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Dear Peter

Discussion Paper: *Measurement Bases for Financial Accounting – Measurement on Initial Recognition*

The Australian Accounting Standards Board (AASB) is pleased to provide comments on the abovenamed Discussion Paper.

Summary

The AASB thinks the Discussion Paper provides many valuable insights into the relative merits of possible measurement bases for initial recognition and a useful framework for analysing the issues. The Discussion Paper also identifies various measurement issues and constraints that need to be addressed, some of which are not widely appreciated. For example, the AASB found the discussion of information asymmetry (in paragraphs 183-187 of the main Discussion Paper), the dimensions of measurement uncertainty (in paragraphs 204-223 of the main Discussion Paper), and considerations for determining cost as a substitute for fair value (in Appendix C) to be particularly helpful.

An important feature of the Discussion Paper is its proposed definitions of measurement terms, which provide a basis for developing international agreement on the meanings of those terms and thus helping to minimise "noise" during measurement debates.

However, the AASB has some significant concerns with the analysis and conclusions in the Discussion Paper. Its main concerns are that:

(a) the claimed superior relevance of the market value measurement objective is not adequately explained (see comments on Question 6);

(b) it cannot conclude whether the market value measurement objective is more relevant than an entity-specific measurement objective until subsequent measurement is considered (see comments on Question 6);

(c) the proposal that the best market source on initial recognition is the market in which the asset or liability being measured was acquired or issued is inconsistent with the principle that the market value of an asset or a liability is measured in the most advantageous market available to the reporting entity (see comments on Question 10); and

(d) an estimate of fair value should not be treated as a "substitute measure" for fair value in the absence of the evidence described in Levels 1 and 2 of the main Discussion Paper's proposed measurement hierarchy, particularly because to do so would preclude the adoption of a single measurement basis by many entities (see comments on Question 15).

The AASB's specific comments on the Questions asked in the Invitation to Comment are attached.

If you have queries regarding any matters in this submission, please contact Jim Paul (jpaul@aasb.com.au) or myself.

Yours sincerely

David Boymal

David Boymal
Chairman

Measurement Bases for Financial Accounting – Measurement on Initial Recognition

Specific Comments

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 Discussion Paper) sets out the bases that should be considered? If not, please indicate and explain any changes that you would make.*

Yes.

The AASB doesn't consider current cost, replacement cost and reproduction cost to be separate measurement bases, but has no objection to their separate mention because different terms have been used in different jurisdictions to refer to essentially the same measures.

Because reproduction is one means of reproducing the service potential embodied in an asset, the AASB thinks reproduction cost should be regarded as a subset of replacement cost. If that view were adopted, there would be no need for a concept of current cost ("replacement cost" would do the same job). This is relevant to the AASB's comments about the proposed definition of "deprival value" in Question 2.

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 Discussion Paper)? If not, please explain what changes you would make. In particular, do you have any comments on the term "fair value" and its definition (in light of the discussion in paragraphs 46-48 of the condensed version and paragraphs 88-93 of the main Discussion Paper)?*

The AASB agrees with the definitions, except for the following matters:

(a) In the definition of ***fair value*** in paragraph 88 of the main Discussion Paper, the AASB thinks the reference to an "arm's length transaction" should be amended to "a transaction with unrelated parties". The AASB thinks "arm's length" is a colloquial, and less precise, way of saying "with unrelated parties".

(b) In the definition of ***deprival value*** in paragraph 94 of the main Discussion Paper, the reference to "replacement cost" might imply ignoring reproduction cost. If that were the intention, the AASB would disagree, because reproduction can sometimes be the most economic way to currently acquire the productive capacity or service potential of an asset. In this regard, the AASB disagrees with the comment in paragraph 352 of the main Discussion Paper that "It seems difficult to conceive of a situation in which the reproduction cost of an asset could be less than its replacement cost." It thinks reproduction cost could be less than replacement cost (if replacement cost is intended to exclude reproduction cost) when the entity possesses unique skills or efficiencies in creating an asset, as might occur with some internally purpose-built assets.

These comments in the paragraph above reflect the AASB's uncertainty about whether replacement cost and reproduction cost are meant to be mutually exclusive. Paragraph 352 of the main Discussion Paper says that if reproduction cost were lower than the cost of any other replacement possibilities, it would seem that it must be replacement cost. However, replacement cost and reproduction cost are described as competing measurement bases in paragraphs 321-323 of the main Discussion Paper, and paragraph 359 of the main Discussion Paper refers to using current cost (not replacement cost) as a substitute for fair value when (among other things) it is reasonable to assume that it is recoverable.

