), para. 102.

⁴⁵⁹ *IASB* (2005b), para. 111.

ment objective).⁴⁶⁰ Due to market inefficiencies and irrational behaviour of market participants the market price may not be the best indicator of fair value.⁴⁶¹

The National Association of Insurance Commissioners (NAIC) emphasises that "... the fair value objective ... extends beyond situations in which observable market prices exist."⁴⁶² Moreover, the Joint Working Group states that there may be situations where "... an observed exit price is not determined by normal market interactions ..."⁴⁶³. In this case observed exit prices should not be used "... as the primary basis for determining fair value."⁴⁶⁴ It is hard to understand how fair value can be relevant where no market exchanges incurred, as for example regarding taxes.⁴⁶⁵ The discussion leads to the logic that fair value cannot be measured reliably, if there are no observable market prices or no market based values to be modelled. Fair value can only be measured reliably, when an active market exists.⁴⁶⁶ If a market is not an active one, quoted prices may have to be adjusted.⁴⁶⁷ Where a perfect market does not exist, there is no market value to represent.

Missing an observable market price, and thus having to estimate a market price, i.e. fair value, is based on subjective assumptions.⁴⁶⁸ Hence, it seems to be more an entity-specific measurement objective (see chapter 5.3.2 below).⁴⁶⁹ Considering that fair value has to be estimated wherever a market price cannot be observed, the assumption of active markets inherent in the market value measurement objective should explicitly be excluded from the fair value measurement objective.⁴⁷⁰ If there is no

⁴⁶⁰ See *RICS Valuation Faculty* (2006), pp. 1, 4, 5.

⁴⁶¹ See *EFRAG* (2006), p. 5; see also *NAIC* (2006), p. 4; *SFRSC* (2006), p. 3.

⁴⁶² *NAIC* (2006), p. 5.

⁴⁶³ *Joint Working Group* (2000), para. 88.

⁴⁶⁴ *Joint Working Group* (2000), para. 88.

⁴⁶⁵ See *F. Hoffmann-La Roche Ltd.* (2006), covering letter p. 3 (paginated); see also *industrie-holding* (2006), p. 3; *Syngemat International AG* (2006), p. 2.

⁴⁶⁶ See *Mazars & Guérard* (2006), pp. 2-3.

⁴⁶⁷ See *FSR* (2006), pp. 5-6.

⁴⁶⁸ See *IDW* (2006), p. 7.

⁴⁶⁹ See *NAIC* (2006), p. 5.

⁴⁷⁰ See *AASB* (2006), p. 6.

efficient market, many of the arguments in favour of fair value do not hold.⁴⁷¹

The CNC believes that the fair value objective is not necessarily to reflect market value since the fair value definition might also be applied to individual transactions where no active market exists.⁴⁷² The AASB states that prices in inactive markets should not be equated to fair value before verifying whether better evidence of fair value exists.⁴⁷³

According to Roland Verhille, "... market value is more an abstraction than a fact."⁴⁷⁴ Any resource accounted for, as a difference between the price incurred and the market value is hypothetical and will not be available before it is exchanged in the market. The aim of entities is to recover cash invested in non-cash resources by exchanging products through consumption or usage for production of new non-cash resources, i.e. a utility. Measuring such non-cash resources at any market value leads only to either a hypothetical resource or a hypothetical loss the entity does not actually experience.⁴⁷⁵

Estimated prices will be far from being equal to the market value, and thus may not be reliable, i.e. verifiable within the margin of acceptable deviation.⁴⁷⁶ An estimate of fair value lacking a market price or underlying market inefficiencies may be exposed to significant measurement uncertainty.⁴⁷⁷ Valuation models may not be able to secure a margin of deviations and uncertainty and unreliability may lead to fraud (see also chapter 5.5 below, p. 76 on manipulation). Fair value measurement should only be

⁴⁷¹ See *F. Hoffmann-La Roche Ltd.* (2006), p. 3 (paginated); see also *industrie-holding* (2006), p. 3.

⁴⁷² See *CNC* (2006), appendix q. 4.

⁴⁷³ See *AASB* (2006), pp. 14-15.

⁴⁷⁴ *Verhille, Roland* (2006), p. 2.

⁴⁷⁵ See *Verhille, Roland* (2006), pp. 2, 4, 5.

⁴⁷⁶ See *FSR* (2006), p. 2.

⁴⁷⁷ See *CNC* (2006), appendix q. 13.

applied with reference to an active or semi-active market or in assessing the lowest value, i.e. the value in use for the reporting entity.⁴⁷⁸

Attempting to estimate market value would only endanger that the provided information is misunderstood.⁴⁷⁹ Wherever fair value has to be calculated, measurement is based on hypothetical transactions that have not yet occurred.⁴⁸⁰ Estimating fair value may appear to have the effect of simulating a hypothetical market.⁴⁸¹ The Monash University states concerns on describing a measure not derived from an active market as fair value.⁴⁸² The DP does not sufficiently acknowledge situations in which evidence of fair value is not available.⁴⁸³ Goldman Sachs International purports that market prices are an approximation of fair value rather than vice versa.⁴⁸⁴

Existing standards already require the use of fair value in circumstances where the proposed market definition is not met, e.g. certain intangible assets in business combinations. Thus, fair value is already applied in circumstances, where it cannot be measured reliably.⁴⁸⁵

As described in chapter 3.1 above in detail, the purpose of financial statements needs to be defined first before concluding on the measurement objective since it would be entirely different, if for example stewardship would be set as the aim.⁴⁸⁶

⁴⁷⁸ See *FSR* (2006), pp. 2-3.

⁴⁷⁹ See *ASB* (2006), section A para. 7-11.

⁴⁸⁰ See *ICAEW* (2006), para. 46.

⁴⁸¹ See *Grant Thornton International* (2006), p. 8.

⁴⁸² See *Monash University* (2006), p. 2.

⁴⁸³ See *SFRSC* (2006), p. 5.

⁴⁸⁴ See *Goldman Sachs International* (2006), section "Market Value objective".

⁴⁸⁵ See *ICAEW* (2006), para. 13; similar *Grant Thornton International* (2006), p. 11.

⁴⁸⁶ See *DRSC* (2006), p. 7.

5.3.2 Entity-Specific Inputs and Influences on Fair Value Measurement

In many situations, it might not be possible to separate entity-specific measurement objectives from market value measurement objectives since most assets and liabilities do not have an observable market price.⁴⁸⁷ Measuring at fair value on initial recognition given the definition of markets, i.e. perfect and efficient ones, would virtually lead to management's intention replacing market prices since most assets and liabilities lack such a perfect market.⁴⁸⁸ The calculation of fair value in order to estimate an exchange price seems more like an entity-specific measurement objective.⁴⁸⁹

Denying that management's intentions have an impact on measurement but considering it in determining future cash flows is controversial. Choosing a "suitable" valuation model and applying its parameters involves management's decision.⁴⁹⁰ According to the South African Institute of Chartered Accountants (SAICA), Accounting Practice Board (APB) of South Africa and the Accounting Practices Committee (APC) of SAICA, every fair value model relies on entity-specific inputs.⁴⁹¹ Expectations of marketplace participants are mostly influenced by entity-specific expectations, and therefore these are not clearly separable.⁴⁹²

Further, management's intentions may be reflected in an asset's market value, which is different if an entity intends to dispose of the asset rather than continuously using it.⁴⁹³ In addition, there are cases in which it will be

⁴⁸⁷ See *Bundesverband deutscher Banken e.V.* (2006), pp. 3-4; see also *SAICA / APB of South Africa / APC of SAICA* (2006), p. 6; *SFRSC* (2006), p. 5; *Zentraler Kreditausschuss* (2006), p. 2.

⁴⁸⁸ See *Hundred Group of Finance Directors* (2006), appendix q. 5; see also *ICAEW* (2006), para. 51.

⁴⁸⁹ See *NAIC* (2006), p. 5.

⁴⁹⁰ See *SAICA / APB of South Africa / APC of SAICA* (2006), p. 6; see also *Zentraler Kreditausschuss* (2006), p. 3; *European Banking Industry* (2006), enclosure p. 5; *Bundesverband deutscher Banken e.V.* (2006), pp. 3-4.

⁴⁹¹ See *SAICA / APB of South Africa / APC of SAICA* (2006), p. 6.

⁴⁹² See *NRS* (2006), p. 5.

⁴⁹³ See *Appraisal Institute* (2006), p. 3; see also *IVSC* (2006), appendix q. 5; *RICS Valuation Faculty* (2006), pp. 5-6.

necessary to look at the position of the entity owning the asset in order to determine the market. Thus, market value can include entity-specific assumptions. The RICS Valuation Faculty points out that especially regarding real estate, an analyst will have to look at the trading history of the item.⁴⁹⁴

UBS AG gives a different example where management's judgement plays a role for market prices: In deciding on the acquisition of a certain asset, management will make use of entity-specific assumptions. Through the process of acquisition, the purchaser becomes a marketplace participant and his expectations influence the determination of the price of the asset. If he acquires more items – perhaps because he receives block discounts – this demand might increase the price in the long run.⁴⁹⁵ Entity-specific considerations may be a hint to the performance of a typical marketplace participant and may be relevant in assessing the market value, if these considerations conform to the objectives of most market participants.⁴⁹⁶

The Appraisal Institute, which represents the views of real estate businesses, states that market value is based on a property's highest and best use. Although, an owner's objectives might coincide with this highest and best use these objectives are irrelevant for assessing the market value.⁴⁹⁷ However, according to the AFRAC fair value measures a value received, just like historical cost and reproduction cost and as a marginal price fair value does not indicate the highest and best use of an asset.⁴⁹⁸

On the other hand, assuming that fair value includes management's insider information, and thus that the market disposes of all available information is not very realistic.⁴⁹⁹ Mazars & Guérard note that substituting management's intentions for market prices where active markets do not

⁴⁹⁴ See *RICS Valuation Faculty* (2006), p. 5.

⁴⁹⁵ See *UBS AG* (2006), p. 7.

⁴⁹⁶ See *Appraisal Institute* (2006), p. 2; see also *IVSC* (2006), q. 3a.

⁴⁹⁷ See *Appraisal Institute* (2006), p. 3.

⁴⁹⁸ See *AFRAC* (2006), p. 15.

⁴⁹⁹ See *IFRSRC of KASB* (2006), pp. 10-11.

exist is sometimes perceived critically and considered inappropriate.⁵⁰⁰ Missing a recent market transaction, an estimate derived solely from management's judgment should not be considered a market value.⁵⁰¹ If management's assessments have to be applied in order to derive a fair value, financial reporting may be no longer neutral.⁵⁰²

5.3.3 Reliability Limitations

5.3.3.1 Equating a Single Transaction Exchange Price to Fair Value

The DP proposes:

“It is suggested that a transaction price paid or received for an asset or liability should not be described as its fair value on initial recognition unless there is persuasive evidence that it does have the essential properties of market value.”⁵⁰³

Many respondents hold the opposite of this statement for true: A single transaction price will be evidence of an asset's market value unless there is convincing indication that it is not.⁵⁰⁴ Hence, convergence would be achieved with the FASB's and the IASB's ED (exposure draft) Business Combinations. There an overpayment or a bargain deal is considered to be the exception.⁵⁰⁵ The statement as proposed would result in too much burden. The requirement to provide convincing evidence that a transaction price has essential properties of market prices will result in material additional costs that may not be justified by the benefit for the users (see also chapter 3.2 above on the cost/benefit constraint).⁵⁰⁶ Applying

⁵⁰⁰ See *Mazars & Guérard* (2006), p. 6.

⁵⁰¹ See *Martinez, Chris* (2006), p. 5.

⁵⁰² See *F. Hoffmann-La Roche Ltd.* (2006), covering letter p. 3 (paginated); see also *industrie-holding* (2006), p. 3.

⁵⁰³ IASB (2005a), para. 106.

⁵⁰⁴ See *CNC* (2006), covering letter section 4.1.2, appendix qs. 6, 15; see also *FEE* (2006), p. 8; *FSR* (2006), p. 10; *IDW* (2006), p. 17; *IFRSRC of KASB* (2006), p. 10; *IVSC* (2006), appendix q. 15; *JICPA* (2006), p. 5; *Markit Valuations* (2006), p. 5; *NSW Treasury* (2006), p. 8; *RICS Valuation Faculty* (2006), p. 8; *SFRSC* (2006), p. 13; *Shell International Ltd.* (2006), p. 8.

⁵⁰⁵ See *FASB* (2005), para. B168, B183; similar *ASBJ* (2006), p. 6; *GNAIE* (2006), p. 12.

⁵⁰⁶ See *CNC* (2006), covering letter section 4.1.2; see also *IDW* (2006), p. 17; *JICPA* (2006), p. 5; similar *IFRSRC of KASB* (2006), p. 10.

historical cost can avoid this. Moreover, such a requirement may depreciate the reliability and relevance of fair value, and thus diminish the cases where values resulting from market transactions are applicable. Instead, surrogates derived through valuation techniques will enable further judgement.⁵⁰⁷ In addition, if the majority of exchange prices cannot be presumed to represent fair value, the relevance of fair value as an initial measurement basis is also put into question.⁵⁰⁸

According to Chris Martinez, an active market does not exist for specialized or unique assets. Thus, a single transaction exchange price should be considered as a market price.⁵⁰⁹ "For assets that are more generic and for which there is an active market, a single price occurring within a period of inactivity may not be considered to be representative of the current market value."⁵¹⁰ A greater sales volume would have to be looked at.⁵¹¹ Different marketplace participants have different expectations, and therefore a single price is not necessarily equal to fair value.⁵¹²

Moreover, this proposal of the DP is also like other statements based on markets being highly efficient and active and ignores that they are thinly traded in practice. However, fair value is not capable of reliable estimation in most common situations.⁵¹³ Further, according to the Accounting Standards Board of Japan (ASBJ) the proposal is inconsistent with the a priori expectation that there is only one fair value (see chapter 5.6.1 below), given the definition of fair value being the price exchanged in an arm's length transaction (see chapter 4.5.1 above).⁵¹⁴

⁵⁰⁷ See *IDW* (2006), p. 17.

⁵⁰⁸ See *industrie-holding* (2006), p. 17; see also *Syngemat International AG* (2006), p. 17.

⁵⁰⁹ See *Martinez, Chris* (2006), p. 5.

⁵¹⁰ *Martinez, Chris* (2006), p. 5.

⁵¹¹ See *Martinez, Chris* (2006), p. 5.

⁵¹² See *ICAI* (2006), p. 8.

⁵¹³ See *SAICA / APB of South Africa / APC of SAICA* (2006), p. 10; see also *Shell International Ltd.* (2006), p. 8.

⁵¹⁴ See *ASBJ* (2006), p. 6.

5.3.3.2 Valuation Models and Techniques

The DP proposes "... that a measurement model or technique cannot be considered to achieve a reliable estimation of fair value if it depends significantly on entity-specific expectations that cannot be demonstrated to reliably represent market expectations ..."⁵¹⁵. It can be agreed with this proposal, given the implication that entity-specific information is inferior and the objective is to achieve market-based measurement.⁵¹⁶ However this is not convincingly proven as it is shown in chapter 5.5 below.

The existence of more than one market fair value (see chapter 5.6.1 below) leads to the rejection of the presumed superiority of fair value. Valuation techniques applied to calculate an estimate impair the relevance and reliability of fair value.⁵¹⁷

The RICS Valuation Faculty argues that the DP's proposal should appropriately be reversed stating that fair value uses entity-specific measures unless these can be proven to be inconsistent with market expectations.⁵¹⁸ The Institute of Chartered Accountants in Ireland (ICAI) does not accept the proposal since many times entity-specific expectations are a good substitute for fair value.⁵¹⁹ In practice, management performs value measurements. However, others may assess the same information differently.⁵²⁰ Introducing models and estimates means that different preparers will arrive at different assessments. Thus, the decision-usefulness is impaired, if not all preparers report the same fair values.⁵²¹ Steve Impey stresses: "By definition valuation of any kind is subjective and inconsistent."⁵²² Valuation models will be difficult to understand and

⁵¹⁵ IASB (2005a), para. 116.

⁵¹⁶ See *Group of 100* (2006), p. 8.

⁵¹⁷ See *IDW* (2006), p. 10.

⁵¹⁸ See *RICS Valuation Faculty* (2006), p. 15.

⁵¹⁹ See *ICAI* (2006), p. 8.

⁵²⁰ See *Shell International Ltd.* (2006), p. 2.

⁵²¹ See *LSCA* (2006), p. 3.

⁵²² *Impey, Steve* (2006), p. 2 (paginated).

exposed to significant reliability issues.⁵²³ Further, they will be costly and complex.⁵²⁴

Entity-specific expectations can often be assumed to represent the expectations of an average marketplace participant and can hence be used to arrive at a reliable estimate of fair value.⁵²⁵ The CNC argues, "... that there is systematic opposition between entity-specific and market expectations."⁵²⁶ Lacking an observable market price, it can be assumed that the best estimate of a knowledgeable market participant is the best approximation of fair value. Thus, it will not be necessary or possible to prove consistency with market expectations.⁵²⁷

The Union of Industrial and Employers' Confederation of Europe (UNICE), on the contrary, states that a valuation or choice made by just any market participant differs from the specific entity's viewpoint and is thus not relevant.⁵²⁸ Further, it is questionable if estimates portray a good approximation of market based fair value when the applied technique is based on entity-specific forecasts rather than the ones of market participants.⁵²⁹

Since most of the time markets are imperfect and information asymmetry exists (see chapter 5.2.2 above), it would be very difficult to derive an estimate without considering entity-specific consideration. Thus, the latter should be included.⁵³⁰ In the absence of an active market, estimates based on private empirical information reliably estimate fair value.⁵³¹ However, Hermes Investment Mgmt. Ltd. states that "the estimations in a modelled market transaction would introduce significantly more such

⁵²³ See *Grant Thornton International* (2006), p. 2.

⁵²⁴ See *DRSC* (2006), p. 12; see also *Grant Thornton International* (2006), pp. 2, 11.

⁵²⁵ See *IVSC* (2006), appendix q. 15b.

⁵²⁶ *CNC* (2006), appendix q. 15.

⁵²⁷ See *CNC* (2006), appendix q. 15.

⁵²⁸ See *UNICE* (2006), section 2.

⁵²⁹ See *CIPFA* (2006), p. 13; see also *Consiglio Nazionale dei Dottori Commercialisti / Consiglio Nazionale dei Ragionieri* (2006), q. 15.

⁵³⁰ See *CPA Australia* (2006), p. 8; see also *FSR* (2006), p. 10.

⁵³¹ See *NAIC* (2006), p. 9.

imperfections.”⁵³² There exist already many imperfections in markets. The introduction of estimations in a hypothetical market transaction would introduce even more imperfections.⁵³³

In addition, disclosure of entity-specific assumptions is supported in order to enable users to make their judgments since expected future cash flows often include management’s intention.⁵³⁴ Further, the British Gas (BG) Group favours historical cost as more reliable in common situations where market value is not measurable. Thus, in these cases entity-specific models and techniques have to be applied in order to determine a fair value if required.⁵³⁵

5.4 Entity-Specific Measurement Objectives

The DP proposes:

“An entity-specific measurement objective reflects management’s expectations based on its intentions.”⁵³⁶

Several respondents agree that entity-specific measurement concepts reflect management’s expectations about future cash flows, which the entity can generate through exploiting its competitive advantages.⁵³⁷ Other respondents, on the contrary, challenge that entity-specific measurement is related to observable facts rather than simply expectations, i.e. management’s expectations.⁵³⁸ It is an over-simplification to assume that entity-specific measures are based on management’s intentions. Entity-specific measures are arrived at through the entity taking abilities of incurring an

⁵³² *Hermes Investment Mgmt. Ltd.* (2006), q. 15.

⁵³³ See *Hermes Investment Mgmt. Ltd.* (2006), q. 14.

⁵³⁴ See *SAICA / APB of South Africa / APC of SAICA* (2006), p. 6.

⁵³⁵ See *BG Group* (2006), p. 7.

⁵³⁶ *IASB* (2005a), para. 58.

⁵³⁷ See *AASB* (2006), p. 5; see also *AFRAC* (2006), p. 8; *CCDG* (2006), appendix, q. 5; *Consiglio Nazionale dei Dottori Commercialisti / Consiglio Nazionale dei Ragionieri* (2006), q. 5; *CPA Australia* (2006), p. 5; *DRSC* (2006), p. 7; *F. Hoffmann-La Roche Ltd.* (2006), appendix q. 5; *FICPA* (2006), p. 3; *FSR* (2006), p. 6; *ICAI* (2006), p. 4; *IDW* (2006), p. 8; *industrie-holding* (2006), p. 9; *IFRSRC of KASB* (2006), p. 4; *Monash University* (2006), p. 2; *Martinez, Chris* (2006), p. 3; *Nestlé* (2006), p. 2; *NSW Treasury* (2006), p. 5; *NRS* (2006), p. 3; *Syngemat International AG* (2006), p. 8.

⁵³⁸ See *EFRAG* (2006), p. 11; see also *Group of 100* (2006), p. 4; *Verhille, Roland* (2006), p. 10.

asset or settling a liability into account and by putting aside options, which are not realistic.⁵³⁹ Differences in the reported value of the same asset owned at the same time by two different companies may arise due to economic constraints and opportunities, e.g. one might get a block discount.⁵⁴⁰

Businesses that intend to make profit rely on imperfect markets. Entities are exposed to different economic barriers and opportunities. It would be illogic to require them to prepare their financial statements based on perfect, efficient markets. For example, a tradesman would have to report a newly acquired car at a higher amount than the dealer. It seems inadequate for the tradesman to report a loss because the difference arises from the involved parties' different economic position rather than simply management's assumptions.⁵⁴¹

Further, there may also be information specifically available to the entity that is not subjective, e.g. a manufacturer has rates of failure on a certain product.⁵⁴² Thus, not only management's expectations affect an entity's resources reflected in financial statements. Differences to other entity's resources may arise from the different exploitation of opportunities and synergies.⁵⁴³ Entity-specific measurement objectives are not solely based on management's intentions but rather on the entity's capabilities. Investors hold management responsible for the overall profitability achieved and cash generated. It is doubted whether "... this overall profitability is best featured by measuring against market (most of the time hypothetical) each single transaction the entity enters into, since most of the resulting gains and losses are either not realizable or never to be turned into cash."⁵⁴⁴

⁵³⁹ See *EFRAG* (2006), p. 11.

⁵⁴⁰ See *EFRAG* (2006), p. 11; see also *Group of 100* (2006), p. 4.

⁵⁴¹ See *ASB* (2006), section A para. 13-14.

⁵⁴² See *CIPFA* (2006), p. 9; see also *EFRAG* (2006), p. 11.

⁵⁴³ See *CIPFA* (2006), p. 8; see also *Group of 100* (2006), p. 4.

⁵⁴⁴ *ACTEO / AFEP / MEDEF* (2006), appendix p. 2; *UNICE* (2006), section 2.

