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Accounting Standards Committee of Germany ® Der Standardisierungsrat

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Berlin, 19. Mai 2006

Dear Sir,

On behalf of the German Accounting Standards Board (GASB) I am writing to comment on the IASB discussion paper "Measurement Bases for Financial Accounting - Measurement on Initial Recognition." We appreciate the opportunity to comment on the discussion paper.

We welcome that the IASB and the Canadian Accounting Standards Board is initiating a comprehensive discussion on various measurement issues. With a large number of standards currently under revision and the fair value measurement project under discussion, we think that a discussion of the fundamental questions on measurement and the purpose of financial statements are appropriate now. In addition, we support the efforts of the IASB and the Canadian Accounting Standards Board to achieve consistency between the frameworks and various measurement-related issues. We think, though, that more detailed information by the IASB on how this discussion paper fits into the other IASB projects would be helpful.

We have doubts as to the focus the IASB has chosen for this discussion paper and, consequently, the approach chosen for the project. We do not think it appropriate to focus the discussion separately on the measurement basis on initial recognition.

Any meaningful comment needs and any conclusion implicitly assumes a certain concept of income, a capital maintenance concept and, in line with these concepts, definitions of the terms asset and liability as the elements of the balance sheet. Discussing measurement issues requires a clear understanding of the purpose of financial statements and how that purpose can be achieved.

Assuming that the purpose of financial statements is to provide the user with information, that (i) is useful for making decisions (F.12) and (ii) shows the results of the stewardship of the management (F.14), the discussion paper seems to take the view that only information on the future cash flows as reflected in the fair values of the elements of the balance sheet of

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the reporting entity might fulfil this purpose. We cannot see that this has been proven nor do we think that it is true.

Even if we assumed that the only purpose of the financial statements were to provide information on future cash flows of the *entity*, we doubt whether the financial statements (the balance sheet) could provide information on the future cash flows of the reporting entity at all: Since the sum of each balance sheet item's cash flow will certainly not equal the cash flow of the entity as a whole, but every balance sheet is based on the notion of an individual valuation (item-by-item-approach), a balance sheet simply cannot provide this information. This is due to the fact that an individual valuation (which cannot be abandoned because of reasons of reliability) does not take into consideration synergies between items. Furthermore, self-generated goodwill will not be recognized, but it influences the reporting entity's future cash flows.[1] However, the discussion paper seems to follow an asset/liability-approach, under which every item is measured at the market price. We do not concur with this approach for the reasons mentioned above.

The financial statements may, however, provide the user with information that may enable him/her to perform his/her own predictions of future cash flows. That would require reporting an income figure with predictive value. An income figure will have predictive value if it can be extrapolated into the future. A revenue/expense approach might meet this objective better than an asset/liability-approach. Even if we were to agree to an asset/liability-approach, we think entity-specific measurement bases, i.e. the value in use, would be more suitable to provide relevant information. This can be easily shown if one thinks of special machinery or non-tradable credits where market prices in the common sense do not exist.

We would have expected the paper to discuss these questions, and without these questions satisfactorily answered, any discussion on measurement on initial recognition seems to be completely inappropriate: The purpose of financial statements is fundamental when discussing the concept of income which in turn will be important for the definition of the terms "assets" and "liabilities". Depending on these definitions, the answer to the question in the discussion paper will vary substantially.

Moreover, it follows that any conclusions reached for measurement on initial recognition may by no means be extended to subsequent measurement. Conclusions reached for subsequent measurement may in turn influence the conclusions for initial measurement.

Consequently, for the various reasons mentioned above we think that the scope of the discussion paper is too narrow.