If reproduction cost were not regarded as a subset of replacement cost, the definition of *deprival value* should refer to "current cost" instead of "replacement cost".

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 Discussion Paper.) 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.

The AASB agrees that these are fundamental sources of differences between measurement bases. However, some AASB members think another fundamental source of differences is the concept of capital adopted. For example, current value concepts of capital include operating capability and current cash equivalents. These alternative concepts involve different treatments of transactions costs (for example, under current cash equivalent models, assets are measured at market value less costs to sell, because their objective is to measure the short-run adaptive capacity provided by the entity's assets). The importance of concepts of capital and capital maintenance is discussed in the comments on Question 6.

Q4. The paper analyzes the market value measurement objective and the essential properties of market value.

Q4(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 Discussion Paper)? If not, please explain why not, and what changes you would propose, or different or additional considerations that you think need to be addressed.

Yes.

Q4(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 Discussion Paper)? 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.

Yes.

Q4(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 Discussion Paper)?

Yes, with one exception. The AASB thinks the concept of fair value should be explicitly distinguished from the market value measurement objective in respect of the number of market participants. It agrees with the comment in paragraph 107 of the main Discussion Paper that for the market value measurement objective, a *market* requires "a body of knowledgeable, willing ... parties carrying out sufficiently extensive exchange transactions in an asset or liability to achieve its equilibrium price ...". However, the active market requirement inherent in the market value measurement objective is not included in the working definition of fair value in paragraph 88 of the main Discussion Paper. The AASB agrees with its exclusion, because active markets do not exist for various assets and liabilities, and thinks a single measurement basis should be applied, as far as possible. However, the AASB thinks this difference between the market value measurement objective and fair value should be highlighted.

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 Discussion Paper) and their relationship to management intentions (see paragraph 58 of the condensed version and paragraphs 117-121 of the main Discussion Paper)? If not, please explain why you disagree.

Yes.

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 Discussion Paper) and with the proposed conclusion that the market value measurement objective has important qualities that make it more relevant than entity-specific measurement objectives for assets and liabilities on initial recognition (see paragraphs 60-61 of the condensed version and paragraphs 123-129 of the main Discussion Paper)? If not, please explain your views.*

The AASB agrees with the comparison.

However, it thinks the claimed superior relevance of the market value measurement objective is not adequately explained in the Discussion Paper. This is because:

(a) The Discussion Paper's arguments for the superior relevance of market value measurement over entity-specific measurement are variations of its statement that with market value measurement, "competitive market forces work to resolve diverse expectations of various entities' managements to a single price that impartially reflects all publicly available information on any given measurement date" (paragraph 128 of the main Discussion Paper). This is an argument for the greater reliability, rather than greater relevance, of the market value measurement objective. The views of many provide greater assurance that a value is reliably determined, but this does not necessarily mean the value is more relevant.

(b) The Discussion Paper does not discuss how investors, creditors and other users would use values in making resource allocation decisions; and how market value (fair value) compares with other measurement bases in meeting those purposes, specifically in terms of its effects on balance sheets and income statements.

<u>Concepts of capital and capital maintenance, and subsequent measurement</u>

Some AASB members cannot conclude whether the market value measurement objective is more relevant than an entity-specific measurement objective until alternative concepts of capital are evaluated. This is because, in their view, the concept of capital adopted (such as nominal monetary units invested, operating capability or current cash equivalents) defines the nature of future economic benefits, and therefore the nature of assets and liabilities. The Discussion Paper excludes an evaluation of alternative capital maintenance concepts (as mentioned in the first sentence of paragraph 51 of the main Discussion Paper).

Inevitably, evaluations of alternative concepts of capital involve evaluations of their implications for concepts of capital maintenance, which determine the measurement of an entity's profit for the period. Some AASB members think assessing the relevance of a measurement basis—even on initial recognition—necessarily includes considering its implications for the measurement of profit.

Evaluating different concepts of capital maintenance is related to subsequent measurement, not measurement on initial recognition. However, some measurement bases close off choices in respect of concepts of capital maintenance. Paragraph 51 of the main Discussion Paper says, "... the selection of a basis for measuring the assets and liabilities of an entity has implications for the measurement of capital to be maintained, and different measurement bases have different capital maintenance attributes". It illustrates this by noting that paragraph 106 of the IASB *Framework* says the physical capital maintenance concept requires the adoption of the current cost basis of measurement. This illustrates the difficulty of determining an appropriate measurement basis on initial recognition without considering its implications for subsequent measurement.