Stating that management's assumptions lack predictive value, i.e. decision-usefulness, underpins the superiority of fair value. However, this is not sufficiently justified by the DP.⁵⁴⁵ Entity-specific measures may carry probable future cash flows and reflect management's specific knowledge on the entity's opportunities and barriers. Therefore, they incorporate a high degree of predictive value, which makes them more reliable. Assessment information otherwise not accessible by the public improves decision usefulness of financial statements.⁵⁴⁶

An example clarifying that entity-specific measurement objectives are not solely driven by management's expectations is historical cost. Historical cost is apparently an entity-specific measure since it reflects what has been actually received or given away by an entity. However, management's judgement is generally not relevant in determining the cost.⁵⁴⁷ Industrie-holding and Syngenat International AG state that "...an observed transaction price is an objective fact."⁵⁴⁸

Moreover, the term "entity-specific" seems to be applied inconsistently by the DP.⁵⁴⁹ This caveat can also be seen at the CASB's proposal that in the case of multiple markets the best price should be chosen by the individual entity in an accessible market. However, elsewhere it is argued that measurement should be free from entity-specific judgement.⁵⁵⁰ The ASB argues that it is often solely used to describe any measurement basis other than fair value.⁵⁵¹

⁵⁴⁵ See *ACTEO / AFEP / MEDEF* (2006), covering letter p. 1, appendix p. 3.

⁵⁴⁶ See *ACTEO / AFEP / MEDEF* (2006), appendix, p. 2; see also *UNICE* (2006), section 2.

⁵⁴⁷ See *ICAEW* (2006), para. 51; see also *industrie-holding* (2006), p. 19; *Syngenat International AG* (2006), p. 20; similar *EFRAG* (2006), pp. 11, 19; *FEE* (2006), pp. 5, 9.

⁵⁴⁸ See *industrie-holding* (2006), p. 19; see also *Syngenat International AG* (2006), p. 20.

⁵⁴⁹ See *ASB* (2006), section B q. 5; see also *EFRAG* (2006), pp. 11, 19; *industrie-holding* (2006), p. 19; *Syngenat International AG* (2006), p. 20.

⁵⁵⁰ See *Bundesverband deutscher Banken e.V.* (2006), p. 4; see also *Group of 100* (2006), p. 5; *Zentraler Kreditausschuss* (2006), p. 4.

⁵⁵¹ See *ASB* (2006), section B q. 5.

The IAA purports that the concept of entity-specific measurement objectives should be restated in order to be in accordance with the FASB's draft on FVM.⁵⁵² There the terms "... unobservable market inputs (inputs that reflect the reporting entity's assumptions of market inputs, developed based on its own data, adjusted to exclude factors specific to the reporting entity if information is available that indicates that market participants would use different assumptions) ..." ⁵⁵³ rather than entity-specific are used.⁵⁵⁴

The IAA, representing the view of the insurance sector, emphasises that an entity-specific concept differs from a portfolio-specific concept. Data observed in the specific portfolio would not be affected, if the portfolio were transferred to another entity. However, data arising from the entity's experience may no longer be available, if solely the portfolio is transferred, however not if the entire entity is sold.⁵⁵⁵

5.5 The Superiority of the Market Value Measurement Objective

The DP states:

"It is proposed that the market measurement objective has important qualities that make it superior to entity-specific measurement objectives, at least on initial recognition."⁵⁵⁶

Hence, any information that is not obtainable by all market participants is subjective, and thus less important to users.⁵⁵⁷ There is a vast majority disagreeing with this statement. In the absence of an efficient market, and thus an observable market price, the market value measurement objective seems less appropriate and less relevant than entity-specific measurement objectives. The conclusion that market value measurement is more

⁵⁵² See IAA (2006), p. 4.

⁵⁵³ FASB FVM Team (2006), p. 8.

⁵⁵⁴ See IAA (2006), p. 4.

⁵⁵⁵ See IAA (2006), pp. 11-12.

⁵⁵⁶ IASB (2005a), para. 60.

⁵⁵⁷ See *European Banking Industry* (2006), enclosure p. 4.

relevant than entity-specific measurement, which incorporates information inaccessible to market participants and which is subjective and less important is not undermined by persuading argumentation and is hence not found convincing.⁵⁵⁸ The assertions made for a market-based approach are inappropriate and the DP does not acknowledge the advantages of entity-specific objectives properly.⁵⁵⁹

The entire discussion leading to the conclusion that the market value measurement objective is superior is based on the theoretical concept of perfect markets (see chapter 5.2.2 above).⁵⁶⁰ Further, the conclusion is based on the presumption of publicly available information and knowledgeable marketplace participants, which may not exist in reality.⁵⁶¹ The DP has not adequately examined the applicability of the proposal on cases where markets are not fully efficient. The rejection of the entity-specific objective results from the weak analysis of the market value measurement objective.⁵⁶²

Given fair value is not reliably measurable, entity-specific measurement objectives or transaction prices may be more relevant.⁵⁶³ In the absence of perfect markets, entity-specific measurement objectives are more impor-

⁵⁵⁸ See ACCA (2006), qs. 5, 6; see also ASB (2006), section B q. 4; ACT (2006), q. 6; ACTEO / AFEP / MEDEF (2006), appendix p. 2; ASBJ (2006), pp. 1-2; BG Group (2006), pp. 3-4; British American Tobacco (2006), pp. 2-3; Bundesverband deutscher Banken e.V. (2006), p. 3; CIPFA (2006), p. 9; CNC (2006), covering letter section 4.2, appendix qs. 6, 5, 8, 12; Consiglio Nazionale dei Dottori Commercialisti / Consiglio Nazionale dei Ragionieri (2006), qs. 4, 6; E&Y (2006), p. 5; EFRAG (2006), pp. 2, 6, 10, 11; European Banking Industry (2006), enclosure pp. 5-6; F. Hoffmann-La Roche Ltd. (2006), appendix q. 4c; FEE (2006), pp. 1, 4, 5, 7; Hong Kong Institute of CPA (2006), p. 1; GNAIE (2006), p. 7; Group of 100 (2006), p. 4; IBF (2006), covering letter; ICAS (2006), p. 2; IDW (2006), pp. 7, 9; industrie-holding (2006), p. 8; IOSCO (2006), "General Comments" section 3; ISDA (2006), p. 2; LSCA (2006), pp. 3-4; Martinez, Chris (2006), p. 3; Mazars & Guérard (2006), pp. 2, 6; Nestlé (2006), p. 2; SAICA / APB of South Africa / APC of SAICA (2006), pp. 5-6; UBS AG (2006), pp. 2, 6; Zentraler Kreditausschuss (2006), p. 3.

⁵⁵⁹ See Mazars & Guérard (2006), pp. 2, 5.

⁵⁶⁰ See British American Tobacco (2006), pp. 2-3; see also FSR (2006), p. 6; Grant Thornton International (2006), p. 8; ICAEW (2006), pp. 11-12; ICAS (2006), p. 2; Shell International Ltd. (2006), p. 4.

⁵⁶¹ See ICPAK (2006), covering letter.

⁵⁶² See CPA Australia (2006), p. 4.

⁵⁶³ See UBS AG (2006), p. 2.

tant since they reflect economic reality.⁵⁶⁴ It is not convincing that when an active market does not exist a market-based value derived from a hypothetical market is more reliable than any entity-specific measure.⁵⁶⁵ The CNC argues that especially where markets are not perfect entity-specific measurement objectives do not necessarily have to differ from market value measurement objectives. Entity-specific prices may be within the range of observed market prices.⁵⁶⁶ Where a market does not exist at all such as in the insurance business there is not even a choice between entity-specific measurement objectives and market value measurement objective.⁵⁶⁷ An acquisition market may also not be identifiable for self-constructed assets.⁵⁶⁸

The main argument for choosing the market value measurement objective over entity-specific objectives is comparability over time and between different entities.⁵⁶⁹ Comparability is a very important factor for making financial reporting informative.⁵⁷⁰ It is reasoned that eliminating entity-specific factors enhances comparability. Similar assets might be reported at different values due to different economic strengths or weaknesses that are exploited by different entities. For example, one entity may obtain block discounts while others may not.⁵⁷¹ The BG Group points out that it is undesirable to carry a small group of items at market value, if the rest is carried at historical cost, especially if similar items might end up being treated the one way as well as the other. This would reduce comparability of financial information.⁵⁷² According to the Chartered Financial Analyst (CFA) Institute, historical cost is never comparable between entities since costs are incurred at different dates by different companies.⁵⁷³ The same type of assets will result in recognition at different values by different

⁵⁶⁴ See *ASB* (2006), section B q. 5.

⁵⁶⁵ See *ICAS* (2006), p. 2.

⁵⁶⁶ See *CNC* (2006), appendix q. 5.

⁵⁶⁷ See *GNAIE* (2006), p. 6.

⁵⁶⁸ See *Martinez, Chris* (2006), pp. 3, 4.

⁵⁶⁹ See *industrie-holding* (2006), p. 10; see also *Syngemat International AG* (2006), p. 9.

⁵⁷⁰ See *SFRSC* (2006), p. 6.

⁵⁷¹ See *Group of 100* (2006), p. 4.

⁵⁷² See *BG Group* (2006), pp. 7, 8.

⁵⁷³ See *CFA Institute* (2006), p. 2.

entities and the users may therefore miss comparability between the financial statements.⁵⁷⁴

Nevertheless some respondents argue that entity-specific measurements are much more constant over time than market-based measurements.⁵⁷⁵ The DP proposes that an asset should be measured at the date of delivery. Hence, if the fair value at the date a contract is entered differs from the fair value at the later date of delivery, this difference will be recognised (for more detail see chapter 6.1.5 below, p. 108).⁵⁷⁶ Measuring two identical assets at different amounts because of significant lead-time between the contract date and the delivery date would not reflect economic reality.⁵⁷⁷ Thus, a reader's ability to compare different entities is not facilitated.⁵⁷⁸ The SFRSC notes that it is not proven that the presumed inter-temporal applicability of fair value outperforms uncertainties such as identification and estimation difficulties for all transactions.⁵⁷⁹

Chris Martinez proposes that lacking comparability in applying entity-specific measurement objectives could be overcome by disclosing the changed circumstances between the current and previous fiscal year.⁵⁸⁰ However, management's expectations may change over time as well as between entities operating in the same markets, not only within the same entity. This will not necessarily impair the comparability of financial statements. However, the readers' ability to understand and compare entity-specific measurements depends significantly on disclosing the entity's strengths and weaknesses compared to the market.⁵⁸¹ Nevertheless, disclosing relevant items cannot cope with excluding them from the

⁵⁷⁴ See *Pervez, Ashraf* (2006), point 3.

⁵⁷⁵ See *Disclosure Solutions Ltd.* (2006), section "Why fair value is unsuitable for initial recognition"; see also *Syngenat International AG* (2006), p. 8.

⁵⁷⁶ See *IASB* (2005a), para. 179-180.

⁵⁷⁷ See *Disclosure Solutions Ltd.* (2006), section "Why fair value is unsuitable for initial recognition"; see also *Syngenat International AG* (2006), p. 8.

⁵⁷⁸ See *Syngenat International AG* (2006), p. 8.

⁵⁷⁹ See *SFRSC* (2006), p. 6.

⁵⁸⁰ See *Martinez, Chris* (2006), p. 3.

⁵⁸¹ See *industrie-holding* (2006), pp. 10-11; see also *Syngenat International AG* (2006), p. 10.

balance sheet.⁵⁸² Industrie-holding and Syngenat International AG point out that "... entity-specific measurements deserve more than simply disclosure."⁵⁸³

Some respondents argue that the objectives and the instruments necessary to reach those objectives are confused.⁵⁸⁴ The superiority of the market value measurement objective is reasoned to be superior simply by naming it an objective.⁵⁸⁵ However, market and entity-specific measurements are not objectives of financial statements, according to the IDW.⁵⁸⁶ The DRSC also supports this view: "The terminology used ... seems to obscure the difference between the measurement base and the aim of financial reporting ..."⁵⁸⁷. Measuring assets and liabilities is not an end itself but a means to fulfil the objectives of financial statements.⁵⁸⁸ The objectives of accounting are decision-usefulness and stewardship, as stipulated by the IASB Framework (see chapter 3.1 above).⁵⁸⁹

The DP discusses the market value measurement objective and entity-specific measurement objectives without comparing them with respect to their capability of meeting financial reporting objectives.⁵⁹⁰ The decision on either one's superiority should be made based on users' needs.⁵⁹¹ Hence, the discussion is incomplete as far as the objectives for financial reporting are not set sufficiently in advance (see also chapter 3.1 above).⁵⁹² Deciding on the superiority of the market value measurement objective over entity-specific objectives, and consequently, on the most relevant

⁵⁸² See *industrie-holding* (2006), p. 10; see also *Syngenat International AG* (2006), p. 9; similar *ACTEO / AFEP / MEDEF* (2006), appendix p. 3; *CFA Institute* (2006), p. 2.

⁵⁸³ *industrie-holding* (2006), p. 10; *Syngenat International AG* (2006), p. 9.

⁵⁸⁴ See *DRSC* (2006), p. 5; see also *FEE* (2006), p. 2; *IDW* (2006), p. 2.

⁵⁸⁵ See *IDW* (2006), p. 2.

⁵⁸⁶ See *IDW* (2006), p. 5.

⁵⁸⁷ *DRSC* (2006), pp. 5-6.

⁵⁸⁸ See *FEE* (2006), p. 2; see also *IDW* (2006), pp. 2, 6, 8; *industrie-holding* (2006), p. 5; *Syngenat International AG* (2006), p. 4.

⁵⁸⁹ See *IASB* (2002), para. 12-14; see also *DRSC* (2006), p. 6; *FEE* (2006), p. 2; *IDW* (2006), p. 2.

⁵⁹⁰ See *ACTEO / AFEP / MEDEF* (2006), appendix p. 3; see also *ICAS* (2006), p. 2; similar *CNC* (2006), appendix q. 6; *Nestlé* (2006), p. 2.

⁵⁹¹ See *ASB* (2006), section B q. 5; see also *CNC* (2006), appendix qs. 3, 6.

⁵⁹² See *ACTEO / AFEP / MEDEF* (2006), appendix p. 3; see also *DRSC* (2006), p. 7; *Mazars & Guérard* (2006), p. 2.

measurement basis on initial recognition (see chapter 6.1 below), depends on what one considers to be the objective of measuring: Is it to record assets and liabilities at a value that may be achievable in a sale, then market value is the most objective measure (for more detail see chapter 6.1.5 below).⁵⁹³ However, is the aim to provide information on how resources have been previously invested, market value might not be as appropriate.⁵⁹⁴

Generally, it shall be assumed that management behaves economically rational when incurring costs instead of believing it intends to manipulate initial measurement by accepting higher transaction prices.⁵⁹⁵ Relying on the actual transaction price on initial recognition might encourage manipulation through using “reference trades”. Measuring at fair value shall prevent this.⁵⁹⁶ On the contrary, the ASBJ suspects that manipulation may be possible, if fair value is used. For example, assuming that the transaction price for inventories differs from fair value, the entity may be able to manipulate the profit by purchasing larger quantities on stock and recognizing the difference as profit, according to the CASB’s proposal.⁵⁹⁷ The Florida Institute of Certified Public Accountants (FICPA) points out that measurement generally is a subjective process and exposed to potential manipulation (see also chapter 5.3.1 above, p. 60).⁵⁹⁸

The CASB itself names important arguments for reflecting management’s assumptions in measurement, namely that management knows its assets and its own business better than the market.⁵⁹⁹ Further, the DP fails to convince why management’s assumptions would result in information less decision-useful, even though management may provide information closer to expected cash flows.⁶⁰⁰

⁵⁹³ See *IVSC* (2006), appendix qs. 4c, 14.

⁵⁹⁴ See *IVSC* (2006), appendix qs. 4c, 14.

⁵⁹⁵ See *DRSC* (2006), p. 9; see also *FSR* (2006), p. 6; *IDW* (2006), p. 10.

⁵⁹⁶ See *Markit Valuations* (2006), p. 5.

⁵⁹⁷ See *ASBJ* (2006), p. 6.

⁵⁹⁸ See *FICPA* (2006), p. 2.

⁵⁹⁹ See *IASB* (2005a), para. 58.

⁶⁰⁰ See *ACTEO / AFEP / MEDEF* (2006), covering letter p. 1.

According to Takeshi Imamura, users are interested in earnings, which again result from management's intentions and expectations.⁶⁰¹ Values determined by management's expectations are more useful for users trying to understand the entity as a whole than values other marketplace participants are willing to pay.⁶⁰² Market-based prices are solely spot prices and reflect only the value to the marginal market participant but not to all, i.e. the marginal trade.⁶⁰³ This holds especially where fair value is an entity-specific measure.⁶⁰⁴ It is not apparent how marginal values are more decision-useful to users than values reflecting an asset's real economic worth.⁶⁰⁵ Users want to understand the entity itself. Thus, entity-specific measurement objectives are more relevant. Differences between entities are real economic differences.⁶⁰⁶ Therefore, the market measurement objective is not superior for assessing an entity's ability to generate cash.⁶⁰⁷ Where observable market prices do not exist due to imperfect markets and information asymmetry entity-specific measures are more relevant with respect to the objectives of financial reporting, namely decision usefulness and the assessment of management's stewardship.⁶⁰⁸

It can be acknowledged that the market value objective provides more information about the asset and the entity's relative advantage in the process of acquisition. However, financial statements shall give a broad view of the entity's performance and position. Since management's performance is relevant for valuing the whole entity, it would be false to ignore the costs management incurred to acquire an asset.⁶⁰⁹

Management must be accountable both for its own expectations and market objectives. Applying market value measurement objectives impairs

⁶⁰¹ See *Imamura, Takeshi* (2006), q. 6.

⁶⁰² See *Nestlé* (2006), p. 2.

⁶⁰³ See *EFRAG* (2006), p. 12; see also *Group of 100* (2006), p. 4.

⁶⁰⁴ See *Group of 100* (2006), p. 4.

⁶⁰⁵ See *EFRAG* (2006), p. 12.

⁶⁰⁶ See *F. Hoffmann-La Roche Ltd.* (2006), appendix q. 6.

⁶⁰⁷ See *SEAG* (2006), p. 6.

⁶⁰⁸ See *CNC* (2006), appendix q. 12; see also *FSR* (2006), pp. 5, 6.

⁶⁰⁹ See *industrie-holding* (2006), p. 10; see also *Syngemat International AG* (2006), p. 9.

the possibility to assess management's stewardship.⁶¹⁰ Entity-specific measures such as historical cost allow owners to hold management accountable for their direct actions. Although, under other measurement bases also attempting to assess the economic value of an asset or liability at a measurement date management might be held accountable for changes in values regardless whether these result from their direct actions or not.⁶¹¹ However, the FSR considers market values to be more objective in holding management accountable.⁶¹²

An estimate based on entity-specific objectives might be superior since it can be easier verified, and thus is more reliable.⁶¹³ The BG Group purports that fair value shall only be used, if there are sufficient exchange transactions in which equilibrium is reached. Otherwise fair value will probably be subjective and not easily be verified and its use will reduce comparability with other entities and within the same entity. Understandability and reliability of financial statements are impaired.⁶¹⁴

Nonetheless, there are respondents that agree with the superior relevance of market value over entity-specific measurement objectives on initial recognition.⁶¹⁵ Although, this is not always clear in practice the NRS (Norsk RegnskapsStiftelse) agrees on the market value measurement objective's superiority in cases where it is clear what constitutes a market and where a market measure exists.⁶¹⁶ Management should be measured against the market where an observable market price for an asset or liability with the same features exists.⁶¹⁷ Other respondents accept the superior relevance of market value measurement objectives where assets and liabilities are independent of unique entity-specific features and where

⁶¹⁰ See *FSR* (2006), p. 6.

⁶¹¹ See *industrie-holding* (2006), p. 7; see also *Syngemat International AG* (2006), p. 6.

⁶¹² See *FSR* (2006), pp. 4-5.

⁶¹³ See *BG Group* (2006), p. 3; see also *FSR* (2006), p. 6.

⁶¹⁴ See *BG Group* (2006), covering letter.

⁶¹⁵ See *CCDG* (2006), q. 6; see also *Consiglio Nazionale dei Dottori Commercialisti / Consiglio Nazionale dei Ragionieri* (2006), q. 6; *FICPA* (2006), p. 3; *ICAI* (2006), p. 4; *IVSC* (2006), appendix q. 6; *JICPA* (2006), p. 3; *IFRSRC of KASB* (2006), p. 4; *RICS Valuation Faculty* (2006), p. 6.

⁶¹⁶ See *NRS* (2006), p. 4.

⁶¹⁷ See *FSR* (2006), p. 5.

these are not affected by management's intentions, e.g. quoted financial instruments. Assets or liabilities dependent on management's intentions and unique to the entity are for example specialized assets.⁶¹⁸ It will be difficult not to take management's intention into account where an observable market does not exist (see chapter 5.3.2).⁶¹⁹

Other respondents believe that it is not appropriate to identify one measurement objective for all types of assets and liabilities. An asset intended for disposal should be measured at market value, while for an asset intended for continuous use an entity-specific perspective might be more appropriate.⁶²⁰ Grant Thornton International states: "Operational assets do not generate cash flows and are not priced on the basis of expected cash flows."⁶²¹ Thus, for operational assets and liabilities that will be settled through performance market measures are less useful.⁶²² Market measures are also less useful for non-current assets like property, plant and equipment. Regarding an entity not intending to continuously use an asset, a market price may provide more information to users and an entity-specific measure may not be relevant.⁶²³ For more detail see chapter 6.1.5 below on the reporting entity's intentions.

Further, the proposal that the market value measurement objective shall be more relevant is not consistent with the discussion on Segment Reporting as well as Management Commentary, which define management's own internal reporting as the basis for reporting.⁶²⁴ According to several respondents, both proposals emphasise that information delivered

⁶¹⁸ See *industrie-holding* (2006), p. 10; similar *FSR* (2006), p. 5; *Syngemat International AG* (2006), p. 9.

⁶¹⁹ See *FSR* (2006), pp. 5, 6.

⁶²⁰ See *ACT* (2006), q. 6; see also *ASBJ* (2006), pp. 2-3; *BG Group* (2006), p. 4; *DRSC* (2006), p. 8; *Grant Thornton International* (2006), p. 8; *Shell International Ltd.* (2006), pp. 4-5.

⁶²¹ *Grant Thornton International* (2006), p. 9.

⁶²² See *ASBJ* (2006), p. 3; see also *Grant Thornton International* (2006), p. 8.

⁶²³ See *DRSC* (2006), pp. 3, 8.