With regard to the market measurement "objective", the discussion paper confuses (i) the objectives of financial reporting (decision-usefulness and stewardship function) and instruments necessary to reach those objectives (market prices of assets and liabilities) and (ii) seems to be based on equilibrium prices (see e.g. par. 101, 424 of the main discussion pa-

1 See e.g. Ballwieser, The Limitations of Financial Reporting, p.61 et seq. in: Leuz/Pfaff/Hopwood (Ed.): The Economics and Politics of Accounting, Oxford, New York 2004, p. 58 et seq.

per). There will only be an equilibrium price on a perfect and complete market and only on a perfect and complete market the fair value is precisely defined. This is of course a theoretical model. However, it can be shown, that under this model, there is no need for the existence of companies and for financial reporting at all.[2] Companies exist because they have advantages in combining production factors and in producing goods and selling services. Financial reporting is necessary in a world where equilibrium prices for time- and state-dependent cash flows do not exist.

In a world with incomplete markets, information asymmetries are not (completely) removed by arbitrage and thus, markets do not capture all available information. Following this empirically justified assumption, the fundamental reasoning of the discussion paper no longer applies: market-based approaches loose their a priori superiority over entity-specific measures like a value in use.

Therefore, as the real-world markets are not perfect, an entity-specific measurement base might be superior over a market-based fair value. However, we acknowledge that a market or selling price may be informative if the entity does not intend to continue using the asset. A value in use would not be relevant in those situations. Therefore, selling prices might be useful for current assets or trading securities. In our view, they are not useful for non-current assets like property, plant & equipment, as they are not good proxies for the contribution that the individual assets make to the value of the company or the cash flows of the company. Furthermore, for financial instruments, even if the financial market is not perfect as well, we think that a fair value might be more decision-useful, provided the fair value can be derived from an active market. In general, we think that an entity-specific value in use would provide more relevant information.

As “relevance” is not the only relevant qualitative characteristic according to the IFRS framework, reliability has to be kept in mind. Since a value in use may not be capable of reliable determination, we would suggest looking for a suitable entity-specific alternative measurement base. This might be historical cost, at least on initial recognition.

Please find our detailed comments on the questions raised in the discussion paper in the appendix below. If you would like to discuss our comments further, please do not hesitate to contact me.

Yours sincerely,

Prof. Dr. Harald Wiedmann
President

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[2] See Beaver/Demski, The Nature of Income Measurement, Accounting Review 1979, p. 28, 33.

Detailed comments on the questions in the discussion paper

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

With respect to the aspect of completeness we suggest adding another measurement base to the list: the face value or notional amount. This measurement base is currently used by the IFRSs, e.g. for the paid-in (issued) capital in IAS 1.68. It also might be used for liabilities, as the notional amount is usually the amount due on redemption. This corresponds with the settlement values of liabilities, "that is, the undiscounted amounts of cash or cash equivalents expected to be paid to satisfy the liabilities in the normal course of business." (F.100(c))

Independent from the aspect of completeness the list includes some measurement bases which we deem less relevant for measurement on initial recognition. For example, we deem the net realisable value or the current cost to be less relevant on initial recognition. The deprival value is, as laid out in par. 72 of the discussion paper (long version) a combination of other measurement bases. We therefore focus our comments on the historical cost, the value in use and the fair value.

Q2. Do you agree with the working terms and definitions, and supporting interpretations, of each of the identified measurement bases? If not, please explain what changes you would make. In particular, do you have any comments on the term "fair value" and its definition?

The definition of the term "fair value" is consistent with current IFRS. Although attributing the market perspective to the term as currently defined seems not obligatory to us, we note that some parts of the definition ("willing parties in an arm's length transaction", "*could* be exchanged") seem to imply the existence of more than just two parties, i.e. a body of parties as defined in par. 107 of the discussion paper (long version) and, therefore, allow attributing the (broad, liquid and/or active) market perspective to the current definition.

We note, though, that there might be a difference between the fair value of the consideration given (that is, cash in the case of the acquisition of an asset) and the fair value of the consideration received (that is, the acquired object).