The omission to evaluate alternative concepts of capital and capital maintenance, despite the statement in the last sentence of paragraph 51 of the Discussion Paper that "... conclusions reached on appropriate asset and liability measurement bases may require some changes to existing conceptual framework discussions of capital maintenance", gives primacy of measurement bases over concepts of capital and capital maintenance. Some AASB members disagree with this, because they think an evaluation of concepts of capital and capital maintenance should inform the selection of an appropriate measurement basis for assets and liabilities (on initial recognition and subsequently).

The AASB thinks firm conclusions about measurement bases on initial recognition should not be made in isolation of considering subsequent measurement. Otherwise, different measurement bases might be agreed for initial and subsequent measurement, which would be illogical.

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 Discussion Paper). Do you agree with this conclusion? If not, please explain why you disagree.

Yes.

Q7(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 Discussion Paper.) 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 Discussion Paper).

Do you agree with these proposals, within the caveats and discussion presented? If not, please explain why you disagree.

Yes. The AASB also thinks it should not be assumed that the market value of all liabilities on initial recognition should be equivalent to the fair value of the assets received as compensation for incurring those liabilities. For example, if a retailer sells a product with a right of refund for $100 cash in advance, and another entity would legally assume its obligations (in a business to business market) for $75, the difference of $25 would reflect the ability of the retailer to access a supply market that its customer cannot (market position), plus the value of the selling services it has provided to the customer (including providing convenient access to the product by operating a range of stores, providing a range of products for the customer to choose from, and assisting the customer with its choice of product). To regard such differences as differences between apparent market values for seemingly identical assets and liabilities on initial recognition would involve misspecification of the liability to the customer, because it would treat the entity as having performed no services at the time of incurring its obligations to the customer. This aspect is relevant to Question 10.

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 Discussion Paper)? If you do not agree, please explain the basis for your disagreement.

Yes.

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 Discussion Paper).

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 Discussion Paper).

Do you agree with these proposals within the caveats and discussion presented? If not, please explain why, and in what respects, you disagree.

Question 9(a)

For homogeneous assets or liabilities, such as securities, the AASB disagrees that the unit of account on initial recognition should be the unit of account in which the reporting entity acquired the assets or incurred the liabilities. The AASB thinks the objective of measurement is to measure each asset and liability, and therefore, to the extent feasible, the unit of account should be each asset and liability.

Question 9(b)

For dissimilar items, the AASB thinks the unit of account (level of aggregation) chosen should facilitate subsequent accounting for the asset(s) or liability (liabilities). For example, the unit of account in which an entity incurs a liability to a customer might be regarded as the contract with the customer. However, the contract might specify various performance obligations that will be extinguished at different times. Therefore, it is necessary to attribute values to each performance obligation, and those values should be determined on a consistent basis. Therefore, it would seem more appropriate for the unit of account to be each performance obligation.

Question 9(b) specifically addresses non-contractual assets. The AASB disagrees with the proposal in that question, mainly for the reasons in the next paragraph of comments. It thinks the principle in the paragraph above also applies to these assets. When active markets exist for non-contractual assets (the assets are not specialised), the appropriate unit of account is the unit of account traded in those markets.

In principle, the AASB agrees with the comment in paragraph 158 of the main Discussion Paper that the transformation of inputs in the creation of specialised assets means the fair value of such assets is not established in entry markets in which their inputs were acquired. However, adopting the proposal 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 seems likely to lead to recognition and measurement of cash-generating units. This seems contrary to the objective of financial statements to report an entity's assets and liabilities rather than the value of its business(es). (The AASB acknowledges that impairments are identified and recognised on the basis of cash-generating units but, generally, assets are not carried at impaired amounts.) The AASB thinks this problem is more serious than omitting to capture the synergies created by the transformation of inputs. Therefore, it concluded that it is more appropriate that the unit of account for non-contractual assets (e.g., specialised assets) is each input acquired in a market to which the entity has ready access. When there is a choice of such markets, the reference market should be that in which inputs can be acquired most economically (the most advantageous market).

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 Discussion Paper). 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.

The AASB disagrees with the proposal because it is inconsistent with the principle that the market value of an asset or a liability is measured in the most advantageous market available to the reporting entity. For example, applying that proposal would lead to measuring the market value of all liabilities on initial recognition at the market value of the assets received in exchange for incurring them. However, the most advantageous market for extinguishing a liability may be a business-to-business market rather than the retail market in which it is incurred. As is said in the comments on Question 7, measuring the market value of liabilities on initial recognition at the market value of the assets received in exchange for incurring them can result in mis-specifying liabilities. In addition, it measures the future sacrifice of economic benefits to extinguish an obligation indirectly (by reference to the assets received in exchange) rather than directly.