⁶²⁴ See *IASB* (2005c), para. 14-23; see also *IASB* (2006b), p. 5, para. IN2; *ASB* (2006), section B q. 5; *Bundesverband deutscher Banken e.V.* (2006), p. 3; *EFRAG* (2006), p. 12; *Group of 100* (2006), p. 5; *IDW* (2006), p. 8; *Zentraler Kreditausschuss* (2006), p. 3.

by management who knows its assets best support investors in making their investment decisions.⁶²⁵ The European Banking Industry states the example of a loan relationship manager who knows his customers personally and is therefore important for assessing the price and its future recoverability.⁶²⁶

Although, it is reasoned that there may be more than one single price for an asset or liability on a measurement date (see chapter 5.3.3.1 above) this finding is not at all regarded in concluding that the market value measurement objective is more relevant and more reliable.⁶²⁷ Further, whether the market value measurement objective or entity-specific measurement objectives are more relevant depends on the concept of capital adopted. An evaluation of the concepts of capital and capital maintenance should underlie the selection of an appropriate measurement basis.⁶²⁸ For more detail see chapter 2.3 above.

5.6 Value-Affecting Sources of Differences

5.6.1 Underlying Assumption: The A Priori Expectation

The DP proposes that:

“The a priori expectation reasoned from the market value measurement objective is that there can be only one market (fair) value for an item on any measurement date ...”⁶²⁹

IAS 39 opposes the a priori expectation and accepts more than one fair value and that fair value is still reliable, even though it is within a range of

⁶²⁵ See *Bundesverband deutscher Banken e.V.* (2006), pp. 3-4; see also *European Banking Industry* (2006), enclosure p. 5; *Zentraler Kreditausschuss* (2006), p. 3.

⁶²⁶ See *European Banking Industry* (2006), enclosure p. 5.

⁶²⁷ See *UNICE* (2006), section 2.

⁶²⁸ See *AASB* (2006), pp. 6-7.

⁶²⁹ *IASB* (2005a), para. 62.

measures.⁶³⁰ Some respondents accept this general proposition.⁶³¹ Other respondents accept this statement broadly in theory considering the definition of a perfect, efficient, and complete market and its idealised conditions. However, acknowledging that most markets in reality do not meet this definition, they cannot follow the CASB's conclusion (see chapter 5.2.2 above).⁶³²

Replacing the terms “can be only” with “in most cases there should be only”⁶³³ is suggested by the AFRAC. E&Y does not even accept an exclusive fair value in theory, not to mention in practice. It questions that in cases where an observable market price does not exist and needs to be estimated a market can only be presumed as well as the “competitive market forces” accompanying it. Thus, a single price can only be presumed either.⁶³⁴

Market prices may vary and inefficient markets may create a range of prices within which entities with different motivations, expectations and financial backgrounds may trade. Thus, the expectation of an exclusive market value should be rejected.⁶³⁵ In practice, there is often not just one single fair value for all marketplace participants.⁶³⁶ According to Chris Martinez, on an active stock exchange there are wide ranges of buy and sell prices. However, lacking a recent exchange activity it may be difficult

⁶³⁰ See IAS 39 (2004), para. AG74-AG82; see also *Hong Kong Institute of CPA* (2006), p. 1; *SAICA / APB of South Africa / APC of SAICA* (2006), p. 7.

⁶³¹ See *AASB* (2006), p. 7; see also *CCDG* (2006), q. 7; *FICPA* (2006), p. 3; *Monash University* (2006), p. 3.

⁶³² See *ACCA* (2006), q. 7; see also *ACTEO / AFEP / MEDEF* (2006), appendix p. 3; *AFRAC* (2006), p. 9; *ASBJ* (2006), p. 1; *CIPFA* (2006), p. 10; *CPA Australia* (2006), p. 6; *DRSC* (2006), p. 9; *F. Hoffmann-La Roche Ltd.* (2006), appendix q. 7a; *FSR* (2006), p. 7; *Group of 100* (2006), pp. 2, 5, 6; *Hundred Group of Finance Directors* (2006), appendix q. 7a; *ICAEW* (2006), para. 20-21; *ICAS* (2006), p. 2; *IDW* (2006), p. 9; *IFRSRC of KASB* (2006), p. 5; *Mazars & Guérard* (2006), p. 6; *NAIC* (2006), p. 6; *RICS Valuation Faculty* (2006), p. 6.

⁶³³ *AFRAC* (2006), p. 9.

⁶³⁴ See *E&Y* (2006), p. 4.

⁶³⁵ See *CNC* (2006), appendix q. 7; see also *Consiglio Nazionale dei Dottori Commercialisti / Consiglio Nazionale dei Ragionieri* (2006), q. 7; *DASB* (2006), p. 5; *EFRAG* (2006), p. 13; *Grant Thornton International* (2006), p. 1; *HSBC Holdings plc.* (2006), p. 3; similar *HSBC Holdings plc.* (2006), pp. 2-3; *IDW* (2006), p. 9; *IFRSRC of KASB* (2006), p. 5; *SFRSC* (2006), p. 11.

⁶³⁶ See *LIBA* (2006), p. 2.

to establish a single market price.⁶³⁷ In imperfect markets information asymmetry and restricted access to information prevails, especially in non-financial but also in financial markets.⁶³⁸ Thus, the conclusion does not hold and is solely theoretical.⁶³⁹

Regarding assets or liabilities with specific characteristics, the IFRSRC of KASB confirms the a priori expectation because they are unique and have a specific market price on their own.⁶⁴⁰ Chris Martinez believes that differences in a buyer's risk tolerance can influence the market value, if trading activities rarely incur.⁶⁴¹

The term "measurement date" of the proposed statement should not be taken literally. From an active financial market's point of view quoted prices change in the course of a day.⁶⁴² Even homogenous and highly traded products experience fluctuations in the course of one day and enable arbitrage.⁶⁴³ "Initial recognition may occur minutes before the market close and the subsequent remeasure will take place at the close."⁶⁴⁴

Moreover, the CASB points out that differences may arise due to value-affecting properties and that market inefficiencies can exist after adjusting for value-affecting properties and entity-specific charges (see chapters 5.6.2 and 5.6.3 below).⁶⁴⁵ Identical items are frequently sold in different quantities or purchased by buyers with different credit risk. Thus, assets and liabilities with different value-affecting properties may also be found in the same market.⁶⁴⁶ Hence, it has to be acknowledged that the CASB

⁶³⁷ See *Martinez, Chris* (2006), p. 4.

⁶³⁸ See *DRSC* (2006), p. 9; similar *IDW* (2006), p. 9.

⁶³⁹ See *DRSC* (2006), p. 9; see also *industrie-holding* (2006), p. 11; similar *F. Hoffmann-La Roche Ltd.* (2006), appendix q. 7a; *IDW* (2006), p. 9; *Shell International Ltd.* (2006), p. 6.

⁶⁴⁰ See *IFRSRC of KASB* (2006), p. 5.

⁶⁴¹ See *Martinez, Chris* (2006), p. 4.

⁶⁴² See *industrie-holding* (2006), p. 11; see also *Syngemat International AG* (2006), p. 10.

⁶⁴³ See *F. Hoffmann-La Roche Ltd.* (2006), appendix q. 7a.

⁶⁴⁴ *Markit Valuations* (2006), p. 2.

⁶⁴⁵ See *IASB* (2005a), para. 63.

⁶⁴⁶ See *Hundred Group of Finance Directors* (2006), appendix q. 7.

itself suggests declining the a priori expectation.⁶⁴⁷ Multiple markets are another example, why there is not only one single fair value (see chapter 5.6.4 below).⁶⁴⁸ The CASB admits that bargain purchases and overpayments incur regularly.⁶⁴⁹ However, in perfectly complete markets there is no arbitrage. There the values of individual assets added up equal the fair value of the whole investment.⁶⁵⁰ Bargain deals or overpayments will not incur in a market as defined by the CASB.⁶⁵¹ The EFRAG considers it inappropriate to base a thorough analysis on an assumption, i.e. the a priori expectation, which is apparently not true.⁶⁵²

5.6.2 Unit of Account

Having defined the unit of account is an important premise for determining the value-affecting properties of assets or liabilities.⁶⁵³ In this regard, two issues are worth mentioning:

- firstly, the portfolio concept, i.e. the appropriate individual item or portfolio unit of account in which the individual items retain their identities, and
- secondly, the appropriate level of aggregation creating a different asset or liability and the individual items lose their separate identities.⁶⁵⁴

The European Banking Industry identifies weaknesses regarding the portfolio concept. It considers it to be too narrow and stresses: “The basic feature of a portfolio is that instruments within the portfolio share one or

⁶⁴⁷ See CNC (2006), appendix qs. 3, 7; see also *Consiglio Nazionale dei Dottori Commercialisti / Consiglio Nazionale dei Ragionieri* (2006), q. 7; EFRAG (2006), p. 13; FICPA (2006), p. 3; FSR (2006), p. 7.; *Grant Thornton International* (2006), p. 8; *industrie-holding* (2006), p. 7; IVSC (2006), appendix qs. 7a, 9b; *Shell International Ltd.* (2006), pp. 5-6; *Syngemat International AG* (2006), p. 6.

⁶⁴⁸ See CNC (2006), covering letter section 4.3.

⁶⁴⁹ See IASB (2005a), para. 108.

⁶⁵⁰ See EFRAG (2006), p. 10; see also FSR (2006), p. 1.

⁶⁵¹ See EFRAG (2006), p. 10; see also FSR (2006), p. 1; ICAEW (2006), para. 58.

⁶⁵² See EFRAG (2006), p. 14.

⁶⁵³ See IDW (2006), p. 5.

⁶⁵⁴ See IASB (2005a), para. 67, 71.

more distinct characteristics and that they are being managed together.”⁶⁵⁵ Further, it is not acknowledged in this definition that a portfolio can incorporate assets as well as also liabilities.⁶⁵⁶

The ICAEW purports that the appropriate unit of account depends on the chosen measurement basis as follows:

- is the measurement basis historical cost, the appropriate unit of account is that in which it was acquired,
- is it fair value or net realizable value, the appropriate unit of account is that in which it would realise the highest value,
- is it current cost or replacement cost, the appropriate unit of account is that in which it could be replaced most economically.⁶⁵⁷

Historical cost accounting would be less problematic since the unit of account were just the units acquired. Fair value measurement on the other hand imposes the difficulties of imperfect markets, information asymmetry, arbitrage, and eventually the existence of more than just one single fair value.⁶⁵⁸ Only the accumulated costs model avoids profit recognition at initial recognition.⁶⁵⁹

Moreover, for non-contractual assets a market price usually does not exist. Then historical cost is the measurement basis chosen on initial recognition and the unit of account is not an issue.⁶⁶⁰ The AASB proposes that given an active market exists for non-contractual assets the appropriate unit of account is the one traded in this market, i.e. each input acquired in a market accessible to the reporting entity. The recognition and measurement of cash-generating units would result in financial statements reporting the value of an entity’s business rather than its assets and liabilities.⁶⁶¹

⁶⁵⁵ *European Banking Industry* (2006), enclosure p. 7.

⁶⁵⁶ See *European Banking Industry* (2006), enclosure p. 7.

⁶⁵⁷ See *ICAEW* (2006), para. 60.

⁶⁵⁸ See *Mazars & Guérard* (2006), p. 7.

⁶⁵⁹ See *ACTEO / AFEP / MEDEF* (2006), appendix p. 4.

⁶⁶⁰ See *BG Group* (2006), p. 5; see also *JICPA* (2006), p. 3.

⁶⁶¹ See *AASB* (2006), pp. 9-10.

A portfolio of assets or liabilities may have a fair value higher than that of the sum of the individual fair values.⁶⁶² This may be due to economies of scale and intangible benefits.⁶⁶³ Arbitrage may be created, if the prices on the market for an individual asset differ from the one of the portfolio.⁶⁶⁴ An entity may have access to several entry markets corresponding to different levels of units of account, i.e. individual units or portfolios.⁶⁶⁵ Identical assets might be valued differently, e.g. a bank enters loans on an individual basis and buys portfolios of similar loans.⁶⁶⁶

A portfolio view implies entity-specific factors to fair value since decisions of purchasing individual items together are made by management.⁶⁶⁷ Therefore, relevant measurement attributes cannot be chosen by simply just any marketplace participant. This again contradicts the superiority of the market value measurement objective.⁶⁶⁸ Another entity-specific factor is that the unit of account in which an asset is acquired depends on the entity's intended use: Is the intention to sell the acquired portfolio, the unit of account on initial and re-measurement is the portfolio. Is the intention to acquire individual items and sell the bundle, or acquire a portfolio and sell the unbundled components, profit or loss resulting from the bundling or unbundling will appropriately be postponed.⁶⁶⁹ Hence, the appropriate unit of account depends on when an entity intends to bundle individual items or unbundle a portfolio.⁶⁷⁰ The SFRSC, on the contrary, disagrees that financial instruments bought separately and then bundled together should be measured differently than buying the same in a portfolio in the first place.⁶⁷¹ The ISDA also disagrees that the appropriate unit of account is solely the unit in which assets were acquired or liabilities were incurred.⁶⁷²

⁶⁶² See *CNC* (2006), appendix q. 9; see also *Markit Valuations* (2006), p. 3; *SAICA / APB of South Africa / APC of SAICA* (2006), p. 8.

⁶⁶³ See *RICS Valuation Faculty* (2006), p. 6.

⁶⁶⁴ See *AFRAC* (2006), p. 10.

⁶⁶⁵ See *CNC*; (2006), appendix q. 9; similar *UBS AG* (2006), p. 3.

⁶⁶⁶ See *CNC* (2006), appendix q. 9.

⁶⁶⁷ See *ACTEO / AFEP / MEDEF* (2006), appendix p. 3; see also *AFRAC* (2006), p. 10.

⁶⁶⁸ See *ACTEO / AFEP / MEDEF* (2006), appendix p. 3.

⁶⁶⁹ See *EFRAG* (2006), p. 14; see also *IDW* (2006), pp. 11-12.

⁶⁷⁰ See *FEE* (2006), p. 7.

⁶⁷¹ See *SFRSC* (2006), pp. 11-12.

⁶⁷² See *ISDA* (2006), p. 3.

Additionally, the DP states "... that the appropriate unit of account for non-contractual assets on initial recognition is the lowest level of aggregation at which an identifiable asset is ready to contribute to the generation of future cash flows."⁶⁷³ Chris Martinez finds the term "ready to contribute to the generation of future cash flows" imprecise since an entity can be assumed to be permanently seeking to improve its earnings. Thus, each expenditure incurred would need to be linked to a cash inflow resulting from it. However, there are also non-identified assets, e.g. goodwill that cannot be linked directly to a future cash flow and where the treatment is unclear.⁶⁷⁴ All assets and liabilities contribute to future cash flows somehow.⁶⁷⁵

The IVSC identifies contradictions since an asset may be capable of contributing to future cash flows on its own, thus constituting the lowest level of aggregation itself. However, it may still have a higher market value as part of a portfolio.⁶⁷⁶ The RICS Valuation Faculty suggests that the lowest level of aggregation should depend on what a willing purchaser with expectations similar to the seller would assume. Given the valuation differs significantly from the market in which the asset was acquired, these differences would need to be disclosed.⁶⁷⁷

The DP proposes that the appropriate unit of account is the one in which the entity acquired the asset or incurred the liability.⁶⁷⁸ One exception however is identified with plant and equipment, which is sold as a single item, but the different component parts may have a useful life shorter than that of the item as a whole.⁶⁷⁹ Also tangible fixed assets in general may

⁶⁷³ IASB (2005a), para. 73.

⁶⁷⁴ See *Martinez, Chris* (2006), p. 4.

⁶⁷⁵ See *IDW* (2006), p. 12.

⁶⁷⁶ See *IVSC* (2006), appendix q. 9.

⁶⁷⁷ See *RICS Valuation Faculty* (2006), p. 7.

⁶⁷⁸ See *IASB* (2005a), para. 68.

⁶⁷⁹ See *industrie-holding* (2006), p. 13; similar *SAICA / APB of South Africa / APC of SAICA* (2006), p. 8; *Syngemat International AG* (2006), p. 12.

cause difficulties since the components used to evaluate the useful life usually have a lower level of aggregation than cash generating units.⁶⁸⁰

The issue of unit of account on initial recognition cannot be considered in isolation from subsequent re-measurement.⁶⁸¹ It needs to enable subsequent re-measurement and also derecognition of individual items of a portfolio.⁶⁸² The Hong Kong Institute of CPA sees the difficulty with the lowest level of aggregation to be disaggregation, especially regarding land and equipment.⁶⁸³ The level of aggregation affects the value since it can lead to difficulties on subsequent re-measurement, if businesses want to remodel assets and liabilities in order to increase or decrease value.⁶⁸⁴ Component parts of tangible fixed assets may be needed to be replaceable.⁶⁸⁵

In addition, the CASB introduces the example of equipment, which is acquired and configured for specialized use within an assembly line.⁶⁸⁶ It is not clear whether the costs should be initially expensed and then credited to the market value once configuration is complete, or whether purchase costs should be carried in assets under construction and subsequently restated to market value with a gain or loss being recognised.⁶⁸⁷ However, no recognition until the asset is completely finished would give the impression that also a partially constructed asset has no value.⁶⁸⁸ Whatever the suggested approach was it would end up in the recognition at market value, which according to the BG Group does not reflect economic reality.⁶⁸⁹ Moreover, according to the CNC the decision whether

⁶⁸⁰ See *Nestlé* (2006), p. 3.

⁶⁸¹ See *ACTEO / AFEP / MEDEF* (2006), appendix p. 4; see also *EFRAG* (2006), p. 14; *FEE* (2006), p. 7; *FSR* (2006), p. 8; *IDW* (2006), p. 12; *SAICA / APB of South Africa / APC of SAICA* (2006), p. 8; *UBS AG* (2006), p. 3.

⁶⁸² See *ACCA* (2006), q. 9; see also *FSR* (2006), p. 8.

⁶⁸³ See *Hong Kong Institute of CPA* (2006), p. 2.

⁶⁸⁴ See *IVSC* (2006), appendix q. 9.

⁶⁸⁵ See *F. Hoffmann-La Roche Ltd.* (2006), appendix q. 9.

⁶⁸⁶ See *IASB* (2005a), para. 72.

⁶⁸⁷ See *BG Group* (2006), p. 5; similar *SAICA / APB of South Africa / APC of SAICA* (2006), p. 8.

⁶⁸⁸ See *UBS AG* (2006), p. 8.

⁶⁸⁹ See *BG Group* (2006), p. 5.

the appropriate level of aggregation is the reconfigured equipment or the assembly line depends on entity-specific factors. The entity's production process itself determines whether a machine is sold directly to customers or is worked into another product and then sold. In cases where the value depends on the view specific to the business a market value may not even exist.⁶⁹⁰

Several respondents believe that the purpose of financial statements and what view of the entity's financial performance and financial position they should portray should be set before it can be concluded on the appropriate unit of account.⁶⁹¹ For more detail see chapter 3.1 above. Further, the discussion on the unit of account is very much connected to the debate on the recognition of day 1 profit or loss, which however is outside the DP's scope of the discussion on measurement on initial recognition (see chapter 2.3 above).⁶⁹²

5.6.3 Credit Risk

The DP proposes:

“The credit risk associated with a promise to pay is taken into account in the market's determination of the fair value of a promise to pay as an asset or a liability ...”⁶⁹³

Given the definition of perfect markets, which the DP supposes credit risk should not be an issue since the market would have already included it in the valuation of a debt.⁶⁹⁴ Thus, credit risk affects fair value and since a perfect market implies one single exchange price the fair value of an asset and liability will be the same.⁶⁹⁵ However, in reality perfect and complete

⁶⁹⁰ See *CNC* (2006), appendix q. 9.

⁶⁹¹ See *ASB* (2006), section B q. 9; see also *ACTEO / AFEP / MEDEF* (2006), appendix p. 4; *EFRAG* (2006), p. 14; *FEE* (2006), p. 7; *FSR* (2006), p. 8; *IDW* (2006), p. 11.

⁶⁹² See *FEE* (2006), p. 7.

⁶⁹³ *IASB* (2005a), para. 65.

⁶⁹⁴ See *ACTEO / AFEP / MEDEF* (2006), appendix p. 4; see also *CIPFA* (2006), p. 10; *DRSC* (2006), p. 9; *FSR* (2006), pp. 7-8; *industrie-holding* (2006), p. 12; *Syngenat International AG* (2006), p. 11.

⁶⁹⁵ See *industrie-holding* (2006), p. 12; see also *Syngenat International AG* (2006), p. 11.

markets rarely exist, and thus information asymmetry between the buyer and seller may lead to differing prices (see chapter 5.2.2 above).⁶⁹⁶ The CPA Australia note that differences might arise, if the cash flows are discounted by different rates, which would reflect an entity-specific factor. However, this would contradict the concept of fair value.⁶⁹⁷

Further, what matters to the debtor incurring the liability is the amount payable and not the market price, even if both are equal.⁶⁹⁸ At the time a contract is entered credit risk is reflected in the premises of the contract and the debtor will have to settle the contracted amount not the market value of the liability.⁶⁹⁹ Contracting parties will consider credit risk in pricing a promise to pay. Thus, a liability's fair value will differ from its face value. In order to enable a proper assessment of financial statements the Monash University suggests that both the face amount and the date of discharge of the promise to pay shall be disclosed. An entity might experience restrictions on its ability to discharge the obligation at fair value.⁷⁰⁰ Thus, fair value might not be the most reliable measure or there is a need for supplementary "... disclosure explaining the nature and significance of an inability to discharge the obligation at the recognised amount."⁷⁰¹

In practice, the fair value of the liability valued by the debtor will be greater than that assessed by the creditor because the latter will consider credit risk and the debtor will recognise the amount at which he assumes to settle the liability.⁷⁰² Some respondents disagree with the CASB's proposal since the present value of an obligation to make payments in the future, i.e. the full current cost, might be higher than the present value of a

⁶⁹⁶ See *DRSC* (2006), p. 9.

⁶⁹⁷ See *CPA Australia* (2006), p. 6.

⁶⁹⁸ See *DRSC* (2006), p. 9.

⁶⁹⁹ See *Group of 100* (2006), p. 5.

⁷⁰⁰ See *Monash University* (2006), p. 4.

⁷⁰¹ *Monash University* (2006), p. 4.

⁷⁰² See *Hundred Group of Finance Directors* (2006), appendix q. 8.

right to receive such payments, which will be discounted by the risk of bad debt.⁷⁰³

Some respondents agree that credit risk should be included in the determination of fair value.⁷⁰⁴ However, in business-to-business or consumer markets promises to pay are exchanged for goods or services in the short run. Hence, credit risk may not have an impact on fair value but on a participant's willingness to transact, if credit risk is significant.⁷⁰⁵

Considering fair value as an exit value excluding transaction costs, credit risk can be seen to enter into the determination of fair value. However, some respondents view historical cost as the most relevant measurement basis on initial recognition. Regarding promises to pay, historical cost will regularly equal fair value, but taking transaction costs into account.⁷⁰⁶ Thus, it can be concluded that credit risk enters into the market value of liabilities. However, fair value is not considered as a relevant measurement basis on initial recognition.⁷⁰⁷

Other respondents question the decision usefulness of taking credit risk in measuring liabilities into account.⁷⁰⁸ Assuming that an entity experiences a downgrading in its credit standing, this would result in an income being recognised in its profit and loss, i.e. a potential worsening in an entity's ability of going concern would lead to reported earnings. Vice versa a loss would be reported, if a company's credit standing improves. This seems absurd and will confuse users of financial statements rather than provide

⁷⁰³ See *ICAI* (2006), p. 5; see also *IVSC* (2006), appendix q. 8; *RICS Valuation Faculty* (2006), p. 6.