We also note that the market perspective, if attributed to the term, would have to be explained in more detail. In particular, the characteristics that constitute a market in the sense of the definition would need to be specified. We can think of some situations in which we have doubts due to the quality of the fair values, even if the market definition would probably be met. E.g. there might be a number of willing sellers to deliver a specialized tool or a specialized piece of plant, made to the specifications of the buyer, but the asset's market price would probably equal the scrap value, which we would deem irrelevant to the users of the financial statements. Consider the duopoly in the market for newly built large aircraft: A willing company to sell an airplane may be found at any time, but only two companies (Boeing,

Airbus) offer aircraft on this market. Consider as a third example an investment in another company. When acquiring an investment for strategic and not merely financial purposes, the price the investing entity is willing to pay is likely to include entity-specific synergies (blockage factor).

With respect to the term "fair value", we would like to point out that the definition is rather broad and encompasses a number of amounts of different qualities. We think that there are important differences between e.g. a fair value determined as a market price in an active market and a calculated fair value. Labelling all these amounts as "fair value" obscures the different qualities. We therefore suggest refining the definition and the terms (please see also our answer to question no. 18).

There seems to be a major difference to the FASB "fair value measurement" working draft, in which the fair value definition has an exit price notion. We note that the discussion paper does not contain an exit price notion and does not differentiate between entry and exit prices. Indeed, on a perfect and complete market, there will only be one equilibrium price. Again, as the real-world markets are not perfect, there will always be a difference between entry and exit prices. Therefore, a differentiation seems necessary and the question whether to use an entry price or an exit prices is not trivial.

Even for financial markets, where the market for some financial instruments is highly liquid, there will always be a difference between entry and exit prices (bid-ask-spread). What is the fair value within that range the reporting entity is supposed to use on initial recognition? The discussion paper (par. 242, long version) sees no conceptual justification in using the mid-point within that range. Consequently, there would be no fair value (level 1 of the hierarchy) in such cases. If one concurs with the assumption that the financial markets are among the most active markets, we must conclude that there would never be a fair value on level 1 of the hierarchy even for financial instruments traded in liquid markets.

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.

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 fundamental sources of differences between measurement bases are dependent upon the concept of income and the definitions of both assets and liabilities. The terminology used in the discussion paper seems to obscure the difference between the measurement base

and the aim of financial reporting: The "market value measurement objective" (see e.g. par. 107 of the discussion paper, long version) is not an objective in itself – the aim of financial reporting and the instruments used to archive this aim should not be blended. This argument is also valid for other questions related to the market value measurement "objective", e.g. question no. 4.

According to the Framework, the financial statements should provide the user with decision-useful information and information that show the results of the stewardship of the management. Important information in this sense from our point of view seems to be reporting an income figure which has predictive value. An income figure will have predictive value if it can be extrapolated into the future. A revenue/expense-approach might meet this objective better than an asset/liability-approach. To report changes in fair values as income will generally not lead to an income figure with predictive value, as the changes are non-repetitive. On the contrary, a fair value determined as a present value of future cash flows does not allow the user to asses the amount, structure and risks of future cash flows. However, this information would be needed.

This again proves our point from the introduction about the scope of the discussion paper. Talking about measuring aspects of accounting without defining its goals and fundamental concepts as well is a futile attempt.

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

(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. 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". 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?

We refer to our general comments. We do not agree that the discussion paper discussed the properties and characteristics of markets in sufficient detail. As the discussion paper is referring to an "equilibrium price" (see e.g. par. 101, 424 of the main discussion paper), we take it that the discussion paper assumes perfect and complete markets, as only perfect and complete markets will be in equilibrium. Under this implicit assumption, we would have expected the discussion paper to analyse how the equilibrium is reached in the marketplace. We would also like to point out that in a theoretical world of perfect markets, it can be demonstrated that there is no need for accounting at all, as mentioned in our general comments.

If we assume that the discussion paper is only assuming information-efficient, but not perfect and complete markets, we would have expected more references to the relevant finance literature, as there is conclusive empirical evidence that markets (even financial markets, albeit goods markets) are not information-efficient in reality.