Paragraph 176 of the main Discussion Paper argues that in respect of warranty obligations that theoretically could be assumed by third party insurers for a lower price than the price in the entry market with customers, a "knowledgeable customer may be unlikely to allow the retailer to pass the liability to an insurer that may not be as good a risk .... On the other hand, although the customer may be content to allow the retailer to pass the liability to an insurer that is a better risk, that insurer is likely to charge the retailer more for assuming the risk than the retailer received from its customer." The AASB disagrees with this because:

(a) An upgrade in the credit standing of a warranty resulting from a transfer of the warranty should be excluded from the measurement of the existing warranty's market value, because it results in a different asset (to the holder of the warranty) and liability (of the reporting entity).

(b) Insurers regularly assume extended warranty obligations from retailers for considerably less than the prices at which retailers sold the warranties to their customers, because, once an extended warranty contract for standard goods is sold, it is normally highly profitable.

In addition, the AASB disagrees with the proposal in Question 10 because it implies that the market value of two sets of obligations identical in every respect, except the market in which they were incurred, should be measured differently, even if they were incurred simultaneously. However, market participants are indifferent as to how a particular set of liabilities was incurred.

For the same reasons, the AASB also disagrees with the implication in paragraph 177 of the main Discussion Paper that the "which market" conundrum for measuring performance obligations could be overcome by immediately remeasuring the obligations at a "reliably estimable exit market value" if specified conditions justifying such remeasurement are met. Whilst the AASB agrees with using an exit market value (a price in a business-to-business market) to measure the market value of performance obligations, it disagrees that this is a remeasurement issue. If nothing changes except the passage of a nanosecond, the AASB thinks there is no reason to look to different markets (from those used for measurement on initial recognition) to estimate market value. In other words, it thinks the general rule should be to measure the market value of performance obligations on initial recognition using exit market values.

Applying the proposal in Question 10 to nails held by a hardware retailer, paragraph 169 of the main Discussion Paper argues that "the appropriate market for the retailer in measuring the fair value of nails on initial recognition is its entry (wholesale) market, and that any excess of the retail price over the wholesale price is a result of retailing activities subsequent to initial recognition". Whilst the AASB agrees that measuring the fair value of the nails at retail prices would anticipate the benefit of future retailing activities, it is not convinced that the entire difference between wholesale and retail prices for the nails should be attributed to future activities. It thinks part of the difference between the prices can be attributable to market access (the ability to obtain nails at wholesale prices when retail customers cannot), and this results from past efforts as well as future retailing activities. The AASB thinks that, in principle, rather than choosing between wholesale and retail markets to price inventories (or other assets held), accepted valuation techniques should be used to estimate the value that market participants place on future value-adding activities. For example, professional valuers estimate the market value of subdivisional land by deducting from the market price for developed land the market's estimate of the cost of remaining development work plus an estimate of market profit margins on such costs. This principle can be applied to measurement on initial recognition, and may mean that gains or losses arise on acquisition of assets to be enhanced before sale. For some assets, limitations of market information and/or cost-benefit considerations may warrant choosing wholesale prices as a proxy for their fair value—however, these are practical considerations that should be segregated from valuation concepts.

Adopting the proposal that the best market source on initial recognition is the market in which the asset or liability being measured was acquired or issued generally precludes gains arising on initial recognition of assets or liabilities (however, the AASB notes that adopting the proposal to exclude transaction costs from initial measurement of assets and liabilities would give often rise to losses on initial recognition). The implication of the proposed treatment is that this is a more important consideration than whether the asset or liability being measured is measured on the basis of an exchange in the most advantageous market available to the reporting entity.

Equivalence of entry values and exit values

Paragraph 164 of the main Discussion Paper says, "Of course, what is an entry market to one entity (the buyer in that market) will be an exit value to another entity (the seller in that market)." Whilst the AASB generally agrees with that comment, the transformation of inputs acquired in entry markets into different (often specialised) assets—as discussed in paragraph 158—can cause the aggregate entry price for an asset to differ from the asset's selling price. In other words, because of the transformation of inputs when specialised assets are developed, there may not exist an observable entry price for the specialised asset. The only observable market price for the asset might be an exit price for its sale as scrap.