⁷⁰⁴ See *ACT* (2006), q. 8; see also *industrie-holding* (2006), p. 12; *Syngemat International AG* (2006), p. 11.

⁷⁰⁵ See *industrie-holding* (2006), p. 12; see also *Syngemat International AG* (2006), p. 11.

⁷⁰⁶ See *IDW* (2006), p. 10.

⁷⁰⁷ See *ACT* (2006), q. 8; see also *Group of 100* (2006), p. 5.

⁷⁰⁸ See *ACTEO / AFEP / MEDEF* (2006), appendix p. 4; see also *FEE* (2006), p. 6; *IAA* (2006), p. 6; *CNC* (2006), appendix q. 8; *EFRAG* (2006), p. 13; *ASB* (2006), section B q. 8; *Bundesverband deutscher Banken e.V.* (2006), pp. 4-5; *Zentraler Kreditausschuss* (2006), pp. 4-5; *IDW* (2006), pp. 10-11.

them with information.⁷⁰⁹ Additionally, changes in a company's credit standing are accompanied by changes in an internally generated goodwill. Thus, if the deterioration in an unrecognised goodwill is not expensed, the related income should not be recognised either.⁷¹⁰

The ASBJ notes that taking credit risk into account on re-measurement may lead to unreasonable results because measurement based on an entity's own creditworthiness is inconsistent with the premise of going concern, assuming an entity's intention to fully balance all its liabilities. Further, adjustments – given they are reliably measurable – are only relevant, if a liability can be transferred to a third party, and therefore a gain may be realised.⁷¹¹ Thus, credit risk shall not be considered on subsequent re-measurement except the entity is no longer a going concern.⁷¹² According also to the ICAI, a debtor's credit worthiness is only assessed at subsequent re-measurement.⁷¹³ However, including the entity's credit risk might still lead to unreasonable recognition of gains or losses after initial recognition.⁷¹⁴

Assuming that the objective of financial reporting is only to satisfy investors' needs, it can be agreed with the proposal. However, stewardship should also be acknowledged to the same extent (see chapter 3.1 above).⁷¹⁵ In addition, some agree with the proposal concerning initial recognition but state concerns regarding subsequent re-measurement.⁷¹⁶

⁷⁰⁹ See *Bundesverband deutscher Banken e.V.* (2006), pp. 4-5; see also *Zentraler Kreditausschuss* (2006), pp. 4-5; similar *ACTEO / AFEP / MEDEF* (2006), appendix p. 4; *CNC* (2006), appendix q. 8; *EFRAG* (2006), p. 13; *FEE* (2006), p. 6; *IAA* (2006), p. 6; *IDW* (2006), pp. 10-11.

⁷¹⁰ See *ASBJ* (2006), p. 4; see also *IDW* (2006), p. 11.

⁷¹¹ See *ASBJ* (2006), pp. 4-5.

⁷¹² See *Industrie-holding* (2006), p. 12; see also *Syngemat International AG* (2006), p. 11.

⁷¹³ See *ICAI* (2006), p. 5.

⁷¹⁴ See *DRSC* (2006), p. 9; see also *DASB* (2006), p. 5.

⁷¹⁵ See *SFRSC* (2006), p. 11.

⁷¹⁶ See *ACCA* (2006), q. 8; similar *ACT* (2006), q. 8; *ACTEO / AFEP / MEDEF* (2006), appendix p. 4; *ASBJ* (2006), pp. 4-5; *CNC* (2006), appendix q. 8; *DASB* (2006), p. 5; *EFRAG* (2006), p. 13; *FEE* (2006), p. 6; *ICAI* (2006), p. 5; *Monash University* (2006), p. 4; *Mazars & Guérard* (2006), p. 7; *SFRSC* (2006), p. 11.

The proposal to include credit risk in fair value may not necessarily be extended to subsequent re-measurement.⁷¹⁷

5.6.4 Multiple Markets

Several respondents disagree with the a priori expectation since the CASB and the FASB themselves conclude that there are multiple markets originating different prices.⁷¹⁸ More than one reference market may exist for identical assets or liabilities.⁷¹⁹ There will be more than one fair value on a measurement date since market participants will have access to different markets.⁷²⁰ One single fair value may be observable in one market, but since there are multiple markets the equilibrium price, e.g. in the “retail” market will differ from the one in the “wholesale” market.⁷²¹ This is because the latter is not accessible to “retail” customers due to transaction costs. Thus, even in mature economies different prices can be observed.⁷²² Alternative prices found on multiple markets prove the difficulty with fair valuing when there is simply no perfect market price.⁷²³

Differences can also arise between measuring in an entry opposed to an exit market. Measurement should not be based on a hypothetical market.⁷²⁴ Assuming differences between entry and exit prices contradicts the assumption of an open and competitive market.⁷²⁵ However, the DP does not sufficiently take into account that there are numerous businesses operating in both an entry as well as an exit market.⁷²⁶

⁷¹⁷ See ACCA (2006), q. 8.

⁷¹⁸ See *Grant Thornton International* (2006), p. 8; see also *NSW Treasury* (2006), p. 5; *SFRSC* (2006), p. 12.

⁷¹⁹ See *CNC* (2006), appendix q. 7.

⁷²⁰ See *ISDA* (2006), p. 2.

⁷²¹ See *British American Tobacco* (2006), p. 2; see also *Group of 100* (2006), p. 4; *Hong Kong Institute of CPA* (2006), p. 1; *Markit Valuations* (2006), p. 4.

⁷²² See *British American Tobacco* (2006), p. 2; see also *Markit Valuations* (2006), p. 4.

⁷²³ See *Mazars & Guérard* (2006), p. 8.

⁷²⁴ See *University of Wisconsin* (2006), q. 3.

⁷²⁵ See *IVSC* (2006), appendix q. 7a.

⁷²⁶ See *UBS AG* (2006), p. 8.

Further, the a priori expectation of one fair market value does not hold for dual listed entities.⁷²⁷ The CPA Australia give an example when shares are traded on different exchange markets, e.g. London and Hong Kong. Price differences are perceived due to differences in time when the markets operate and currency differences.⁷²⁸ Thus, "... the relevant value would depend on the relevant market in which the shares are traded."⁷²⁹

The ICAEW believes that given the proposed definition of markets (see chapter 5.2.1 above), multiple markets do not exist. Any value-affecting properties, e.g. nails traded wholesale compared to retail, or block discounts, i.e. for large amounts compared to individual items, incur in different markets. However, this can also be ascribed to the fact that markets in reality do not meet the proposed definition.⁷³⁰ Different prices could exist for the same asset due to inefficient markets.⁷³¹ The IVSC purports that in many circumstances it is not different markets that affect the market value of an asset but different assumptions on how an assets is presented to the market.⁷³²

5.6.5 The Most Advantageous Market

The DP suggests that an entity should generally look to the market in which it acquired the asset or liability when measuring it.⁷³³ Several respondents support this view.⁷³⁴ The ICAI also considers the entry price to be most appropriate. The value added on the process of exit is solely a re-measurement issue.⁷³⁵

⁷²⁷ See *CPA Australia* (2006), p. 6; see also *Group of 100* (2006), p. 5.

⁷²⁸ See *CPA Australia* (2006), p. 6.

⁷²⁹ *CPA Australia* (2006), p. 6.

⁷³⁰ See *ICAEW* (2006), para. 55-56.

⁷³¹ See *Consiglio Nazionale dei Dottori Commercialisti / Consiglio Nazionale dei Ragionieri* (2006), q. 7.

⁷³² See *IVSC* (2006), appendix q. 10.

⁷³³ See *IASB* (2005a), para. 75.

⁷³⁴ See *CIPFA* (2006), p. 11; see also *European Banking Industry* (2006), enclosure p. 9; *Hundred Group of Finance Directors* (2006), appendix q. 10; *Zentraler Kreditausschuss* (2006), p. 4.

⁷³⁵ See *ICAI* (2006), p. 5.

Regarding assets acquired or liabilities incurred in a business combination or a multiple-element transaction, individual measurement of the asset or liability should look at the market in which the same is usually acquired or incurred individually, i.e. the entry market, rather than the market in which it will be normally sold, i.e. the exit market. The latter will bring a recoverable amount on re-measurement.⁷³⁶

The CASB's proposal however does not refer to the most advantageous market since this might in most cases be a business-to-business market rather than the market in which an asset was acquired or a liability incurred. Further, the proposal suggests that two identical assets would be measured differently because they were incurred in different markets.⁷³⁷ Moreover, it has to be borne in mind that identical items may be found with different value-affecting properties in the same market.⁷³⁸

The AFRAC perceives an entity-specific factor in the reference to the market in which the asset or liability was acquired.⁷³⁹ However, if the most advantageous market price differs from the one actually incurred, this may lead to a recognised loss implying a judgment on management's stewardship.⁷⁴⁰ The FSR finds that management's intention needs to be considered since management has hidden knowledge and the market's strategy might differ from that of the entity.⁷⁴¹

Some respondents purporting historical cost measurement argue that measuring an asset or liability in the market in which it was acquired or incurred will lead to measuring it at historical cost.⁷⁴² Thus, the question of what the most advantageous market is would not even arise when

⁷³⁶ See *industrie-holding* (2006), p. 13; see also *Syngemat International AG* (2006), p. 13.

⁷³⁷ See *AASB* (2006), pp. 10-11.

⁷³⁸ See *Hundred Group of Finance Directors* (2006), appendix q. 7.

⁷³⁹ See *AFRAC* (2006), p. 11.

⁷⁴⁰ See *CNC* (2006), appendix q. 10.

⁷⁴¹ See *FSR* (2006), pp. 8-9.

⁷⁴² See *AFRAC* (2006), p. 11; see also *industrie-holding* (2006), p. 11; similar *Mazars & Guérard* (2006), p. 8.

measuring at historical cost.⁷⁴³ Measuring at fair value on initial recognition, the appropriate market would be that in which the asset could be realised at the highest value or the liability could be settled at the lowest value.⁷⁴⁴ Transaction costs would need to be considered in deciding which market to address and to determine fair value.⁷⁴⁵ However, considering an entity changes its intention to use an asset recently acquired, the market in which the asset was acquired may no longer be accessible. The entity will have to look at a different market, which will lead to a different fair value simply due to the entity's changed intention.⁷⁴⁶

It is noted that the proposed conclusion again is based on the assumption of perfect markets (see chapter 5.2.2 above), but wholesale and retail trade may not be explained in perfect markets.⁷⁴⁷ Thus, significant problems arise when the theoretical model of perfect markets is applied in practice.⁷⁴⁸ Different markets exist due to information asymmetry, but also within the same market the same assets and liabilities may be traded at different prices because marketplace participants avail of imperfect knowledge.⁷⁴⁹ Further, there are also issues impacting the behaviour of marketplace participants that need to be given consideration, e.g. convenience might drive a buyer to purchase in a different market.⁷⁵⁰

The BG Group points out that choosing the most advantageous market would mean incurring additional costs for minimum benefit.⁷⁵¹ Having to determine, if the market in which an asset was acquired is actually the most advantageous market will be impractical.⁷⁵²

⁷⁴³ See *ICAEW* (2006), para. 62; see also *Hundred Group of Finance Directors* (2006), appendix q. 10.

⁷⁴⁴ See *ICAEW* (2006), para. 62.

⁷⁴⁵ See *CPA Australia* (2006), p. 7; see also *ICAEW* (2006), para. 62.

⁷⁴⁶ See *DRSC* (2006), p. 10.

⁷⁴⁷ See *DRSC* (2006), p. 10; similar *SAICA / APB of South Africa / APC of SAICA* (2006), p. 8.

⁷⁴⁸ See *DRSC* (2006), p. 10.

⁷⁴⁹ See *Hundred Group of Finance Directors* (2006), appendix q. 7.

⁷⁵⁰ See *SAICA / APB of South Africa / APC of SAICA* (2006), p. 8.

⁷⁵¹ See *BG Group* (2006), p. 5.

⁷⁵² See *IDW* (2006), p. 10.

5.7 Further Suggestions and Remarks

The fundamental sources of differences depend on the nature of the market transactions referred to rather than just the market in which the transaction is incurred.⁷⁵³ The ICAEW determines that the following measurement bases should be used for the stated transactions:

- historical cost for actual past entry transactions,
- fair value for hypothetical past transactions at the balance sheet date,
- current cost and deprival value for hypothetical past entry transactions at the balance sheet date,
- net realizable value for hypothetical past exit transactions, against which hypothetical past entry transactions are netted – all transactions at the balance sheet date, and
- value in use for hypothetical future exit transactions, against which hypothetical future entry transactions are netted.⁷⁵⁴

The aim is to use market prices for all measurement bases, but whether this can be achieved varies. For example calculated fair values, i.e. future cash flows, will be based only on hypothetical future transactions since by definition the asset is not sold at the measurement date. It needs to be explained how just any sources of differences produce actual differences between the identified measurement bases.⁷⁵⁵ The EFRAG points out that “... the only time that initial measurement is really interesting is when there are differences on initial recognition between the various possible measurement bases.”⁷⁵⁶ The differences may also result from the use of different valuation techniques or assumptions.⁷⁵⁷ See also chapter 6.1.3 below on this issue.

⁷⁵³ See ICAEW (2006), para. 44; see also IDW (2006), p. 10.

⁷⁵⁴ See ICAEW (2006), para. 44.

⁷⁵⁵ See ICAEW (2006), para. 42, 46.

⁷⁵⁶ EFRAG (2006), p. 9.

⁷⁵⁷ See SAICA / APB of South Africa / APC of SAICA (2006), p. 7.

Moreover, according to the FEE differences can also result from different markets' locations for seemingly identical assets.⁷⁵⁸ The BG Group rejects that differences result from value-affecting properties or only entity-specific charges. Originating factors are rather the composition and liquidity of the involved markets and the expectations, risk tolerance, and objectives of its participants.⁷⁵⁹

6 Comparative Analysis of the Alternative Measurement Bases

6.1 The Most Relevant Measurement Basis on Initial Recognition

6.1.1 Overview

The DP proposes that "... fair value must be considered more relevant than measurement bases that depend on entity-specific expectations, as long as it can be reliably measured."⁷⁶⁰ The CASB concludes that the most relevant measurement basis on initial recognition should be fair value when it can be measured reliably.⁷⁶¹ Hence, entity-specific expectations should be removed and the consideration actually paid or received on initial recognition does not play a role. Consequently, gains and losses will be recognised, if fair value differs from the consideration actually paid or received.⁷⁶² The carrying forward of any expected entity-specific advantages or disadvantages to future periods is prevented.⁷⁶³ However, the CASB does not explicitly state that gains and losses should be treated this way.⁷⁶⁴ If an entity's performance should be measured against market values and profits and losses arising when market values and transaction

⁷⁵⁸ See *FEE* (2006), p. 6.

⁷⁵⁹ See *BG Group* (2006), p. 4.

⁷⁶⁰ *IASB* (2005a), para. 102.

⁷⁶¹ See *IASB* (2005a), para. 101-119.

⁷⁶² See *ASBJ* (2006), pp. 1-2.

⁷⁶³ See *SEAG* (2006), p. 6.

⁷⁶⁴ See *AFRAC* (2006), p. 3.

prices differ should be recognised immediately, the CASB should also clearly express, justify, and explain this.⁷⁶⁵

Many respondents argue that the DP overstates the strengths of fair value and the weaknesses of other measurement bases, especially historical cost. At the same time the weaknesses of fair value and the strengths of other measurement bases are understated.⁷⁶⁶ The CPA Australia describe the discussion as "... very highly geared towards the use of fair value, which suggests that the tone is not completely objective."⁷⁶⁷ Hence, it is biased towards fair value and the advantages and disadvantages of the other measurement bases listed by the DP are not considered in a neutral way.⁷⁶⁸

Applying a single measurement basis on initial recognition seems to reduce complexity. However, one basis may not be able to cope with all issues of initial measurement sufficiently. Applying different measurement bases on different types of assets or liabilities is not inconsistent with the objectives of providing decision-useful information.⁷⁶⁹

6.1.2 The Assumption of Market Perfection and Existence

The DP's assumptions leading to fair value as the most relevant measurement basis on initial recognition are based on the existence of perfectly efficient markets. However, market conditions in reality are different.⁷⁷⁰

⁷⁶⁵ See ASB (2006), section A para. 6; see also CNC (2006), covering letter section 2, appendix q. 3, 16; EFRAG (2006), p. 5; *industrie-holding* (2006), p. 5; *Syngemat International AG* (2006), p. 4.

⁷⁶⁶ See ACTEO / AFEP / MEDEF (2006), appendix p. 7; see also CPA Australia (2006), p. 9; DASB (2006), p. 8; EFRAG (2006), p. 18; *F. Hoffmann-La Roche Ltd.* (2006), appendix q. 16; FSR (2006), p. 11; *Grant Thornton International* (2006), p. 3; *Group of 100* (2006), p. 8; *industrie-holding* (2006), p. 17; *Martinez, Chris* (2006), p. 2; NRS (2006), p. 5; SAICA / APB of South Africa / APC of SAICA (2006), p. 11; SEAG (2006), pp. 1, 7; *Shell International Ltd.* (2006), p. 9; *Syngemat International AG* (2006), p. 18.

⁷⁶⁷ CPA Australia (2006), p. 9.

⁷⁶⁸ See ASB (2006), covering letter para. 2; see also CPA Australia (2006), p. 9; E&Y (2006), p. 5; FEE (2006), p. 9; JICPA (2006), p. 2; SEAG (2006), p. 7; SFRSC (2006), pp. 3, 14; *Syngemat International AG* (2006), p. 3; UNICE (2006), section 5.

⁷⁶⁹ See *Syngemat International AG* (2006), p. 2.

⁷⁷⁰ See FSR (2006), p. 11; see also NRS (2006), p. 6; SFRSC (2006), p. 14.

One of the reasons that cost and fair value differ are imperfect markets.⁷⁷¹
The objectiveness of the DP in this regard is questionable.⁷⁷²

The DP's proposal seems to be grounded on the assumption that the market value measurement objective is more relevant than entity-specific measurement objectives.⁷⁷³ It is rather theoretical due to the assumption of perfect markets, which in reality rarely exist.⁷⁷⁴ A fair value will need to be estimated since for most assets and liabilities, except e.g. marketable securities, a market price is not observable.⁷⁷⁵ Consequently the relevance and practicability of fair value is questionable.⁷⁷⁶ The ASB suspects that a measurement approach based solely on the advantages of efficient market fair values that failed to convince may more probably prevent a wider use of current values in financial reporting.⁷⁷⁷

6.1.3 Fair Value and Historical Cost

According to the CFA Institute, investment decisions are based on fair value and expected future changes in fair value. Thus, financial statements based on outdated historical cost are less useful. The CFA Institute challenges that "... reported Information must be timely, accurate, understandable, and comprehensive."⁷⁷⁸ It purports fair value measurement on initial recognition in all cases.⁷⁷⁹ It further emphasises "... that it is better to know what something is worth now than what it was worth at some

⁷⁷¹ See ASB (2006), section A para. 8; see also SFRSC (2006), p. 3.

⁷⁷² See CPA Australia (2006), p. 9.

⁷⁷³ See ACT (2006), q. 14.

⁷⁷⁴ See ASB (2006), section B q. 14; see also ACTEO / AFEP / MEDEF (2006), appendix p. 6; BBA (2006), p. 2; Bundesverband deutscher Banken e.V. (2006), pp. 5-6; CPA Australia (2006), p. 8; EFRAG (2006), p. 17; FEE (2006), p. 8; FSR (2006), pp. 9-10; HSBC Holdings plc. (2006), p. 2; IDW (2006), p. 14; IDW (2006), p. 15; SAICA / APB of South Africa / APC of SAICA (2006), p. 2; Zentraler Kreditausschuss (2006), p. 5.

⁷⁷⁵ See Bundesverband deutscher Banken e.V. (2006), pp. 5-6; see also GNAIE (2006), p. 11; Zentraler Kreditausschuss (2006), p. 5.

⁷⁷⁶ See ACTEO / AFEP / MEDEF (2006), appendix p. 6; see also BBA (2006), p. 2; Bundesverband deutscher Banken e.V. (2006), pp. 5-6; CPA Australia (2006), p. 8; EFRAG (2006), p. 17; FEE (2006), p. 8; FSR (2006), pp. 9-10; HSBC Holdings plc. (2006), p. 2; IDW (2006), p. 14; IDW (2006), p. 15; SAICA / APB of South Africa / APC of SAICA (2006), p. 2; Zentraler Kreditausschuss (2006), p. 5.

⁷⁷⁷ See ASB (2006), covering letter para. 3.

⁷⁷⁸ CFA Institute (2006), p. 2.

⁷⁷⁹ See CFA Institute (2006), p. 2.

moment in the past ...”⁷⁸⁰ Fair value seems to be more relevant than historical cost already incurred decades ago.⁷⁸¹ The Hong Kong and Shanghai Banking Corporation Holdings Public Ltd. Company (HSBC Holdings plc.) states that fair values “... factor in future expectations of cash flows to form a theoretical estimate of current market value.”⁷⁸²

Nevertheless, most respondents prefer historical cost as the most relevant measurement basis on initial recognition in all or in some circumstances. Some point out that it is inappropriate to substitute a modelled market price for a price paid in an arm’s length transaction, i.e. historical cost, and that the latter provides more useful information.⁷⁸³ The estimation in a modelled market transaction would introduce even more market imperfections.⁷⁸⁴ Therefore, whenever fair value cannot be derived from an active market reliability of fair value is impaired and historical cost is more relevant and more reliable.⁷⁸⁵ Cost should then be used on initial recognition where a price resulting from an arm’s length transaction is determinable.⁷⁸⁶ If historical cost is not available because an exchange transaction has not incurred, fair value may be the most relevant measurement basis.⁷⁸⁷ Such situations include multiple-element transactions, non-monetary exchanges, as well as business combinations.⁷⁸⁸ Hence, historical cost is the most relevant measurement basis on initial recognition, although in certain cases fair value can be a good approximation for historical cost, e.g. in business combinations.⁷⁸⁹ Apart from business combinations historical cost is usually known on initial recognition.⁷⁹⁰ The

⁷⁸⁰ *CFA Institute* (2006), p. 2.

⁷⁸¹ See *NASB* (2006), introduction.