With respect to question c), we do not agree: If perfect and complete markets are assumed, the market measurement “objective“ is a tautology or a mere triviality. If not, the first step would be to define the aim of financial statements as the measurement “objective“ depends upon the function of the financial statements. If e.g. stewardship was postulated as the aim, the measurement “objective“ would be completely different.

Q5. Do you agree with the definition and discussion of entity-specific measurement objectives and their relationship to management intentions? If not, please explain why you disagree.

We agree. (With respect to the term measurement “objective” in this context we refer to our answer to question no. 3.)

Q6. Do you agree with the comparison of market and entity-specific measurement objectives 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? If not, please explain your views.

We do not agree. As mentioned previously, we think that without a common understanding of the purpose of financial statements this question cannot be satisfactorily answered. The purpose of financial statements is fundamental when discussing the concept of income which in turn will be important for the definition of the terms “assets” and “liabilities”. Depending on these definitions, the answer to the question in the discussion paper will vary substantially. In addition, we would like to point out that “relevance” is not the only relevant qualitative characteristic according to the IFRS framework.

One may argue that by reporting every balance sheet item at its fair value the balance sheet will provide a better approximation of the entity’s value as compared to other measurement bases. Even if we were to concur with the purpose of the balance sheet to provide information on the entity’s value as a whole, we have doubts as to this argument being valid. A certain relation between the fair values of single items and the value of the entity is based on certain conditions, which would have to be proven instead of just assumed. However, these conditions cannot be proved in general – consider the following examples:

- The entity value is determined by discounting the future cash flows with a rate of return, which is determined by comparing an investment in the respective entity to an alternative investment. This rate of return of the alternative investment may change. Consequently, the entity’s value will change. However, the fair values of the item reported in the balance sheet need not have changed at all (e.g. the entity’s cash) or

may change in a completely different manner (e.g. items whose fair values depend on interest rates, i.e. loans, financial liability). It is unclear whether the sum of historical cost based amounts approximates the entity's value better than the sum of fair value based amounts.

- The entity value generally includes a self-generated goodwill. The fair value of the assets may rise, but the self generated goodwill may drop in value for other reasons at the same time. The net effect is indeterminate; historical cost accounting may lead to a book value of equity that is a better approximation of the entity's value than the book value based on fair values.
- The fair value (if a market perspective is attributed to the term as in the discussion paper) of highly customized tools is likely to be zero, but the contribution to the entity's value may be substantial. The historical cost will normally be in excess of zero, and the value in use will be even higher. Therefore, the value in use would better approximate the contribution to future cash flows. Reporting the item at fair value would not result in providing information on the future cash flows.

With respect to the sound basis related to the alternatives mentioned in par. 124 et seq. (main discussion paper), we can think of some decision rules. One rule e.g. could be that if the entity intends to dispose of the item (as a result of a change in intention or according to the normal course of business, e.g. inventories, assets held for trading, finished goods to be sold), the market value perspective might be more relevant, whereas with respect to items the entity intends to use (e.g. property, plant & equipment), the entity-specific perspective could be more relevant. Current IFRS contain a number of such distinctions, e.g. current and non-current assets.

Another sound basis might be the question whether the market is truly or nearly information-efficient. Only market prices observed in information-efficient markets would justify the market perspective as only these market prices would incorporate the advantages attributed to them in the discussion paper.

As mentioned in our general comments, market prices might provide decision-useful information if the entity does not intend to continue using the item any longer (e.g. current assets, trading securities, assets held for sale).

Q7. (a) It is reasoned that there can be only one market (fair) value for an asset or liability on a measurement date. 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.

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

We can imagine a bundle of assumptions under which the conclusion “one market (fair) value on a measurement date for a particular item” is valid. If the real world was matching the theoretical model of a perfect and complete market, the conclusion would be a mere tautology. If not, the validity of the conclusion would vary according to the information efficiency of the market. We have serious doubts as to the efficiency of non-financial markets.