The comment in paragraph 164 also does not address the fundamental issue that businesses may have access to markets that their customers do not, and therefore their exit markets for obligations arising from contracts with customers may be distinct from entry markets for those obligations.

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 Discussion Paper). 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.*

The AASB agrees with the proposed definition and the conclusion above.

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 Discussion Paper)? If not, please explain why you disagree, and indicate how you would settle trade-offs between the relevance and reliability of alternative measurement bases.*

Yes.

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 Discussion Paper)? If not, please explain your view.*

Yes.

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 Discussion Paper)? If not, please explain why.*

The AASB cannot decide an answer to this question until the implications of fair value for subsequent measurement are also evaluated.

The AASB's answer to Question 6 included a comment that the Discussion Paper does not discuss how investors, creditors and other users would use values in making resource allocation decisions and how market value (fair value) compares with other measurement bases in meeting those purposes. The AASB thinks the following decision usefulness aspects of deprival value should be taken into account in such an evaluation:

(a) Deprival value measures the entity's capacity to continue to provide goods and services in its current line of business, and indicates the resources needed to replace assets (at current prices) in order to continue in the same line of business.

(b) Measuring depreciation on a deprival value basis is a necessary input to assessments of whether the entity is recovering the cost of the goods and services it provides. This is important for assessing the entity's ability to generate returns on inputs in its current line of business (input-output analysis) and, similarly, to generate future net cash-equivalent flows from the entity's existing assets.

Although, as the Discussion Paper notes, entities frequently dispose of operations and invest in new activities, such changes often entail significant costs, especially when the entity currently uses specialised assets. If the measurement objective is to enable assessments of the entity's financial flexibility, assets should be measured at their current cash equivalents (net market values). The net market value of specialised equipment would be their scrap values if no available buyers for those assets have their existing use (usually highest and best use) in mind. That is, the current cash equivalents of such assets are not necessarily their fair value less cost to sell.

The AASB's answer on when acceptable reliability would exist to measure an asset or a liability at fair value is given in respect of Question 15.

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 Discussion Paper)? 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 Discussion Paper), 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 Discussion Paper)?

Please provide explanations for your views on these questions if they differ significantly from the conclusions and supporting arguments presented in the paper.

For the reasons below in respect of Question 15(a), the AASB disagrees with the comment that "fair value cannot be estimated reliably in some fairly common situations" (paragraph 279 of the main Discussion Paper). It thinks it is important not to preclude the adoption of a single measurement basis by reporting entities. Accordingly, the AASB thinks any best estimate of fair value should be described as fair value, regardless of the nature of the evidence available to support that estimate. On this issue, it agrees with the approach in the draft FASB Statement *Fair Value Measurements*.

Question 15(a)

The AASB agrees that a single transaction price (a price in an inactive market) is not necessarily equal to fair value, for the reasons given in paragraph 246 of the main Discussion Paper. However, this does not lead it to conclude that in the absence of the evidence described in Levels 1 and 2 of the main Discussion Paper's proposed measurement hierarchy (see paragraph 423), an exchange price should not be accepted to be equal to fair value. Rather, the AASB thinks the key point about prices in inactive markets is that they should not be assumed to be fair value without considering whether better evidence of fair value exists.

The AASB also thinks verifiability is not an essential aspect of reliability (or faithful representation). Verification provides assurance that the information is reliable, or representationally faithful. However, the AASB thinks a lack of such assurance (such as prices for the same or similar item in an active market) does not necessarily mean the information fails that qualitative characteristic. It notes that the IASB *Framework* does not specify verifiability as an essential aspect of reliability.

Question 15(b)

The AASB disagrees with the view set out in Question (b) for the same reasons it disagrees with the view in Question 15(a).

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 Discussion Paper);

b) current cost — reproduction cost and replacement cost (see paragraphs 138-154 of the condensed version and paragraphs 320-361 of the main Discussion Paper);

c) net realizable value (see paragraphs 155-161 of the condensed version and paragraphs 362-375 of the main Discussion Paper);

d) value in use (see paragraphs 162-169 of the condensed version and paragraphs 376-392 of the main Discussion Paper); and

e) deprival value (see paragraphs 170-178 of the condensed version and paragraphs 393-409 of the main Discussion Paper)?

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.

Yes, except for the omissions and points of disagreement noted below. However, for the reasons noted in the comments on Question 6, at this stage the AASB cannot conclude whether fair value is a superior measurement basis to each of these bases.