⁷⁸² *HSBC Holdings plc.* (2006), p. 3.

⁷⁸³ See *ACT* (2006), q. 14; see also *ASBJ* (2006), p. 6; *Hermes Investment Mgmt. Ltd.* (2006), covering letter, qs. 14, 18; *Hundred Group of Finance Directors* (2006), appendix q. 4.

⁷⁸⁴ See *Hermes Investment Mgmt. Ltd.* (2006), q. 15.

⁷⁸⁵ See *FEE* (2006), pp. 3-4; similar *IDW* (2006), pp. 15-16.

⁷⁸⁶ See *Grant Thornton International* (2006), p. 3.

⁷⁸⁷ See *Hundred Group of Finance Directors* (2006), appendix qs. 2, 14; see also *industrie-holding* (2006), p. 15; *Syngemat International AG* (2006), p. 15.

⁷⁸⁸ See *industrie-holding* (2006), p. 15; see also *Syngemat International AG* (2006), p. 15.

⁷⁸⁹ See *ICAEW* (2006), para. 66.

⁷⁹⁰ See *Hundred Group of Finance Directors* (2006), covering letter section “Why fair value?”.

NASB favours historical cost at initial recognition when cash or cash equivalent is paid, except for related party transactions.⁷⁹¹ It may be difficult to arrive at fair value in many related party transactions.⁷⁹²

Historical cost is more relevant and reliable because of its close connection to cash flows that actually occurred in exchange transactions.⁷⁹³ Disclosure Solutions Ltd. ascribes the attributes “understandable, ... neutral, objective and verifiable ...”⁷⁹⁴ to historical cost. Grant Thornton International describes it as “... relatively straightforward to determine and verify; and reliably measurable.”⁷⁹⁵ It is not solely entity-specific since it is arrived at in an exchange transaction with an unrelated party.⁷⁹⁶ Further, it is comparable since other buyers transact in the same markets at similar prices.⁷⁹⁷ On the contrary, the CFA Institute considers historical cost to be never comparable since different companies incurred costs at different points in time.⁷⁹⁸ Historical cost however is rather capable of producing meaningful information in financial statements reflecting management’s success or failure since owners want to know on what management has spent their investments.⁷⁹⁹ Reporting on past performance helps users to assess management’s performance and to judge on the reliability of other sources of information and their relevance to forecast future cash flows.⁸⁰⁰

Historical cost and fair value are the same in most exchange transactions.⁸⁰¹ Therefore, in cases where they are the same the CASB’s proposal would effectively not lead to any changes in accounting.

⁷⁹¹ See *NASB* (2006), para. 2.

⁷⁹² See *Hong Kong Institute of CPA* (2006), p. 1.

⁷⁹³ See *HSBC Holdings plc.* (2006), p. 3.

⁷⁹⁴ *Disclosure Solutions Ltd.* (2006), section “Historical cost”.

⁷⁹⁵ *Grant Thornton International* (2006), p. 11.

⁷⁹⁶ See *Grant Thornton International* (2006), p. 11.

⁷⁹⁷ See *Disclosure Solutions Ltd.* (2006), sections “Historical cost”, “Why fair value is unsuitable for initial recognition”.

⁷⁹⁸ See *CFA Institute* (2006), p. 2.

⁷⁹⁹ See *Disclosure Solutions Ltd.* (2006), sections “Historical cost”, “Why fair value is unsuitable for initial recognition”.

⁸⁰⁰ See *ICAEW* (2006), para. 25.

⁸⁰¹ See *ASBJ* (2006), p. 6; see also *CIPFA* (2006), p. 1; *Grant Thornton International* (2006), p. 11; *HSBC Holdings plc.* (2006), p. 3; *industrie-holding* (2006), p. 15; *SEAG* (2006), p. 7; *Syngenat International AG* (2006), p. 15.

However, in many commercial situations there is significant lead-time between the date a contract is entered and a price agreed and the actual delivery date. Thus, in these cases there would be significant difference between historical cost and fair value.⁸⁰²

Historical cost may differ from fair value due to entity-specific advantages and disadvantages compared to the market. Consequently, the entity's strengths or weaknesses produce above or below average returns compared to the market.⁸⁰³ In most major economies regulations intend to reduce these affects on exchange prices through e.g. competition laws.⁸⁰⁴ Differences may be due to features that are entity- or market-specific to the transaction. It may be useful to show these differences between the amounts paid in an arm's length transaction and the fair value since businesses' purchasing power can be evaluated against the industry average. However, it is questionable whether comparing a large entity recognising gains to a small entity recognising losses is decision-useful. Further, due to the lack of completely efficient markets information on what fair value is may not even exist.⁸⁰⁵ Thus, if historical cost differs from fair value or not can only be observed in efficient markets.⁸⁰⁶ As a consequence, where a price resulting from an arm's length transaction is determinable and does not differ significantly from fair value on initial recognition an asset should be measured at the former.⁸⁰⁷ However, if it differs significantly, fair value is the most relevant measurement basis on initial recognition.⁸⁰⁸

⁸⁰² See *Hundred Group of Finance Directors* (2006), covering letter section "Measurement hierarchy".

⁸⁰³ See *EFRAG* (2006), p. 17; see also *industrie-holding* (2006), pp. 15, 18; *Syngemat International AG* (2006), pp. 15, 19.

⁸⁰⁴ See *industrie-holding* (2006), p. 15; see also *Syngemat International AG* (2006), p. 15.

⁸⁰⁵ See *LSCA* (2006), p. 2.

⁸⁰⁶ See *FEE* (2006), p. 9; see also *Group of 100* (2006), p. 8.

⁸⁰⁷ See *ASBJ* (2006), pp. 1-2, 6; similar *JICPA* (2006), pp. 4-5.

⁸⁰⁸ See *ASBJ* (2006), pp. 1-2, 6; similar *JICPA* (2006), pp. 4-5; *NSW Treasury* (2006), p. 2.

The question which measurement basis to use on initial recognition – historical cost or fair value – only arises when the amounts differ.⁸⁰⁹ Therefore, it is more important to analyse why, how often, and to what extent the amounts differ.⁸¹⁰ Most of the time fair value and the alternative measurement bases listed by the DP are likely to coincide on initial recognition.⁸¹¹

6.1.4 Recognition of Gains or Losses on Initial Recognition

Full fair value accounting on initial recognition would bring a drastic change to current accounting practice where assets and liabilities are generally measured at historical cost, except for e.g. financial instruments.⁸¹² Therefore, any recognition of day 1 gains or losses except where fair value is already applied should be opposed.⁸¹³ The recognition of day 1 gains contradicts current accounting frameworks, which interdict their recognition because bargain deals do not fulfil a revenue recognition criterion when the entity has not yet started using the asset.⁸¹⁴

Favouring fair value could be argued “... because gains and losses arising from the entity’s use of its strengths and weaknesses in acquiring the asset or incurring the liability would be reported in performance as soon as the item is initially recognized.”⁸¹⁵ However, “measurement inadequacies, market imperfections and market movements”⁸¹⁶ could also result from

⁸⁰⁹ See *CNC* (2006), appendix q. 16; similar *EFRAG* (2006), p. 19; *Group of 100* (2006), p. 8; *LSCA* (2006), p. 3.

⁸¹⁰ See *ACCA* (2006), section “Major overall comments”; see also *ASB* (2006), section B q. 3; *AFRAC* (2006), p. 5; *CNC* (2006), appendix qs. 6, 16; *EFRAG* (2006), p. 19; *FEE* (2006), pp. 2, 7; *Group of 100* (2006), p. 8; *IBF* (2006), section “Capital Markets”; *LSCA* (2006), p. 3.

⁸¹¹ See *FEE* (2006), pp. 2, 4.

⁸¹² See *ICAEW* (2006), para. 9.

⁸¹³ See *DASB* (2006), p. 2.

⁸¹⁴ See *Syngenat International AG* (2006), p. 3.

⁸¹⁵ *Syngenat International AG* (2006), p. 16.

⁸¹⁶ *industrie-holding* (2006), p. 16; *Syngenat International AG* (2006), p. 16.

measuring at fair value.⁸¹⁷ It is not proven how this recognition in profit and loss can improve decision-usefulness.⁸¹⁸

Due to differences between the entity's and the market's efficiencies featuring market imperfections it will be necessary to recognise a gain or loss on initial recognition, if measuring at fair value. However, it is questioned whether this provides relevant information assisting in making investment decisions.⁸¹⁹ Steve Impey notes that it violates fundamental principles of accounting to recognise a profit from revaluation given that an asset's value is greater than its cost at acquisition. The benefit from holding the asset has not been realised yet, and thus should not be accounted for.⁸²⁰ Historical cost has to be prioritised over fair value and the recognition of gains or losses on initial recognition to be avoided, according to the ASBJ.⁸²¹

Steve Impey points out that full fair value accounting will lead to a balance sheet reflecting currently valued assets and liabilities. The profit and loss will reflect changes in wealth resulting from ongoing daily trading but also from values of assets based on their observed ability to generate future cash flows over the expected future time value of money and risk. This use of fair value however includes future expectation or unearned wealth.⁸²²

6.1.5 The Reporting Entity's Intentions

The choice of the most relevant measurement basis on initial recognition, and thus the appropriateness of recognizing any gain or loss depend on

⁸¹⁷ See *industrie-holding* (2006), p. 16; see also *Syngenat International AG* (2006), p. 16.

⁸¹⁸ See *DRSC* (2006), p. 14; see also *EFRAG* (2006), p. 17; *IDW* (2006), p. 20; *industrie-holding* (2006), p. 16; *Syngenat International AG* (2006), p. 16.

⁸¹⁹ See *Bundesverband deutscher Banken e.V.* (2006), p. 6; similar *ACTEO / AFEP / MEDEF* (2006), appendix p. 6; *Zentraler Kreditausschuss* (2006), p. 6.

⁸²⁰ See *Impey, Steve* (2006), p. 2 (paginated).

⁸²¹ See *ASBJ* (2006), p. 2.

⁸²² See *Impey, Steve* (2006), p. 1 (paginated).

an entity's intention to use or to sell an asset.⁸²³ Applying fair value as most relevant measurement basis on initial recognition simulates the disposal of an asset, which is actually intended for use.⁸²⁴ Hence, anticipated gains or losses are immediately recognised.⁸²⁵ Immediately recognising the present value of a project's gain over its entire life before it has been realised violates the prudence principle.⁸²⁶ Further, it can be noted that assuming changes in tax regulation are performed the taxation of unearned income might additionally harm businesses.⁸²⁷

Considering an asset intended for usage, large gains and losses reflected in the profit and loss, which will never be realised, are even less relevant for assessing a business's performance. An entity's ability to generate cash through the continuous use of the asset adds more relevance than the value achievable through sale.⁸²⁸ Given that an entity intends to use an asset, it is not relevant whether the costs are recoverable through immediate sale or not. Historical cost is more reliable than fair value because it results from a market exchange transaction. Consequently, historical cost is also more relevant than fair value.⁸²⁹ Assuming that the asset is held for use rather than resale, recognition at fair value would not reflect the economic position of the asset in the business.⁸³⁰ It is not understandable why exit values assuming a sale are of more interest in general just because they are when an entity intends to sell an asset or settle a liability.⁸³¹ Resources expected to flow from the use of the asset or the settlement of the liability according to the ongoing business are more reliable and relevant than amounts never to be incurred based on a

⁸²³ See *Basel Committee on Banking Supervision* (2006), p. 4; see also *GNAIE* (2006), p. 11.

⁸²⁴ See *CNC* (2006), appendix q. 14.

⁸²⁵ See *CNC* (2006), appendix q. 14; similar *Hundred Group of Finance Directors* (2006), covering letter section "Why fair value?".

⁸²⁶ See *NASB* (2006), para. 8; see also *BG Group* (2006), p. 4.

⁸²⁷ See *NASB* (2006), para. 8.

⁸²⁸ See *BG Group* (2006), p. 4.

⁸²⁹ See *IDW* (2006), p. 18.

⁸³⁰ See *CNC* (2006), appendix q. 14.

⁸³¹ See *F. Hoffmann-La Roche Ltd.* (2006), covering letter p. 2 (paginated); see also *industrie-holding* (2006), p. 2.

hypothetical transaction.⁸³² Further, it needs to be pointed out that although fair value results in an accounting loss it does not lead to an economic loss.⁸³³

According to the IDW and UBS AG, fair value does not incorporate any information about the entity's intended use of non-financial assets.⁸³⁴ In this case, fair value is not necessarily the best measurement basis.⁸³⁵ Fair value may only provide relevant information where non-financial assets are intended for sale.⁸³⁶ Financial statements should reflect the different uses. Thus, a total return investment should be measured at fair value, however an asset intended for long-term use should not.⁸³⁷ Industrie-holding considers having reliable historical information much more important.⁸³⁸ Historical cost is a better indicator for predicting future net income of assets that are not held for disposal. However, fair value embodies market expectations of future cash flows of assets and liabilities to be disposed of in the short run.⁸³⁹ For an industrial entity that holds assets for the long run fair value as an exit value will not provide users with reliable information since it does not reflect the funds the entity has invested.⁸⁴⁰

Regarding the objective of financial statements to assist users in forecasting future cash flows, historical cost is more relevant.⁸⁴¹ Fair value can only achieve this where assets and liabilities are to be turned into cash. F. Hoffmann-La Roche Ltd. accepts fair value where the realisation of the item concerned is not subject to any significant uncertainties, e.g. securities held for trading.⁸⁴² Nestlé Ltd. acknowledges the use of fair value only for specific assets that are already accounted for under current IFRS,

⁸³² See *British American Tobacco* (2006), p. 3.

⁸³³ See *E&Y* (2006), p. 6.

⁸³⁴ See *IDW* (2006), pp. 15-16; similar *UBS AG* (2006), p. 10.

⁸³⁵ See *Goldman Sachs International* (2006), section "Fair Value".

⁸³⁶ See *IDW* (2006), p. 13.

⁸³⁷ See *GNAIE* (2006), p. 12.

⁸³⁸ See *industrie-holding* (2006), p. 2.

⁸³⁹ See *BG Group* (2006), p. 8; see also *Nestlé* (2006), p. 1.

⁸⁴⁰ See *Nestlé* (2006), p. 1.

⁸⁴¹ See *BG Group* (2006), p. 7.

⁸⁴² See *F. Hoffmann-La Roche Ltd.* (2006), appendix q. 14.

e.g. financial instruments and assets held for sale.⁸⁴³ According to Nestlé Ltd., in order for users to understand an entity's capability to generate future cash flows it is relevant to know what an entity has actually paid for an asset. However, the use of fair value would only add "as if"⁸⁴⁴ values to the balance sheet that have not actually occurred to the entity. Measuring at historical cost will always represent costs that management incurred and for which management can be held accountable.⁸⁴⁵

Analysts experience difficulties in what a figure is supposed to reflect. An experienced user will perceive right away, if an asset is not sufficiently exploited and capable of achieving a higher value. Recognising the asset at a value that could be achieved when the entity ceases to use it, contradicts the going concern principle.⁸⁴⁶ The SFRSC states that from management's perspective in most cases the fair value approach is not relevant since management has more of a going concern view. Investors on the other hand look also for alternative usage of their funds. The former bears in mind continuously using a resource, the latter selling it.⁸⁴⁷

The objective of financial reporting is to help investors in forecasting future cash flows through assessment of the investment. As a consequence, the ASBJ and the Japanese Institute of Certified Public Accountants (JICPA) purport that the choice of the most relevant measurement basis on initial recognition is made also with respect to the purpose of the investment. Historical cost is most relevant for non-financial investments and fair value for financial investments, as it is currently practice.⁸⁴⁸ Profit or loss will not be based on a marked to market measurement in the case of non-financial investments, however on a marked to market measurement for financial investments.⁸⁴⁹ Financial instruments measured at fair value enhance financial statements to better reflect the risks undertaken by the reporting

⁸⁴³ See *Nestlé* (2006), p. 4.

⁸⁴⁴ *Nestlé* (2006), p. 4.

⁸⁴⁵ See *Nestlé* (2006), p. 4.

⁸⁴⁶ See *IVSC* (2006), appendix q. 19.

⁸⁴⁷ See *SFRSC* (2006), p. 6.

⁸⁴⁸ See *ASBJ* (2006), pp. 3, 7; see also *JICPA* (2006), p. 1.

⁸⁴⁹ See *ASBJ* (2006), p. 3.

entity.⁸⁵⁰ Serious reliability issues arise when fair value measuring of non-financial instruments is not supported by substantive evidence.⁸⁵¹

The DP purports that if the fair value of an asset at the date a contract is entered differs from the fair value at the later date of delivery, the asset should be recognised at the fair value at the latter date.⁸⁵² However, insufficient information about the market price on the date of delivery may cause problems. For example, for assets not deliverable off the shelf the fair value obtainable at the date of delivery may only be a fair value at a later delivery date. Thus, difficult and expensive and maybe not even possible adjustments would need to be performed.⁸⁵³

In addition, this proposal differs from the DP's acknowledgment that the amount of cash or cash equivalents paid should always equal the fair value.⁸⁵⁴ Where the acquisition took place for the purpose of non-financial investment a market where net cash settlement can take place may not exist. Thus, in this case the proposal has to be opposed and the asset measured at historical cost.⁸⁵⁵ Further, the cash flow-generating value of the asset has not increased by the delivery date. Thus, the decision-usefulness of a recognised gain or loss is put into question.⁸⁵⁶ It is not sufficiently defended by the CASB why recognising gains and losses would provide useful information.⁸⁵⁷

6.1.6 Further Suggestions and Remarks

The IASB considers financial information to be relevant when it impacts users' economic decisions.⁸⁵⁸ However, it is not proven how fair value on initial recognition fulfils this since solely management knows the amount at

⁸⁵⁰ See *ISDA* (2006), p. 2.

⁸⁵¹ See *NASB* (2006), para. 1.

⁸⁵² See *IASB* (2005a), para. 179-180.

⁸⁵³ See *SFRSC* (2006), p. 7.

⁸⁵⁴ See *Imamura, Takeshi* (2006) q. 14.

⁸⁵⁵ See *ASBJ* (2006), p. 3; similar *JICPA* (2006), pp. 3-4.

⁸⁵⁶ See *CNC* (2006), appendix q. 14.

⁸⁵⁷ See *SFRSC* (2006), p. 7.

⁸⁵⁸ See *IASB* (2002), para. 26.

which an asset or liability is recognised initially. Users see only the asset or liability recorded in the financial statement.⁸⁵⁹ However, the uncertainty about relevance is that information may be more relevant to one type of readers of financial statements than to others.⁸⁶⁰

The statement that fair value is more reliable seems to be grounded on the assumption that the sum of the values of an entity's assets and liabilities reflects an entity's value as a whole ignoring any synergies.⁸⁶¹ The users might only get an impression of the future cash flows an asset or liability can generate in isolation, however not from the use of groups of assets or liabilities in a production process.⁸⁶² This assumption can also be drawn back to the presumption of perfectly complete markets, which rarely exist in reality.⁸⁶³ However, it is irrelevant for non-financial instruments.⁸⁶⁴ Analysts evaluate businesses looking at estimates of future cash flows.⁸⁶⁵ Therefore, E&Y challenges the relevance of valuing each item individually given that the cash flows are generated by the combination of assets used in the process of production.⁸⁶⁶ The objective of enabling users to draw conclusions about an entity's ability to generate future cash flows has to be viewed with respect to the company's value as a whole, which cannot simply be calculated by adding the individual assets and liabilities up (see also the discussion on the treatment of synergies in chapter 3.1 above).⁸⁶⁷

Applying fair value generally would establish a purely monetary presentation of the business. This would leave aside the present approach of showing the actual realised value of existing resources and how capital

⁸⁵⁹ See *E&Y* (2006), p. 6.

⁸⁶⁰ See *Martinez, Chris* (2006), p. 5; similar *SAICA / APB of South Africa / APC of SAICA* (2006), p. 12.

⁸⁶¹ See *FEE* (2006), p. 1; see also *FSR* (2006), p. 2; *F. Hoffmann-La Roche Ltd.* (2006), covering letter p. 2 (paginated); see also *industrie-holding* (2006), p. 2.

⁸⁶² See *Hundred Group of Finance Directors* (2006), covering letter section "Why fair value?".

⁸⁶³ See *FSR* (2006), p. 2.

⁸⁶⁴ See *FEE* (2006), p. 1.

⁸⁶⁵ See *F. Hoffmann-La Roche Ltd.* (2006), covering letter p. 2 (paginated); see also *industrie-holding* (2006), p. 2.

⁸⁶⁶ See *E&Y* (2006), p. 2.

⁸⁶⁷ See *Bundesverband deutscher Banken e.V.* (2006), p. 4; see also *Zentraler Kreditausschuss* (2006), p. 4.

was invested.⁸⁶⁸ The proposal moves away from the actual transaction and performance and suggests reporting values at which an asset could be acquired not at which it was actually acquired.⁸⁶⁹ However, the DP does not provide any justification for considering fair value more relevant to users of financial statements.⁸⁷⁰ Any recognised gain or loss on initial recognition seems not decision-useful, as any synergies of aggregating inputs into an asset are not considered.⁸⁷¹

Other respondents believe that the purpose of financial statements and what view of the entity's financial performance and financial position they should portray should be set before it can be concluded on the most relevant measurement basis on initial recognition.⁸⁷² Attention needs to be given to what would practically work and what users' needs are.⁸⁷³ In order to decide what measurement basis is the most relevant on initial recognition it needs to be determined what the objective of financial statements is: Is the company a going concern then its financial statement needs to reflect the performance of its business and its ability to generate future cash flows. Thus, profit and loss and cash flows are considered far more important than the balance sheet. However, if an entity has ceased trading, current values will be far more important. Thus, the value of an asset differs depending on the entity's future prospects.⁸⁷⁴ For more detail on this issue see chapter 3.1 above.

Roland Verhille states that users of financial statements are actually interested in getting to know what "... at a specific date ... the overall money needed to cover the costs of all the cycles of production not yet completed at this date before recovering it when exchanging the products

⁸⁶⁸ See *F. Hoffmann-La Roche Ltd.* (2006), covering letter p. 3 (paginated), appendix q. 3; see also *industrie-holding* (2006), p. 3.

⁸⁶⁹ See *FEE* (2006), p. 2.

⁸⁷⁰ See *Shell International Ltd.* (2006), pp. 1, 8.

⁸⁷¹ See *UBS AG* (2006), p. 3.

⁸⁷² See *Bundesverband deutscher Banken e.V.* (2006), p. 2; see also *CNC* (2006), appendix qs. 14, 16; *FEE* (2006), p. 8; *ICAEW* (2006), q. 14; *LSCA* (2006), p. 3; *NRS* (2006), pp. 1, 5; *Zentraler Kreditausschuss* (2006), p. 2.

⁸⁷³ See *ASB* (2006), section B q. 14.