With respect to the sources of differences in prices another reason could be access to information, which considerably varies even in financial markets. Our impression is that the caveats are significantly higher and the information efficiency of real-world markets is much lower than assumed in the discussion paper. We agree that these issues require further research.

Therefore, we can see no conclusive argument why the actual transaction and the respective transaction price should not be used for measurement on initial recognition. Given the difficulties to choose the relevant market, basing the measurement on initial recognition on the actual transaction seems, from our point of view, to lead to both more relevant and reliable information. We see no conclusive support for the assumption that a transaction price “requires independent substantiation by reference to some acceptable measure of its recoverable amount” (see par. 283 discussion paper, long version). If the entity acts rationally, it will not willingly and knowingly pay a transaction price in excess of the value in use, because the entity would suffer a loss. The starting point of the discussion should be an entity acting rationally and not the management intending to manipulate transaction prices.

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

We agree that if perfect and complete markets exist, the fair value would be the same. However, as real-world markets are neither complete nor perfect, asymmetric information between lender and borrower may cause the subjective prices to diverge. In addition, from the point of view of the entity which has incurred the liability only the amount due (and not the market price of the promise) is the relevant amount. Both amounts might equal each other on initial recognition. We wish to point out that this conclusion reached for measurement on initial recognition may by no means be extended to subsequent measurement. We have serious doubts concerning the changes in the entity’s own credit risk being included in income when re-measuring the liabilities.

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.

(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.

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

The question whether the value of a portfolio equals the sum of the values of each item contained in the portfolio if they are valued separately depends on certain assumptions. These assumptions are not trivial.

With respect to question (b), again the answer depends on the definition of the terms asset and liability. These definitions will in turn depend on the concept of income. Without the respective assumptions or definitions, it is not possible to answer this question.

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. 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.

We are not sure that all implications related to market sources for initial recognition have been identified. However, it seems to prove what substantial difficulties arise when a theoretical model (here: the perfect and complete market) is put into practice. For example, the existence of trade (wholesale, retail) may not be explained in a world of perfect markets without the existence of asymmetrical information and/or transaction costs. We also have doubts as to the consequences: For example, consider an entity which has the intent to sell a recently acquired asset. If the entity cannot access the market in which it *acquired* the asset to *sell* it, the entity would have to look to a different market (“jump the market”). This might lead to a different fair value, with the only reason for the change in the fair value being the entity’s change of intend to use the asset.

Q11. The paper concludes that transaction costs, as defined, are not part of the fair value of an asset or liability on initial recognition. 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.

We do agree that the fair value, as defined in the paper, does not include transactions costs.[3] However, the existence of transaction costs in every real-world market proves that these markets are not as perfect as the discussion paper assumes to justify the market measurement "objective" being superior over the entity-specific measurement objective.

The willingness of the entity to incur transaction costs in excess of the fair value proves that the value in use is higher.

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

We do agree that, assuming the same level of reliability, the more relevant of two alternative measurement bases should be used. From the discussion paper, we get the impression that reliability is taken as a mere constraint. However, we would like to point out that in the IFRS Framework both characteristics, relevance and reliability, have the *same* level of importance. In our opinion, a dominance of relevance is inconsistent with the framework. Furthermore, we support the current framework giving the same level of importance to both relevance and reliability.

Q13. Do you agree with the two proposed sources of limitations on measurement reliability — estimation uncertainty and economic indeterminacy — and supporting discussion? If not, please explain your view.

We find it odd to see uncertainty and indeterminacy discussed under the general topic of "reliability", as we are of the view that there is an important difference between both sources of limitations. With respect to indeterminacy and one-to-many or many-to-many allocations, disclosing the allocation formula will provide useful information and will mitigate the limitation on measurement substantially. With respect to uncertainty, it is impossible to prove the range of possible outcomes and the respective probabilities. Even in cases of large populations and the existence of empirical frequencies, there might be difficulties when extrapolating the results.

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? If not, please explain why.

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3 We note that for insurance contracts there might be a need to re-consider the definition with respect to the insurance project (phase II).