The evaluation of the "cost-revenue matching objective" in relation to historical cost (paragraphs 293-296 of the main Discussion Paper) does not discuss the objective of measuring assets at historical cost to enable assessments of the entity's performance in generating returns on the nominal amount of capital invested in the entity's assets (returns on historical investments).

The AASB thinks the difficulties of reliably estimating replacement cost are somewhat overemphasised in the Discussion Paper. For example, it does not think the example of a luxury car used solely for the purpose of delivering pizzas is representative of the extent of uncertainty involved with determining the service potential that would need to be replaced upon deprival of an asset. For many of the more valuable assets deployed by entities, there are few alternative uses to which the assets could be put and the role of the asset in the entity's operations is clear. This is true for many infrastructure assets, such as heavy equipment, specialised motor vehicles, specialised buildings, dams, roads, railways, ships, and reticulation systems.

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 Discussion Paper)? If not, please explain why.

The AASB disagrees with using substitute measures for fair value. The only circumstances in which it thinks fair value cannot be estimated reliably (whether on initial recognition or subsequently) are when the asset or liability fails the reliability criterion for recognition using any measurement basis.

If certain estimates of fair value (as the AASB sees them) were to be depicted as substitutes for fair value, the AASB would agree that the "substitute" should be selected and applied on as consistent a basis as possible with the fair value measurement objective. This is because the AASB regards such "substitutes" as fair value estimates.

Paragraph 318(a) of the main Discussion Paper argues that when using historical cost as a substitute for fair value (because fair value cannot be estimated with sufficient reliability), the measure of historical cost should exclude transaction costs. If fair value cannot be estimated with sufficient reliability, the AASB thinks it unlikely that the entity will be able to determine which costs are transaction costs, because it would be unlikely to be able to determine with sufficient reliability which costs are "recoverable in the marketplace".

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.

In addition to disagreeing with treating some reliably determinable estimates as substitutes for fair value (see above), the AASB perceives the following problem with liability measurements under Level 3 of the proposed hierarchy. Paragraph 431 of the main Discussion Paper says "Level 3 ... Failing the ability to estimate fair value with acceptable reliability ... (b) a liability should be measured on initial recognition at its current consideration amount, provided that this amount can be reliably estimated and can be reasonably expected to represent the amount owed". If the fair value of a liability cannot be estimated with acceptable reliability, it is unclear how it could be determined whether the current consideration amount can be reasonably expected to represent the amount owed.

> *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 Discussion Paper)? If so, please provide them.*

The AASB thinks further research should be conducted into:

(a) how investors, creditors and other users use values in making resource allocation decisions; and

(b) the unit of account issue (because the AASB disagrees with the proposed unit of account described in Question 9, and because the main Discussion Paper notes in paragraph 161 that further study is needed to fully resolve this issue). Some AASB members commented that the discussion of the unit of account for non-contractual assets (in paragraphs 157-161 of the main Discussion Paper) addresses the transformation of inputs into other assets, but does not explore the decision usefulness implications of various alternative levels of aggregation. They think it is essential to perform this analysis before the unit of account issue can be resolved either for initial recognition or subsequent remeasurement.

Some AASB members also think the relative merits of various concepts of capital and capital maintenance, and the implications of those concepts for measurement bases, should be explored.

The AASB's other comments on the Discussion Paper are provided in the Appendix.

Appendix—Other Comments

Para.	Comment
327	This paragraph says the objective of replacement cost measurement seems "most appropriate" in particular circumstances that exclude rapid technological change and an expectation of significant changes in product lines. It also says the relevance of replacement cost and productive capital maintenance has been questioned in relation to various other classes of assets. It isn't clear whether rapid technological change and expected significant changes in product lines are expected to diminish the relevance or reliability of replacement cost measures, or both. The AASB thinks these circumstances seem to diminish the relevance of *reproduction* cost (but not replacement cost) and potentially the reliability (but not relevance) of replacement cost estimates. However, the last sentence of this paragraph notes that many think the replacement cost objective lacks relevance.
C19	The AASB disagrees with the comment in respect of non-monetary exchanges, that "When neither the fair value of the asset acquired nor of the asset given up is capable of reliable estimation on the date of the transaction, and a reliable Level 4 measurement is not possible, then presumably the asset acquired would be measured at the carrying amount of the asset given up." The AASB thinks that, in these circumstances, the asset acquired fails the reliable measurement criterion for recognition, and therefore should not be recognised. It thinks the reliable measurement criterion for recognition should not be applied differently according to whether an expense would be recognised (for example, the expense that arises from derecognising the asset given up in exchange).