⁸⁷⁴ See *Impey, Steve* (2006), p. 1 (paginated).

for new money [is]”⁸⁷⁵ and whether that money supports the going concern of the business. Any changes in financial capital before products are exchanged for money are hypothetical. Thus, any difference between historical cost and another measurement basis is not real and may not be reflected in the accounts.⁸⁷⁶

One purpose of financial accounting is lowering the cost of capital. Fair value may be questioned to be the most relevant measurement basis since in the light of lowering the cost of capital accounts might get misleading, irrelevant, and users may lack understanding and confidence.⁸⁷⁷ The figures may become more volatile, and thus increase risk.⁸⁷⁸

The DP is claimed to presume without providing sufficient justification that users will prefer fair value to historical cost and have an easier understanding of the former.⁸⁷⁹ Nestlé Ltd. finds that since users are interested in an entity’s ability to generate future cash flows historical cost is a better base for projecting future cash flows.⁸⁸⁰ Other respondents state that the most relevant measurement basis depends on the nature of the item being measured and entity-specific elements.⁸⁸¹ For example, the fair value of a liability not incurred in an exchange transaction will not bring along any predictive value for the entity’s future financial position.⁸⁸²

Several respondents purport a mixed measurement approach. Different measurement bases may be required depending on the specific situation. Thus, a value in use or deprival value may be more appropriate for an

⁸⁷⁵ Verhille, Roland (2006), p. 6.

⁸⁷⁶ See Verhille, Roland (2006), pp. 6, 9.

⁸⁷⁷ See *F. Hoffmann-La Roche Ltd.* (2006), covering letter p. 3 (paginated); see also *Impey, Steve* (2006), p. 1 (paginated).

⁸⁷⁸ See *Bundesverband deutscher Banken e.V.* (2006), p. 6; see also *Impey, Steve* (2006), p. 1 (paginated); *Zentraler Kreditausschuss* (2006), p. 6.

⁸⁷⁹ See *Imamura, Takeshi* (2006), section “General – Underlying Assumption of the Paper”; see also *Shell International Ltd.* (2006), p. 9.

⁸⁸⁰ See *Nestlé* (2006), p. 1.

⁸⁸¹ See *GNAIE* (2006), p. 11; similar *E&Y* (2006), p. 4; *industrie-holding* (2006), p. 15; *Syngenat International AG* (2006), p. 16.

⁸⁸² See *industrie-holding* (2006), p. 15; see also *Syngenat International AG* (2006), p. 16.

entity going concern.⁸⁸³ According to Shell International Ltd., a “one size fits all”⁸⁸⁴ measurement approach is not desirable.⁸⁸⁵ A mixed measurement model resulting from compromises is not necessarily worse. However, inappropriate compromises could negatively affect the quality of financial reporting.⁸⁸⁶ Investors relying on fair value in their decision making process might cause significant effort to be undertaken in order to restate the financial statements to fair value.⁸⁸⁷

Other respondents argue that the measurement basis chosen on subsequent re-measurement is much more important.⁸⁸⁸ If an asset is re-measured at fair value, the basis chosen on initial recognition is rather irrelevant, unless the components of the change are reported individually.⁸⁸⁹ However, if an asset is re-measured at cost, and thus changes in fair value will not be recognised, it would not be logic to recognise any gains or losses on initial recognition.⁸⁹⁰ Due to the uncertainties involved on subsequent re-measurement the discussion would have been more useful for re-measurement.⁸⁹¹ Thus, subsequent re-measurement and initial measurement should be considered simultaneously since both might influence each other and it cannot be concluded on initial measurement in isolation (see chapter 2.3 above).⁸⁹²

6.2 Substitutes for Fair Value

6.2.1 Overview

The DP proposes that where fair value cannot be measured reliably for an asset or liability it should be measured at current cost. If the latter cannot

⁸⁸³ See *CIPFA* (2006), p. 13; see also *FEE* (2006), p. 8; *LIBA* (2006), p. 2.

⁸⁸⁴ *Shell International Ltd.* (2006), p. 8.

⁸⁸⁵ See *Shell International Ltd.* (2006), pp. 4, 8.

⁸⁸⁶ See *Syngemat International AG* (2006), p. 2.

⁸⁸⁷ See *CFA Institute* (2006), p. 3.

⁸⁸⁸ See *DASB* (2006), p. 7; see also *Zentraler Kreditausschuss* (2006), p. 5.

⁸⁸⁹ See *ACCA* (2006), q. 14.

⁸⁹⁰ See *DASB* (2006), pp. 2, 7.

⁸⁹¹ See *CPA Australia* (2006), p. 5.

⁸⁹² See *AASB* (2006), p. 13; see also *ACCA* (2006), q. 14; *CNC* (2006), appendix q. 14; *CPA Australia* (2006), p. 8; *DASB* (2006), p. 8; *FSR* (2006), pp. 4, 10.

be measured reliably, historical cost would be the last resort measurement.⁸⁹³ However, several respondents disagree that the alternative measurement bases listed by the DP are actually substitutes of fair value. The IOSCO states that the measurement bases are acceptable measures of fair value rather than alternatives, e.g. replacement cost may be considered the best evidence of fair value after a long period of time, while historical cost may be fair value at the initial acquisition.⁸⁹⁴

Other respondents state that the alternative measurement bases may only represent fair value in particular situations.⁸⁹⁵ The RICS Valuation Faculty argues that the other measurement bases suggested by the DP, except for historical cost, are only derived from fair value and subsets of it.⁸⁹⁶ It further states that fair value is "... a generic term which incorporates ... all the various other definitions with the exception of historic cost."⁸⁹⁷

According to the GNAIE, "...either a valuation is fair value or it is not ..."⁸⁹⁸. It also considers the alternative measurement bases listed in the DP not as substitutes for fair value and points out that using other measurement bases as substitutes for fair value is confusing since they are well established themselves and are not intended to represent fair value.⁸⁹⁹

6.2.2 Historical Cost

The DP proposes, "... that historical cost would be considered as a substitute for fair value on initial recognition when fair value cannot be estimated with acceptable reliability."⁹⁰⁰ Further, in situations where historical cost differs from fair value it should also be named historical cost.⁹⁰¹ However, presuming that historical cost is equal to fair value in

⁸⁹³ See *IASB* (2005a), para. 150; see also *EFRAG* (2006), p. 1; *ICAEW* (2006), para. 9.

⁸⁹⁴ See *IOSCO* (2006), "General Comments" section 6.

⁸⁹⁵ See *IVSC* (2006), appendix q. 1; see also *RICS Valuation Faculty* (2006), p. 8.

⁸⁹⁶ See *RICS Valuation Faculty* (2006), pp. 1-3.

⁸⁹⁷ *RICS Valuation Faculty* (2006), p. 8.

⁸⁹⁸ *GNAIE* (2006), p. 13.

⁸⁹⁹ See *GNAIE* (2006), p. 13.

⁹⁰⁰ *IASB* (2005a), para. 128.

⁹⁰¹ See *IASB* (2005a), para. 122.

most cases (see chapter 6.1.3 above), the underlying proposal might result in simply suggesting renaming the measurement basis's notation.⁹⁰²

The CASB argues that given fair value and historical cost are convincingly proven to be the same the measure shall be described as fair value.⁹⁰³ However, Grant Thornton International argues that a measure derived from cost shall also be labelled cost.⁹⁰⁴ The FASB's approach is that "... in many situations, the transaction price will represent the fair value of the asset or liability, but not presumptively ..." ⁹⁰⁵ in its project on FVM. UBS AG defends that transaction price and fair value are conceptually different.⁹⁰⁶

The DP proposes that historical cost is less relevant than fair value.⁹⁰⁷ It may be close in many circumstances where it can be used as substitute for fair value.⁹⁰⁸ As already discussed in chapter 6.1 above, the majority of the respondents prefer historical cost over fair value as the most relevant measurement basis on initial recognition in all or in some circumstances.

Further, the CASB suggests that a recoverability test shall be applied to historical cost.⁹⁰⁹ However, regarding fair value it can also not be generally presumed that this is recoverable.⁹¹⁰ The assumption may only hold with respect to commodity items constantly and actively traded in an established market.⁹¹¹ Thus, lacking clear indication that the amount paid is not recoverable such a test is not supported.⁹¹² Further, a price paid above market price may be rational and it should be placed a longer-term view

⁹⁰² See *Grant Thornton International* (2006), p. 11.

⁹⁰³ See *IASB* (2005a), para. 122.

⁹⁰⁴ See *Grant Thornton International* (2006), p. 3.

⁹⁰⁵ *FASB FVM Team* (2006), p. 4.

⁹⁰⁶ See *UBS AG* (2006), pp. 2-3, 9.

⁹⁰⁷ See *IASB* (2005a), para. 128-137.

⁹⁰⁸ See *ICAI* (2006), p. 8.

⁹⁰⁹ See *IASB* (2005a), para. 133.

⁹¹⁰ See *Grant Thornton International* (2006), p. 12; similar *Martinez, Chris* (2006), p. 6; *UNICE* (2006), section 5.

⁹¹¹ See *Martinez, Chris* (2006), p. 6.

⁹¹² See *Grant Thornton International* (2006), p. 12.

on recoverability.⁹¹³ On the other hand, the BG Group agrees with the requirement of a recoverability test in order to prevent that the items are not overstated.⁹¹⁴

Generally, entities can be assumed to act economically rational. Thus, they would not incur costs unless the benefits are at least equal to the costs incurred.⁹¹⁵ The value of any asset is its capability of generating a benefit over its cost.⁹¹⁶ Steve Impey purports: "... owning the asset has to generate directly or indirectly a potential Benefit."⁹¹⁷ Value also depends on an entity's viewpoint. Steve Impey states that a value to one person may be cost to another. If this were not the case, trade would not occur. Thus, only the value placed on an asset by the owner in excess of its costs is relevant.⁹¹⁸ There is no reason to reflect an item at a higher value.⁹¹⁹

The JICPA disagrees that historical cost is a substitute of fair value.⁹²⁰ The potential weakness of historical cost is overcome by subsequent re-measurement.⁹²¹ Changes in market conditions or mistakes in management's behaviour proving to fail the recoverability of costs are issues on re-measurement. Better information of financial statements is enhanced, if costs that are no longer recoverable are presented as re-measurements rather than expensed with other period costs.⁹²²

The DP argues that measuring at fair value on initial recognition provides "... an initial matching point between the marketplace's value of the asset

⁹¹³ See *Disclosure Solutions Ltd.* (2006), sections "Historical cost", "Why fair value is unsuitable for initial recognition".

⁹¹⁴ See *BG Group* (2006), p. 8.

⁹¹⁵ See *FSR* (2006), pp. 6, 11; see also *Group of 100* (2006), p. 3; *Impey, Steve* (2006), p. 2 (paginated); *industrie-holding* (2006), pp. 17-18; *JICPA* (2006), p. 4; *Syngemat International AG* (2006), p. 18.

⁹¹⁶ See *Impey, Steve* (2006), p. 1 (paginated).

⁹¹⁷ *Impey, Steve* (2006), p. 2 (paginated).

⁹¹⁸ See *Impey, Steve* (2006), p. 2 (paginated).

⁹¹⁹ See *Group of 100* (2006), p. 3.

⁹²⁰ See *JICPA* (2006), p. 4.

⁹²¹ See *FSR* (2006), p. 11.

⁹²² See *industrie-holding* (2006), pp. 17-18; see also *Syngemat International AG* (2006), p. 18.

and its historical cost.”⁹²³ Carrying forward the historical cost of an asset differing from its fair value results in less informative matching in future periods since the reported gain or loss will not distinguish the net income effects of initial from subsequent activities (cost-revenue matching objective).⁹²⁴ It can be concluded that the DP considers it more decision-useful, if all differences are reported immediately regardless whether they result from activities related to the acquisition or subsequent activities and the reason for those differences. However, if the difference between historical cost and fair value results from the entity’s advantages and disadvantages compared to the market during the process of acquisition, carrying forward historical cost does not result in less informative matching in subsequent periods.⁹²⁵ Further, the IDW points out that at least when fair values do not result from active markets, matching of historical cost provides financial statements with more relevant information.⁹²⁶

Moreover, the DP emphasises that representational faithfulness is impaired, if significant cost allocations are required because these are subject to one-to-many or many-to-many allocation indeterminacy. This problem occurs especially regarding self-constructed or specialized non-contractual assets.⁹²⁷ However, in this regard reliability of fair value is also low.⁹²⁸ According to Grant Thornton International, the application of fair value “... is equally, if not more, problematic.”⁹²⁹ The need for cost allocation in multiple-element transactions and to differentiate between costs that are fair value and such that are transaction costs proves that fair value is not immune to such issues either. Neither are the other measurement bases listed in the DP: Value in use requires decisions which costs are to be included in the cash flows to be discounted, net realizable value

⁹²³ IASB (2005a), para 124.

⁹²⁴ See IASB (2005a), para 124.

⁹²⁵ See *Syngemat International AG* (2006), p. 19; see also *industrie-holding* (2006), p. 18.

⁹²⁶ See IDW (2006), p. 18.

⁹²⁷ See IASB (2005a), para 130-131.

⁹²⁸ See JICPA (2006), p. 4; similar UNICE (2006), section 5.

⁹²⁹ *Grant Thornton International* (2006), p. 12.

requires the decision which costs are costs to complete and which are selling costs.⁹³⁰

6.2.3 Current Cost

The DP proposes that the sequence of preference regarding the relevance of substitutes for fair value puts replacement cost over reproduction cost over historical cost.⁹³¹ The ICAI supports this: Maintaining operating capacity is more important than reproducing the same asset.⁹³²

Other respondents note that historical cost is less relevant than the current value, although the latter is not provable, and thus less reliable.⁹³³ However, it is not proven that current cost is a more rational amount than historical cost.⁹³⁴ It is not shown that current cost leads to more relevant information than other bases.⁹³⁵

The ICAEW argues that prices, which are entered into transactions by businesses, can be presumed to be rational in the first place. Even if current cost is more rational than historical cost in some cases, it is not proven that it will assist the aim of financial reporting.⁹³⁶ Substantial experience was noted in the 1970s and 1980s with current cost in the UK. However, its use was abandoned again because it was often experienced as unreliable, irrelevant, or even both.⁹³⁷

The DP states that replacement cost is not sufficiently reliable for approximating fair value on an entity-specific basis.⁹³⁸ However, replacement cost is already applied on initial recognition in business combination standards.

⁹³⁰ See *industrie-holding* (2006), p. 19; see also *Syngemat International AG* (2006), p. 20.

⁹³¹ See *IASB* (2005a), para. 150.

⁹³² See *ICAI* (2006), p. 8.

⁹³³ See *BG Group* (2006), p. 8; see also *IVSC* (2006), appendix q. 12.

⁹³⁴ See *EFRAG* (2006), p. 19; similar *FEE* (2006), p. 9; *IDW* (2006), p. 19.

⁹³⁵ See *EFRAG* (2006), p. 19.

⁹³⁶ See *ICAEW* (2006), para. 31.

⁹³⁷ See *Hundred Group of Finance Directors* (2006), covering letter section "Current cost as a substitute for fair value"; see also *ICAEW* (2006), para. 32.

⁹³⁸ See *IASB* (2005a), para. 152.

Further, it may be necessary to use it in multiple-element package transactions, for non-current assets and inventories.⁹³⁹ PWC LLP points out that replacement cost is already used as an estimate for fair value when no market measure is observable under current standards.⁹⁴⁰

According to Grant Thornton International, cases where current cost differ significantly from historical cost are rare, however they need to be considered. For example regarding a self-constructed asset an entity might experience learning effects, which it would exploit, if it were to incur costs in the same situation again.⁹⁴¹

Current cost may only be a relevant measurement basis, if an entity intends to replace an asset. However, this will be unknown on initial recognition. Therefore, it cannot be concluded on its general superior relevance over historical cost. Although, current cost seems conceptually more advantageous because it provides the amount that would have rationally been paid preparers would need to incur additional costs for assessing the cost of a hypothetical replacement or reproduction of an asset that has just been acquired. Significant costs are experienced when applying current cost on e.g. non-financial, non-traded assets and liabilities, which are not compensated by any potential benefit.⁹⁴²

6.2.4 Net Realizable Value

Net realizable value is an exit price. It focuses more on resale rather than future cash flows that can be achieved through usage of an asset. Thus, it is less relevant than historical cost and current cost.⁹⁴³ It can be concluded

⁹³⁹ See *industrie-holding* (2006), p. 20; see also *Grant Thornton International* (2006), p. 12; *Syngemat International AG* (2006), p. 21.

⁹⁴⁰ See *PWC LLP* (2006), p. 4.

⁹⁴¹ See *Grant Thornton International* (2006), p. 12.

⁹⁴² See *industrie-holding* (2006), pp. 3, 20; see also *Syngemat International AG* (2006), pp. 2, 21.

⁹⁴³ See *ICAI* (2006), p. 8.

that net realizable value is not a relevant measurement basis on initial recognition.⁹⁴⁴

However, one exception can be identified: Assets acquired solely for resale in business combinations or multiple-element package transactions.⁹⁴⁵ The ACCA points out that it is by contrast relevant on subsequent re-measurement.⁹⁴⁶

6.2.5 Value in Use

Value in use is considered by some respondents to be the most relevant measurement basis on initial recognition as well as on re-measurement.⁹⁴⁷ For non-financial assets it reflects the intended entity-specific use, if it incorporates management's expectations of the future cash flows an entity is able to generate through the use of the asset, which provides users with the most appropriate information. For financial instruments, value in use will usually equal fair value given that there is an active market.⁹⁴⁸ The best approximation for value in use in cases where reliability is restricted – especially on re-measurement – is historical cost or amortized cost because it can be proven by a transaction that has actually incurred, and thus it is more reliable.⁹⁴⁹ Historical cost is considered a reliable substitute and decision useful because value in use amounts at least up to historical cost.⁹⁵⁰

The ICAI considers value in use to be the closest substitute for fair value. However, because it is based on entity-specific assumptions its reliability and objectivity are questionable.⁹⁵¹ The AFRAC points out that if users of financial statements were interested in predicting future cash flows, value

⁹⁴⁴ See *IASB (2005a)*, para. 161; see also *JICPA (2006)*, p. 4.

⁹⁴⁵ See *industrie-holding (2006)*, p. 20; see also *Syngemat International AG (2006)*, p. 21.

⁹⁴⁶ See *ACCA (2006)*, q. 16.

⁹⁴⁷ See *DRSC (2006)*, pp. 3, 13; see also *IDW (2006)*, pp. 2-3, 19.

⁹⁴⁸ See *IDW (2006)*, pp. 2-3, 19.

⁹⁴⁹ See *DRSC (2006)*, pp. 3, 13; see also *IDW (2006)*, pp. 2-3, 19.

⁹⁵⁰ See *DRSC (2006)*, p. 13.

⁹⁵¹ See *ICAI (2006)*, p. 8.

in use would be the most relevant measurement basis since the entity's cash-generating process seems more relevant than a process based on hypothetical earnings of an average market participant.⁹⁵²

Other respondents on the contrary consider value in use not to be a relevant measure on initial recognition.⁹⁵³ However, the Monash University points out that the incorporated present value technique may be used to estimate fair value.⁹⁵⁴ The ACCA regards value in use to be relevant on re-measurement.⁹⁵⁵

6.2.6 Deprival Value

The DP proposes that the decision rule (see chapter 4.6.2 above) may be restated as "... 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."⁹⁵⁶ The AFRAC proposes to restate this as follows: "the lower of current cost and recoverable amount, with recoverable amount being the present value of the future net cash flows generated by the asset from its best use."⁹⁵⁷ The former implies only an immediate sale. The latter however enables also a sale at any time during an asset's useful life.⁹⁵⁸

Deprival value has decision usefulness for internal management, but the DP argues that it is not relevant on initial recognition.⁹⁵⁹ Anyway, it is not convincing that shortcomings in financial reporting are overcome by disclosure. If investors want to assess management's performance, both internal and external measurement can provide important information. An advantage of deprival value is that because it is a decision rule the chance of

⁹⁵² See AFRAC (2006), p. 4.

⁹⁵³ See JICPA (2006), p. 5; similar Monash University (2006), p. 7.

⁹⁵⁴ See Monash University (2006), p. 7.

⁹⁵⁵ See ACCA (2006), q. 16.

⁹⁵⁶ IASB (2005a), para. 178.

⁹⁵⁷ AFRAC (2006), p. 16.

⁹⁵⁸ See AFRAC (2006), p. 16.

⁹⁵⁹ See IASB (2005b), para. 403-404.

finding the most relevant measurement basis is higher.⁹⁶⁰ It represents the most advantageous path management would take in a given case.⁹⁶¹ A significant disadvantage is that it is complex to calculate.⁹⁶² Further, deprival value may be time consuming and subjective and the benefits achieved may by far not outweigh the costs.⁹⁶³ Moreover, since deprival value might be difficult to assess users may misinterpret its implications.⁹⁶⁴

Other respondents support the use of deprival value on initial recognition where fair value cannot be estimated reliably due to the lack of an efficient market.⁹⁶⁵ The CASB suggests adapting value in use by referring to market-based information rather than management's intentions.⁹⁶⁶ However, the ASB stresses that this will be of little importance as management intending to sell assets will share resent financial results and information with a buyer. Therefore, requiring market-based information in theory may not have an effect in practice.⁹⁶⁷

6.3 Application as Consistent as Possible with Fair Value

The DP proposes that measurement bases have to be applied "... as consistent as possible with the objectives of fair value, and are supported by appropriate disclosures."⁹⁶⁸ Otherwise, according to the Monash University, measures "... would result in aggregate amounts lacking representational faithfulness."⁹⁶⁹ Some respondents agree with this pro-

⁹⁶⁰ See *industrie-holding* (2006), p. 21; see also *Syngemat International AG* (2006), pp. 22-23.

⁹⁶¹ See *ICAI* (2006), p. 8.

⁹⁶² See *industrie-holding* (2006), p. 21; see also *Syngemat International AG* (2006), pp. 22-23.

⁹⁶³ See *ICAI* (2006), p. 9.

⁹⁶⁴ See *Monash University* (2006), p. 7.

⁹⁶⁵ See *ASB* (2006), section A para. 20; see also *CPA Australia* (2006), p. 10.

⁹⁶⁶ See *IASB* (2005b), para. 404-405.

⁹⁶⁷ See *ASB* (2006), section A para. 20-21.

⁹⁶⁸ *IASB* (2005a), para. 186.