We do not agree and refer to our answer to question No. 6. Neither do we think that the fair value is the most relevant measurement basis for assets and liabilities on initial recognition, nor do we think that the fair value may usually be determined reliably.

In addition, we would suggest taking into consideration a cost-benefit analysis. The cash flow statement is compiled using information on cash and cash equivalents paid and received. Historical cost accounting also relies on information on cash and cash equivalents paid and received in a number of transactions. A balance sheet with items measured at fair value would require a completely separate system of bookkeeping *in addition* to one relying on cash and cash equivalents for the cash flow statement. We miss any discussion of the cost-benefit implications of the conclusions reached in the discussion paper.

Q15. Do you agree that fair value is not capable of reliable estimation in some common situations on initial recognition? 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, 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?

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

In our view, fair value is not capable of reliable estimation for most of the non-financial (goods) markets. With respect to financial markets, this depends on the kind of financial instrument traded.

As far as question (b) is concerned, we suggest taking into account a cost-benefit analysis. From our point of view, even if model-based calculation was assumed to achieve a reliable estimation of the fair value, we doubt that this approach would be consistent with the cost-benefit constraint in all cases.

Q16. Do you agree with the paper's analyses and conclusions with respect to the comparative relevance and reliability of:

(a) historical cost;

(b) current cost - reproduction cost and replacement cost;

(c) net realizable value;

(d) value in use; and

(e) deprival value?

(f) 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.

We do not agree with the paper's conclusions with respect to historical cost. Generally, we believe that entity-specific measurement bases will provide more relevant information. For example, we think that the value in use is superior to a fair value. However, the value in use would not be capable of reliable estimation on subsequent measurement. This shows again that this question may not be satisfactorily answered without taking into account subsequent measurement. Historical cost would be an alternative entity-specific measurement base (which we believe to provide more relevant information) and, as it is a transaction price agreed-upon in a real transaction, is highly reliable. On initial recognition, historical cost may be decision-useful, as the value in use will at least equal the historical cost (and may be even higher).

We agree with respect to the measurement bases (b) – (e). However, as already mentioned in our answer to question no. 1, we deem the discussion related to (b), (c) and (e) less relevant. We suggest adding the face value to the list of possible measurement bases.

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? If not, please explain why.

We do not consider this question to be relevant, as we do not believe the fair value or the market measurement "objective" to be superior. If we were to concur with the assumption that the market measurement "objective" was superior, this question would seem tautological.

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

We do not agree. As laid out in our answer to question no. 6, the hierarchy for the measurement may not be discussed without first discussing the purpose of financial statements and the related concept of income. The measurement hierarchy is based upon the market measurement "objective". As we are not convinced of this "objective", we see no point in evaluating the hierarchy.

We would suggest using different 'labels' for the fair value determined as observable market prices (level 1) and by a valuation technique based on market inputs (level 2). We think that there are considerable differences between both levels. These differences should also be made eminent in the 'labels' used for both levels, e.g. "market price fair value" and "calculated fair values based on market inputs". We refer to our answer to question No. 1.

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 discussion paper defines “initial recognition” as the point in time of readiness to contribute to the generation of future cash flows. (see par. 68 of the discussion paper, long version). This point in time will usually be different from the point in time where the entity entered into the transaction. If an item is measured at fair value at the (later) point in time when the item can contribute to the generation of future cash flows, we conclude that this implies that any changes in the fair value between the contractual transaction price and the fair value on initial recognition would be recognized in profit or loss (see par. 410 of the discussion paper, long version). We have doubts about the information content of this accounting treatment.

Again, this shows that a discussion focused on measurement bases on initial recognition seems inappropriate. First the related concept of income has to be discussed and this discussion should be based on a common understanding of the purpose of financial statements.

As already mentioned in our general remarks, the discussion paper seems to be based on certain assumptions related to the fundamental questions mentioned above. We do not concur with these assumptions, but we would be willing to discuss them.