⁹⁶⁹ *Monash University* (2006), p. 8.

posal,⁹⁷⁰ if fair value is chosen as the most relevant measurement basis on initial recognition.⁹⁷¹

When it is not possible to measure fair value reliably it may not be the most relevant measurement basis on initial recognition either.⁹⁷² As a result, it will be difficult to apply another measurement basis as consistent as possible with the fair value objective.⁹⁷³ Considering fair value as the most relevant measurement basis on initial recognition and allowing the use of substitutes of fair value on the other hand is a contradiction.⁹⁷⁴ The ASB accurately notes: “If being consistent does not produce the best answer then it does not make sense to be consistent.”⁹⁷⁵ There will be a reason why fair value cannot be measured reliably, e.g. the lack of liquid markets.⁹⁷⁶ In most practical situations fair value may not be measured reliably and lack relevance due to inefficient or non-existent markets.⁹⁷⁷ Thus, clear guidance is needed which alternative measurement basis is most consistent with fair value where efficient markets do not exist.⁹⁷⁸ A substitute of a not reliably measurable fair value may lack relevance.⁹⁷⁹ Nestlé Ltd. points out that applying parameters that assimilate concepts to fair value might lack reliability.⁹⁸⁰

Moreover, various respondents disagree with the proposal due to the fact that they do not consider the market value objective superior over entity-

⁹⁷⁰ See AASB (2006), p. 16; see also CPA Australia (2006), p. 9; IVSC (2006), appendix q. 17; ICAI (2006), p. 9; Shell International Ltd. (2006), p. 10.

⁹⁷¹ See Shell International Ltd. (2006), p. 10.

⁹⁷² See ACCA (2006), p. 4; see also ASB (2006), section B q. 17; ACT (2006), appendix q. 17; CNC (2006), appendix q. 17; EFRAG (2006), p. 19; Group of 100 (2006), p. 9; industrie-holding (2006), p. 21; Syngenat International AG (2006), p. 23.

⁹⁷³ See Bundesverband deutscher Banken e.V. (2006), pp. 6-7; see also DASB (2006), p. 8; industrie-holding (2006), p. 21; Syngenat International (2006), p. 23; Zentraler Kreditausschuss (2006), p. 7.

⁹⁷⁴ See Zentraler Kreditausschuss (2006), p. 7.

⁹⁷⁵ ASB (2006), section B q. 17.

⁹⁷⁶ See Bundesverband deutscher Banken e.V. (2006), p. 6; see also Syngenat International (2006), p. 23; industrie-holding (2006), p. 21; Zentraler Kreditausschuss (2006), p. 7.

⁹⁷⁷ See F. Hoffmann-La Roche Ltd. (2006), appendix q. 17; see also Hundred Group of Finance Directors (2006), covering letter section “Why fair value?”.

⁹⁷⁸ See NRS (2006), p. 6.

⁹⁷⁹ See SFRSC (2006), p. 14.

⁹⁸⁰ See Nestlé (2006), p. 4.

specific objectives (see chapter 5.5 above).⁹⁸¹ Other respondents disagree because fair value is not the most relevant measurement basis on initial recognition.⁹⁸² Thus, other measurement bases may also not be relevant as substitutes.⁹⁸³ When a reliable estimate cannot be achieved on initial recognition reliability and relevance of financial statements are significantly diminished, if fair value is substituted. A measurement approach where fair value will generally need to be substituted in order to be obtained is questionable.⁹⁸⁴

Theoretically, a measurement objective should be applied the same way to a substitute as the measurement concept itself, according to the IDW.⁹⁸⁵ However, as discussed in chapter 6.1 above many respondents consider historical cost to be the most relevant measurement basis on initial recognition rather than fair value. Assuming that historical cost is the most relevant measurement basis on initial recognition unless it differs significantly from fair value, the proposal does not hold.⁹⁸⁶

The alternative measurement bases suggested by the DP were evaluated based solely on their ability to represent fair value. However, criteria independent from fair value such as decision-usefulness and predictive value need to be considered in order to be more appropriate.⁹⁸⁷ The DP proposes that “fair value” should not be the label for substitutes for fair value.⁹⁸⁸ The EFRAG and PWC LLP agree with this statement.⁹⁸⁹

⁹⁸¹ See ACCA (2006), q. 17; see also ACT (2006), appendix q. 17; ACTEO / AFEP / MEDEF (2006), appendix p. 7; DRSC (2006), p. 13.

⁹⁸² See ACT (2006), appendix q. 17; see also BG Group (2006), p. 8; EFRAG (2006), p. 19; SAICA / APB of South Africa / APC of SAICA (2006), p. 11; Hundred Group of Finance Directors (2006), appendix q. 17.

⁹⁸³ See BG Group (2006), p. 8.

⁹⁸⁴ See Mazars & Guérard (2006), p. 10.

⁹⁸⁵ See IDW (2006), p. 19.

⁹⁸⁶ See JICPA (2006), p. 4.

⁹⁸⁷ See *industrie-holding* (2006), p. 15; Mazars & Guérard (2006), pp. 2, 10; Syngemat International AG (2006), p. 15.

⁹⁸⁸ See IASB (2005a), para. 117.

⁹⁸⁹ See EFRAG (2006), p. 20; see also PWC LLP (2006), p. 4.

6.4 Measurement Hierarchy on Initial Recognition

The DP proposes a four level hierarchy.⁹⁹⁰ The ISDA describes level 1 and 2 as “estimates of fair values” and assigns the terms “substitutes for fair values” to level 3 and 4. Levels 1 and 2 require observable markets and prices or valuation techniques that can be implemented in practice.⁹⁹¹

The proposed levels should be:

- prices directly observable from reference markets for identical assets,
- observable prices for similar assets that can be adjusted,
- values derived from observable market inputs, and
- values based on subjective, entity-specific inputs.⁹⁹²

However, if the conclusion is that historical cost rather than fair value is the most relevant measurement basis on initial recognition, the hierarchy with fair value on level 1 cannot be followed. In this case, the hierarchy may not be applied in practice.⁹⁹³ Otherwise, if fair value is considered the most relevant measurement basis on initial recognition, the hierarchy offers useful guidance.⁹⁹⁴

The ISDA does not support this hierarchy because it might imply that entity-derived fair values are always less relevant than market fair values.⁹⁹⁵ Many respondents consider entity-specific objectives more relevant in certain cases, and thus a market value measurement objective is not always the first choice on initial recognition (see chapter 5.5 above).⁹⁹⁶

⁹⁹⁰ See *IASB* (2005a), para. 181-184.

⁹⁹¹ See *IFRSRC of KASB* (2006), p. 9.

⁹⁹² See *RICS Valuation Faculty* (2006), p. 8; similar *Shell International Ltd.* (2006), p. 2.

⁹⁹³ See *ASBJ* (2006), p. 7; see also *BG Group* (2006), p. 8; *DRSC* (2006), p. 13; *F. Hoffmann-La Roche Ltd.* (2006), appendix q. 18; *FEE* (2006), p. 9; *Hermes Investment Mgmt. Ltd.* (2006), covering letter, q. 18; *Hundred Group of Finance Directors* (2006), appendix q. 18; *industrie-holding* (2006), p. 22; *Nestlé* (2006), p. 5; *Syngemat International AG* (2006), p. 23.

⁹⁹⁴ See *Shell International Ltd.* (2006), p. 10.

⁹⁹⁵ See *ISDA* (2006), p. 3.

⁹⁹⁶ See *British American Tobacco* (2006), p. 2; see also *CNC* (2006), appendix q. 18; *DRSC* (2006), p. 13; *F. Hoffmann-La Roche Ltd.* (2006), appendix q. 18; *Hundred Group of Finance Directors* (2006), appendix q. 18; *FEE* (2006), p. 9; *industrie-holding* (2006), p. 22; *NAIC* (2006), p. 10; *Syngemat International AG* (2006), p. 23.

Other respondents criticise that historical cost is treated as last resort in the hierarchy, although fair value should be the last resort and historical cost the most reliable measurement basis.⁹⁹⁷ Fair value is only adequate where market prices are freely available.⁹⁹⁸ However, this will only hold where markets are fully efficient, what they rarely are in practice (see chapter 5.2.2 above).⁹⁹⁹

Due to a complex and costly analysis for each asset or liability being recognised, the AFRAC proposes to initially recognise an asset or liability at historical cost as best estimate for fair value and only where fair value clearly differs from historical cost it should be measured in accordance with the proposed hierarchy.¹⁰⁰⁰ Mazars & Guérard also state that having to derive substitutes for fair value on level 3 and 4 is a time consuming and costly process. Therefore, historical cost is considered the easier and preferred approach.¹⁰⁰¹

The DRSC suggests to relabel level 1 “market price fair value” and level 2 “calculated fair values based on market inputs” in order to highlight the significant difference between the two levels.¹⁰⁰² The IFRSRC of KASB criticises that level 1 and 2 require observable markets and prices or valuation techniques that can be implemented in practice. Hence, reliable estimations of fair value require developed accounting and financial infrastructure, which will be found mainly in the few developed countries (see p. 23 in chapter 3.3 above).¹⁰⁰³

The ASB expresses concerns that assuming hypothetical markets level 2 might lead to inappropriate fair values.¹⁰⁰⁴ Absenting an efficient market, turning to private empirical data, and thus entity-specific measures as on

⁹⁹⁷ See ACCA (2006), q. 18; see also *Hundred Group of Finance Directors* (2006), appendix q. 18.

⁹⁹⁸ See *Mazars & Guérard* (2006), p. 10.

⁹⁹⁹ See *CNC* (2006), appendix q. 18.

¹⁰⁰⁰ See *AFRAC* (2006), p. 16.

¹⁰⁰¹ See *Mazars & Guérard* (2006), p. 3.

¹⁰⁰² See *DRSC* (2006), p. 13.

¹⁰⁰³ See *IFRSRC of KASB* (2006), p. 9.

¹⁰⁰⁴ See *ASB* (2006), section B q. 18.

levels 3 and 4 might be more reliable.¹⁰⁰⁵ Therefore, the ASB proposes to establish a split after level 1: If an estimate of fair value is judged to be more reliable and appropriate than replacement cost or historical cost, level 2 shall be chosen, otherwise it needs to be proceeded straight to level 3 or 4.¹⁰⁰⁶

The Monash University doubts that level 3 has sufficient connection with fair value. However, assuming supplemental disclosure, it may provide a reasonable interim basis.¹⁰⁰⁷ The Swiss Generally Accepted Accounting Principles Fachempfehlungen zur Rechnungslegung (Swiss GAAP FER) points out that level 3, which will often be applied since most assets are unique results in increased subjective judgment.¹⁰⁰⁸

The GNAIE states that "... an entity-specific value which would reside in Level 4 could be a much better indicator of fair value in some instances than using one of the accepted Level 3 bases which are not intended to measure fair value."¹⁰⁰⁹ Hence, merging a measurement hierarchy with a fair value hierarchy is confusing.¹⁰¹⁰ The ACCA also prefers the fourth level of entity-specific measures since other measures may be unavailable in some circumstances.¹⁰¹¹

The University of Wisconsin believes that e.g. warranties for which a deep and active market does not exist and for which the measurement considers a mix of market and entity-specific inputs might result in a value not clearly derivable on level 2 or level 4. The outcome may also have an effect on usefulness and reliability of information.¹⁰¹² The IVSC notes that

¹⁰⁰⁵ See ASB (2006), section B q. 18; similar NAIC (2006), p. 10.

¹⁰⁰⁶ See ASB (2006), section B q. 18.

¹⁰⁰⁷ See *Monash University* (2006), p. 8.

¹⁰⁰⁸ See *Swiss GAAP FER* (2006), p. 2.

¹⁰⁰⁹ *GNAIE* (2006), p. 13.

¹⁰¹⁰ See *GNAIE* (2006), p. 13.

¹⁰¹¹ See ACCA (2006), q. 18.

¹⁰¹² See *University of Wisconsin* (2006), q. 14.

the levels are not sufficiently distinguished and that assets could be assigned to more than one level.¹⁰¹³

The IFRSRC of KASB proposes according to its assumption that fair value incorporates all other measurement bases (see also chapter 6.2.1 above), to revise the hierarchy into a “two-tier system”¹⁰¹⁴, namely a top tier for fair value and a bottom tier comprising the proposed levels 1 thru 4, where level 1 should be relabelled as “fair market value” rather than “observable market value”.¹⁰¹⁵

The hierarchy presented by the CASB differs from the one presented by the FASB, e.g. in its working draft FVM, and from the IASB's ED on Business Combinations.¹⁰¹⁶ In the former, the FASB combines the levels 2 thru 4 and establishes a three level hierarchy.¹⁰¹⁷ Further, the hierarchy of the CASB distinguishes estimates from substitutes of fair value, whereas the FASB prefers market inputs to valuation techniques.¹⁰¹⁸ The hierarchy of the FASB contains a level for estimates with considerable entity inputs. However, the CASB names these estimates substitutes for fair value.¹⁰¹⁹ Convergence should be achieved on this issue in order to ensure a consistent approach for all standard setters.¹⁰²⁰ Some respondents prefer the hierarchy presented by the FASB.¹⁰²¹ Other respondents state that given the hierarchies do not coincide, the CASB should have chosen a different numbering or labelling for the levels in order to enable a

¹⁰¹³ See *IVSC* (2006), appendix q. 18.

¹⁰¹⁴ *IFRSRC of KASB* (2006), p. 2.

¹⁰¹⁵ See *IFRSRC of KASB* (2006), p. 2.

¹⁰¹⁶ See *Basel Committee on Banking Supervision* (2006), p. 5; see also *CPA Australia* (2006), pp. 1, 9; *DTT International* (2006), p. 2; *NSW Treasury* (2006), p. 2; *PWC LLP* (2006), p. 3.

¹⁰¹⁷ See *FASB FVM Team* (2006), p. 2.

¹⁰¹⁸ See *FVM Team* (2004), p. 2; see also *NSW Treasury* (2006), pp. 9-10.

¹⁰¹⁹ See *Basel Committee on Banking Supervision* (2006), p. 5.

¹⁰²⁰ See *Basel Committee on Banking Supervision* (2006), p. 5; see also *CEBS* (2006), p. 4; *CPA Australia* (2006), pp. 1, 9; *NSW Treasury* (2006), p. 9; *UBS AG* (2006), pp. 3, 10; *University of Wisconsin* (2006), q. 14.

¹⁰²¹ See *Appraisal Institute* (2006), p. 4; see also *Group of 100* (2006), p. 9; *IVSC* (2006), appendix q. 18.

discussion outside the scope of the discussion on measurement on initial recognition.¹⁰²²

Finally, again the hierarchy may not be discussed before the purpose of financial reporting and what view of the entity's financial position and financial performance the financial statement is purported to portray is first concluded upon (see also chapter 3.1 above).¹⁰²³

7 Conclusion and Further Prospects

The majority of the respondents conclude that the DP is biased towards fair value and they prefer historical cost to fair value as the most relevant measurement basis on initial recognition. They criticise that the DP bases its conclusion that fair value is the most relevant measurement basis on initial recognition on several fundamental misinterpretations. In figures 1 and 2 especially the respondents' general opinion contra full fair value accounting can be seen in qs. 14 and 16 (see appendix, figure 2), as well as the views contra the superiority of market value measurement objectives in q. 6 (see appendix, figure 1).

The objectives of financial reporting and what view of an entity's financial position and performance the financial statement should portray are not sufficiently assessed by the DP: It follows an approach disregarding any synergies. Further, the cost/benefit constraint is an important issue in refusing full fair value accounting on initial recognition, which would lead to additional costs that may not be outweighed by any benefit. Moreover, the CASB fails to sufficiently discuss the issue of market imperfections and inexistence since the theoretical assumption that markets are perfectly efficient and highly active is not simply applicable in practice. Finally, an important point that is disregarded in deciding on fair value, as the most relevant measurement basis on initial recognition is that an entity's inten-

¹⁰²² See *industrie-holding* (2006), p. 22; see also *Syngenat International AG* (2006), p. 23.

¹⁰²³ See *DRSC* (2006), p. 13; see also *IDW* (2006), p. 19.

tion whether to use or to sell an asset and the purpose of an investment are not sufficiently acknowledged by the DP. A “one size fits all” accounting approach may not take these different aspects adequately into consideration.

Summarizing, it can be said that the majority of the commenting respondents consider the DP to be biased towards fair value and that the DP does not provide a neutral view on measurement on initial recognition. This is also due to the DP’s insufficient discussion of important aspects, especially initial versus subsequent measurement, market imperfections and inexistence, the objectives of financial reporting, the cost/benefit constraint, and the purpose of financial investments.

The IASB’s further steps regarding the project led to the analysis and discussion of the submitted CLs in its board meeting on 21st September 2006.¹⁰²⁴ The board came to the conclusion to further consider the inputs in the IASB’s and the FASB’s joint project on the Conceptual Framework.¹⁰²⁵ This project comprises several phases:

- A: Objectives and qualitative characteristics,
- B: Elements and recognition,
- C: Measurement,
- D: Reporting entity,
- E: Presentation and disclosure,
- F: Purpose and status,
- G: Application to not-for-profit entities,
- H: Remaining issues, if any.

Phase B containing elements of issues such as financial statements, and recognition and measurement attributes and Phase C treating initial and subsequent measurement may result in different outcomes (see also chapter 2.1 above) as compared to the DP prepared by the CASB.¹⁰²⁶

¹⁰²⁴ See *IASB* (2006a).

¹⁰²⁵ See *IASB* (2006d), pp. 1, 2.

¹⁰²⁶ See *SAICA* (2006), p. 3; see also *FRS* (2006), p. 12;

Thereby, the IASB acknowledges most respondents' demand for a different due process first finishing the project on the Conceptual Framework.

The IASB and the FASB commenced their due process by publishing a DP "Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Objective of Financial Reporting and Qualitative Characteristics of Decision-useful Financial Reporting Information" for comment in July 2006. The issue of an ED on the issues that have already been raised is envisaged for the fourth quarter of 2007. The boards also intend to publish DPs regarding Phase D in the fourth quarter of 2007, Phase B in the second half of 2008, and Phase C in the first half of 2009.¹⁰²⁷

¹⁰²⁷ See IASB (2007).

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Appendix

List of Questions¹⁰²⁸:

- Q1. Do you agree that the list of identified possible measurement bases (see paragraphs 33-51 of the condensed version and paragraphs 69-74 of the main DP) sets out the bases that should be considered? If not, please indicate and explain any changes that you would make.
- Q2. Do you agree with the working terms and definitions, and supporting interpretations, of each of the identified measurement bases (see paragraphs 33-51 of the condensed version and paragraphs 77-96 of the main DP)? If not, please explain what changes you would make. In particular, do you have any comments on the term “fair value” and its definition (in light of the discussion in paragraphs 46-48 of the condensed version and paragraphs 88-93 of the main DP)?
- (i) Historical cost
 - (ii) Current cost
 - (iii) Net realizable value
 - (iv) Value in use
 - (v) Fair value
 - (vi) Deprival value
- Q3. It is proposed 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.
- (See paragraph 52 of the condensed version and paragraph 97 of the main DP.) This proposal and its conceptual implications are the subject of chapters 4 and 5. Do you agree that these are the fundamental sources of differences between asset and liability measurement bases on initial recognition? If not, please indicate the fundamental sources of differences you have identified, and provide the basic reasons for your views. For any different fundamental sources you have identified, please indicate how these might be examined and tested.
- Q4. The paper analyzes the market value measurement objective and the essential properties of market value.

¹⁰²⁸ IASB (2005a), pp. 11-16.

- (a) Do you believe that the paper has reasonably defined the market value objective and the essential properties of market value for financial statement measurement purposes (see paragraphs 54-56 and 105-112 of the condensed version and paragraphs 99-110 and 236-241 of the main DP)? If not, please explain why not, and what changes you would propose, or different or additional considerations that you think need to be addressed.
 - (b) Do you agree with the proposed definition of “market” (see paragraphs 55-56 of the condensed version and paragraphs 107-110 of the main DP)? If not, please explain why you disagree, and indicate any changes you would make and any issues that you believe should be given additional consideration.
 - (c) Do you agree with the fair value measurement objective as proposed, and its derivation from the market value measurement objective (see paragraph 102 of the condensed version and paragraphs 111, 228 and 229 of the main DP)?
- Q5. Do you agree with the definition and discussion of entity-specific measurement objectives (see paragraph 57 of the condensed version and paragraphs 112-116 of the main DP) and their relationship to management intentions (see paragraph 58 of the condensed version and paragraphs 117-121 of the main DP)? If not, please explain why you disagree.
- Q6. Do you agree with the comparison of market and entity-specific measurement objectives (see paragraph 59 of the condensed version and paragraph 122 of the main DP) and with the proposed conclusion that the market value measurement objective has important qualities that make it more relevant than entity-specific measurement objectives for assets and liabilities on initial recognition (see paragraphs 60-61 of the condensed version and paragraphs 123-129 of the main DP)? If not, please explain your views.
- Q7. (a) It is reasoned that there can be only one market (fair) value for an asset or liability on a measurement date (see paragraph 62 of the condensed version and paragraphs 131-138 of the main DP). Do you agree with this conclusion? If not, please explain why you disagree.
- (b) It is proposed 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.
- (See paragraph 63 of the condensed version and paragraphs 131-138 of the main DP). 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 (see paragraphs 74-82 of the condensed version and paragraphs 95-109 of the main DP).

Do you agree with these proposals, within the caveats and discussion presented? If not, please explain why you disagree.

- Q8. Do you agree 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 (see paragraph 65 of the condensed version and paragraphs 142-147 of the main DP)? If you do not agree, please explain the basis for your disagreement.
- Q9. The paper makes the following proposals with respect to defining the unit of account of the asset or liability to be measured on initial recognition:
- (a) The appropriate individual item or portfolio unit of account on initial recognition is generally the unit of account in which the reporting entity has acquired the asset or incurred the liability (see paragraphs 67-70 of the condensed version and paragraphs 149-154 of the main DP).
 - (b) The appropriate level of aggregation for non-contractual assets on initial recognition 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 (see paragraphs 71-73 of the condensed version and paragraphs 157-161 of the main DP).
- Q10. It is suggested 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 (see paragraphs 75-82 of the condensed version and paragraphs 162-182 of the main DP). Do you agree that the paper provides a reasonable analysis of market sources and their implications on initial recognition? If not, please provide reasons for disagreeing, and indicate any additional analysis or research you would think should be carried out.
- Q11. The paper concludes that transaction costs, as defined, are not part of the fair value of an asset or liability on initial recognition (see paragraphs 86-87 of the condensed version and paragraphs 193-200 of the main DP). Do you agree with the proposed definition of transaction costs? Do you agree with the above conclusion? If you disagree, please explain your reasons and what you believe the implications of your different view would be for fair value measurement of assets and liabilities on initial recognition.

- Q12. Do you agree with the proposal that, when more than one measurement basis achieves an acceptable level of reliability, the most relevant of these bases should be selected (see paragraph 89 of the condensed version and paragraph 202 of the main DP)? If not, please explain why you disagree, and indicate how you would settle trade-offs between the relevance and reliability of alternative measurement bases.
- Q13. Do you agree with the two proposed sources of limitations on measurement reliability – estimation uncertainty and economic indeterminacy – and supporting discussion (see paragraphs 90-100 of the condensed version and paragraphs 204-216 of the main DP)? If not, please explain your view.
- Q14. Do you agree that fair value is the most relevant measure of assets and liabilities on initial recognition of assets and liabilities, and therefore should be used when it can be estimated with acceptable reliability (see analyses of fair value and alternative bases in chapter 7, and discussion of measurement date on initial recognition in paragraphs 179-180 of the condensed version and paragraphs 410-415 of the main DP)? If not, please explain why.
- Q15. Do you agree that fair value is not capable of reliable estimation in some common situations on initial recognition (see paragraph 104 of the condensed version and paragraphs 232-277 of the main DP)? More specifically, do you agree 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 (see paragraphs 106-114 of the condensed version and paragraphs 243-252 of the main DP), 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 (see paragraphs 115-118 of the condensed version and paragraphs 263-268 of the main DP)?

Please provide explanations for your views on these questions if they differ significantly from the conclusions and supporting arguments presented in the paper.

- Q16. Do you agree with the paper's analyses and conclusions with respect to the comparative relevance and reliability of:
- (a) historical cost (see paragraphs 120-137 of the condensed version and paragraphs 281-319 of the main DP);
 - (b) current cost – reproduction cost and replacement cost (see paragraphs 138-154 of the condensed version and paragraphs 320-361 of the main DP);
 - (c) net realizable value (see paragraphs 155-161 of the condensed version and paragraphs 362-375 of the main DP);

- (d) value in use (see paragraphs 162-169 of the condensed version and paragraphs 376-392 of the main DP); and
- (e) deprival value (see paragraphs 170-178 of the condensed version and paragraphs 393-409 of the main DP)?

Please provide reasons for any disagreements, and any advice you may have as to additional analysis or research that you believe should be carried out.

- Q17. The paper discusses substitutes for fair value when the fair value of an asset or liability cannot be reliably estimated on initial recognition. Do you agree that, when other measurement bases are used as substitutes for fair value on initial recognition, they should be applied on bases as consistent as possible with the fair value measurement objective (see paragraph 186 of the condensed version and paragraph 417 of the main DP)? If not, please explain why.
- Q18. Do you agree with the proposed hierarchy for the measurement of assets and liabilities on initial recognition (see chapter 8)? If not, please explain your reasons for disagreeing and what alternatives you might propose.
- Q19. Do you have comments on any other issues or proposals, including the proposals for further research (see paragraph 189 of the condensed version and paragraph 441 of the main DP)? If so, please provide them.

Figure 1 : Analysis of the 86 CLs – Questions 1-7

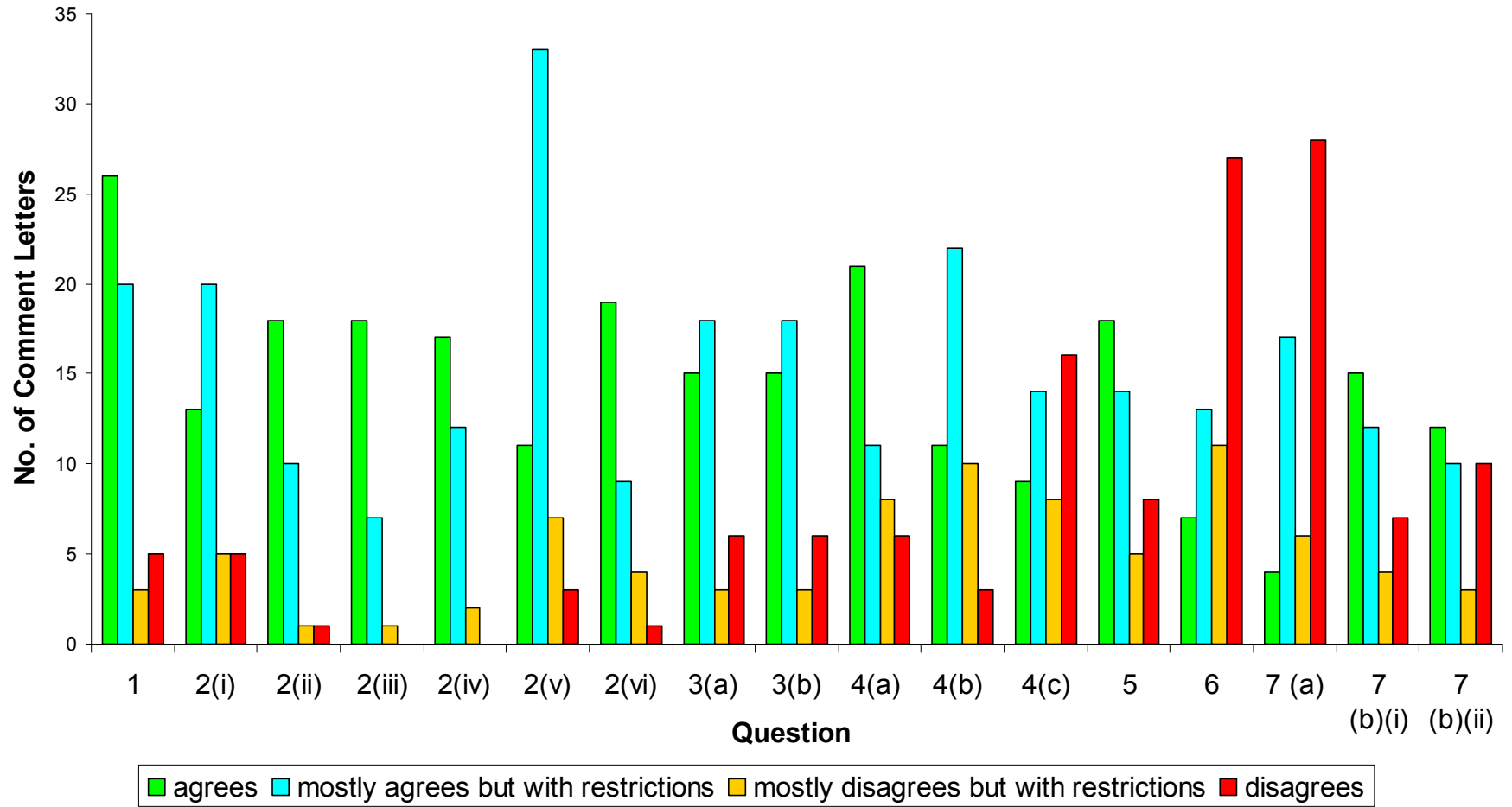
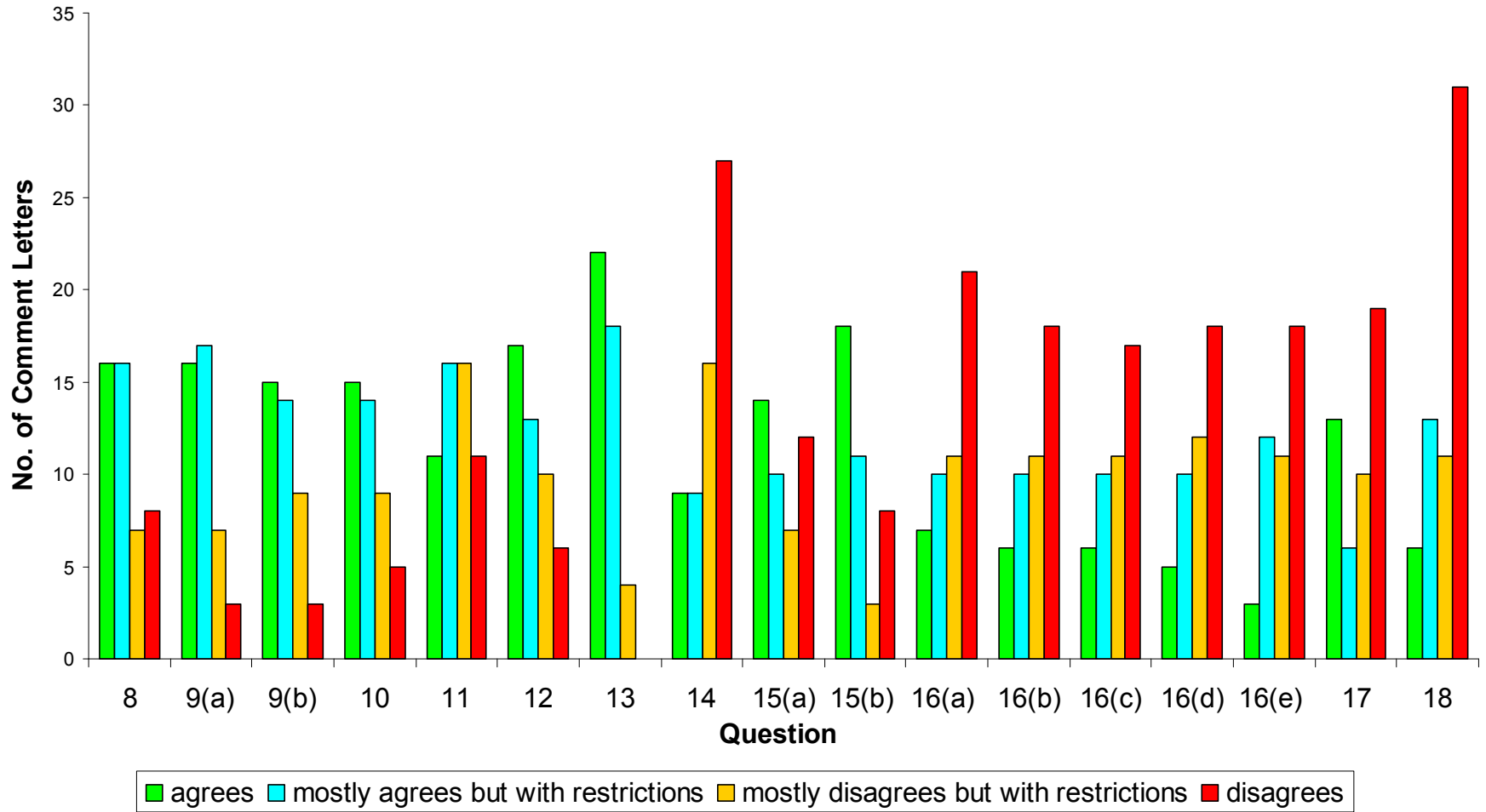


Figure 2: Analysis of the 86 CLs – Questions 8-18



Zusammenfassung

Im November 2005 veröffentlicht das IASB das vom CASB vorbereitete DP „Measurement Bases for Financial Accounting – Measurement on Initial Recognition“. Dieses enthält einen Katalog von 19 Fragen mit der Einladung, diese zu beantworten. In weiterer Folge reichen 86 Autoren CLs ein. Das Projekt wird vom IASB initiiert, weil bestehende Wertmaßstäbe uneinheitlich sind. In den Rechnungslegungsvorschriften nach IFRS werden bei Erstbewertung in den meisten Fällen die historischen Anschaffungs- beziehungsweise Herstellungskosten angewandt. Der beizulegende Zeitwert wird nur in bestimmten Situationen angewandt: so zum Beispiel unter IFRS 3 „Unternehmenszusammenschlüsse“ und unter IAS 39 „Finanzinstrumente: Ansatz und Bewertung einschließlich der Bestimmungen über die Verwendung der Fair Value-Option“. In dem DP schlägt das CASB vor, bei Erstbewertung vorrangig den beizulegenden Zeitwert anzuwenden und nur dort, wo dieser nicht verlässlich ermittelt werden kann, sollten Substitute für den beizulegenden Zeitwert angewandt werden. Dadurch soll Konsistenz in der Finanzberichterstattung erzielt werden.

Der erste Teil dieser Diplomarbeit beinhaltet die graphische Auswertung (siehe Abbildungen 1 und 2) der Antworten der 86 antwortenden Autoren auf die ersten 18 Fragen des Kataloges (die 19. Frage hat lediglich nach weiteren Anregungen gefragt). In diese Auswertung wurden oft durchaus gewollt subjektive Einflüsse miteinbezogen, weil sich ein Teil der Antworten nicht ausdrücklich auf eine konkrete Frage bezieht.

Kapitel 1 dieser Diplomarbeit enthält eine Einführung in das Projekt des IASB und den Aufbau der Diplomarbeit. Im Kapitel 2 folgt eine Abgrenzung des Themas gegenüber anderen laufenden Projekten des IASB und des FASB. Im zweiten Kapitel werden weiters die erstmalige Bewertung und Folgebewertung, die Anerkennung von Gewinnen und Verlusten und die

Kapitalerhaltung behandelt. Einige antwortende Autoren zeigen auf, dass der Umfang des DP in diesen Punkten eingeschränkt ist.

Das dritte Kapitel dieser Diplomarbeit analysiert die Zielsetzungen der Finanzberichterstattung und die Frage, inwieweit allfällige Synergien, die bei einer Gesamtbewertung des Unternehmens nicht berücksichtigt werden, im DP gewürdigt werden. Einige antwortende Autoren zeigen auf, dass das CASB keine umfangreiche Abwägung von Kosten und Nutzen vornimmt, da der vorrangige Ansatz des beizulegenden Zeitwerts bei Erstbewertung zu Kosten führen kann, die in einem allfälligen Nutzen keine Deckung finden. Das Wechselspiel von Relevanz und Verlässlichkeit wird ebenfalls in diesem Kapitel der Diplomarbeit behandelt: Das DP schlägt vor, dass sofern mehr als ein Wertmaßstab ein akzeptables Maß an Verlässlichkeit erreicht, der relevanteste dieser Wertmaßstäbe gewählt werden soll.¹⁰²⁹ Das DP stellt überdies zur Diskussion, dass die Schätzung eines Marktwertes durch Bewertungsunsicherheiten eingeschränkt werden kann.

Kapitel 4 der Diplomarbeit bietet eine Übersicht über vom DP vorgeschlagene alternative Wertmaßstäbe, wobei der Schwerpunkt auf den historischen Anschaffungs- beziehungsweise Herstellungskosten – vor allem für Vermögenswerte, deren Herstellung sich über eine längere Periode erstreckt – und dem beizulegenden Zeitwert liegt. Hinsichtlich des beizulegenden Zeitwerts werden vor allem die Frage, ob dieser einen Zugangs-, einen Abgangswert oder beides darstellt, ob er auf einen Marktwert abstellt, und falls nicht, ob der Begriff „beizulegender Zeitwert“ geteilt werden muss, um die verschiedenen Varianten des Begriffs widerzuspiegeln, von den antwortenden Autoren diskutiert. Weiters werden im vierten Kapitel Transaktionskosten erläutert: Diese sollen bei Erstansatz

¹⁰²⁹ IASB (2005a), para. 89: “when more than one alternative measurement basis achieves an acceptable level of reliability, the most relevant of these measurement bases should be selected”.

nur berücksichtigt werden, sofern sie auf einem Markt wieder einbringlich sind.¹⁰³⁰

Kapitel 5 dieser Diplomarbeit behandelt die Differenzierung in zwei elementare Unterschiede zwischen alternativen Wertmaßstäben, die vom DP vorgeschlagen werden:

- Zielsetzungen, die auf Wertmaßstäben zu einem Marktwert beruhen (market value measurement objective), gegenüber jenen, die auf unternehmensspezifische Wertmaßstäbe abstellen (entity-specific measurement objective), und
- Unterschiede aufgrund wertbeeinflussender Faktoren (value-affecting sources of differences).

Das DP argumentiert, dass der beizulegende Zeitwert entweder den Marktwert repräsentiert, sofern ein Markt vorhanden ist, oder eine Schätzung, was der Marktwert wäre, wobei bei der Ermittlung eines Schätzwertes Bewertungsunsicherheiten auftreten können (siehe Kapitel 3 dieser Diplomarbeit). Eine klarere Abgrenzung zwischen dem beizulegenden Zeitwert als Marktwert und jenem als Schätzwert ist daher ebenfalls zentrales Thema. Einige antwortende Autoren diskutieren in diesem Zusammenhang die Einflüsse von unternehmensspezifischen Zielsetzungen und Vorstellungen auf den beizulegenden Zeitwert. Das CASB vertritt im DP den Standpunkt, dass marktbezogene beizulegende Zeitwerte entscheidende Kriterien aufweisen, die ihnen einen höheren Rang verleihen als unternehmensspezifische Bewertungen. Dieser Vorschlag wird von den meisten Autoren jedoch verworfen, da er auf der theoretischen Annahme vollständig perfekter Märkte beruht und darauf, dass für jeden Vermögenswert auch ein Markt existiert.

In Bezug auf Unterschiede aufgrund wertbeeinflussender Faktoren trifft das DP die Annahme (sogenannte „a priori expectation“), dass es an einem bestimmten Bewertungsstichtag nur einen einzigen beizulegenden Zeitwert für einen Vermögenswert gibt. In der Folge analysiert das DP

¹⁰³⁰ Vgl. IASB (2005a), para. 86: “recoverable in the market-place”.

jedoch Gründe für die Verwerfung dieser „a priori expectation“: die Recheneinheit (unit of account) hinsichtlich Vermögenswerte und das Bonitätsrisiko (credit risk) hinsichtlich Verbindlichkeiten, das allfällige Vorliegen von mehreren Märkten und die Selektion des günstigsten Marktes.

In Kapitel 6 dieser Diplomarbeit wird schließlich der zentrale Vorschlag des CASB, dass der beizulegende Zeitwert der relevanteste Wertmaßstab bei Erstansatz sein soll, sofern dieser verlässlich ermittelbar ist, analysiert. Die Kernpunkte der Diskussion umfassen dabei:

- die Vermutung perfekter Märkte,
- den Ansatz von Gewinnen oder Verlusten bei Erstansatz,
- die Absicht eines Unternehmens, einen Vermögenswert zu nutzen oder zu verkaufen, und ob der Zweck der Investition finanzieller oder nicht finanzieller Natur ist,
- die Zielsetzung der Finanzberichterstattung: welche Information der Leser eines Geschäftsberichts erwartet.

Zuletzt werden in Kapitel 6 Substitute, die ähnlich dem beizulegenden Zeitwert angewandt werden sollen, dargestellt und eine Hierarchie von Wertmaßstäben analysiert.

Die Mehrheit der antwortenden Autoren kommt zu dem Ergebnis, dass das DP gegenüber dem beizulegenden Zeitwert voreingenommen ist und seine Erkenntnisse auf einige wesentliche Fehlinterpretationen stützt: Das DP ignoriert das Bestehen von Synergien. Viele antwortende Autoren haben angeregt, dass die Zielsetzungen der Finanzberichterstattung zuerst im Zuge des Projektes „Conceptual Framework“ festgelegt werden müssten, bevor das DP diese Zielsetzungen beurteilen kann. Eine genauere Abwägung von Kosten und Nutzen durch das CASB würde laut einigen antwortenden Autoren zu der Erkenntnis führen, dass der beizulegende Zeitwert zusätzliche Kosten mit sich bringt, die jedoch nicht in einem zusätzlichen Nutzen Deckung finden. Eine Vielzahl der antwortenden Autoren bevorzugt die historischen Anschaffungsbeziehungsweise Herstellungskosten gegenüber dem beizulegenden

Zeitwert als den relevantesten Wertmaßstab bei Erstansatz. Weiters kann das CASB nicht überzeugen, inwiefern die theoretische Annahme von perfekten und immer existenten Märkten auch durchgängig in der Praxis anwendbar ist. Im DP wurde auch ein wesentlicher Punkt in der Entscheidungsfindung über den relevantesten Wertmaßstab bei Erstansatz vernachlässigt: ob ein Unternehmen beabsichtigt, den Vermögenswert zu behalten und zu gebrauchen oder zu veräußern, und welchen Zweck die Investition verfolgt. Ein einziger Wertmaßstab für alle Situationen vermag diese unterschiedlichen Zielsetzungen nicht zu berücksichtigen.

Zusammenfassend ist also festzuhalten, dass die Mehrheit der antwortenden Autoren das DP dem beizulegenden Zeitwert gegenüber als parteiisch betrachtet und das DP wichtige Gesichtspunkte nicht ausreichend diskutiert: insbesondere die Abgrenzung der Erstbewertung von Folgebewertungen, das Vorliegen unvollkommener und auch das Nichtvorliegen von Märkten, die Zielsetzungen der Finanzberichterstattung, die Abwägung von Kosten und Nutzen und den Zweck finanzieller und nichtfinanzieller Investitionen.

Nach Ablauf der Einreichfrist für Kommentare zu diesem DP analysierte das IASB die CLs und diskutierte diese im Board-Treffen am 21. September 2006. Das IASB kommt zu dem Entschluss, die eingebrachten Kommentare im gemeinsamen Projekt „Conceptual Framework“ des IASB und des FASB zu berücksichtigen. Dieses Projekt besteht aus folgenden Abschnitten:

- A: Zielsetzung und qualitative Eigenschaften,
- B: Abschlussposten und Bilanzansatz,
- C: Bewertung,
- D: Berichterstattende Einheit,
- E: Darstellung des Abschlusses und Angabepflichten, einschließlich Grenzen der Finanzberichterstattung,
- F: Zielsetzung und Status des Rahmenkonzepts,
- G: Anwendung für den Non-Profit-Sektor,
- H: Vollständiges Rahmenkonzept.

Die Phasen B und C könnten im Bezug auf die Zielsetzungen der Finanzberichterstattung und der Verbindung zwischen Erst- und Folgebewertung zu anderen Ergebnissen führen, als das DP des CASB diese vorwegnimmt. Durch den Einbezug der Kommentare im Projekt „Conceptual Framework“ trägt das IASB der Forderung einer Vielzahl der antwortenden Autoren nach vorheriger Festlegung der Zielsetzungen der Finanzberichterstattung im „Conceptual Framework“ Rechnung.

Das IASB und das FASB veröffentlichte im Juli 2006 das DP „Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Objective of Financial Reporting and Qualitative Characteristics of Decisionuseful Financial Reporting Information“. Die Herausgabe eines ED über die bereits behandelten Punkte ist für das vierte Quartal 2007 geplant. Weiters sind DP geplant hinsichtlich der Phase B im zweiten Halbjahr 2008, der Phase C im ersten Halbjahr 2009 und der Phase D im vierten Quartal 2007.

KURZLEBENSLAUF

Ausbildung

06/1999	Reifeprüfung im Bundesrealgymnasium der Redemptoristen in Katzelsdorf, NÖ
Seit 10/2000	Studium der Internationalen Betriebswirtschaft an der Universität Wien
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Berufliche Erfahrungen

11/1999 - 08/2004	Beschäftigt bei Baier Lambert Rechtsanwälte OEG (Bereich: Immobilienverwaltung)
01 - 02/2005	Volontariat bei der Außenhandelsstelle der Wirtschaftskammer Österreich in Berlin
03 - 08/2005	Beschäftigt bei Baier Lambert Rechtsanwälte OEG (Bereich: Immobilienverwaltung)
09/2005 - 02/2006	Berufspraktikum bei Deloitte Services - Wirtschaftsprüfungs GmbH
07/2006 - 01/2007	Beschäftigt bei SAP Österreich GmbH (Bereich: Vertragsabteilung)
Seit 02/2007	Beschäftigt bei SAP Österreich GmbH (Bereich: Controlling)