НСФО

НАЦИОНАЛЬНАЯ ОРГАНИЗАЦИЯ ПО СТАНДАРТАМ
ФИНАНСОВОГО УЧЕТА И ОТЧЕТНОСТИ

*By e-mail: ed.accounting@cica.ca*

May 19, 2006

Director, Accounting Standards
Canadian Accounting Standards Board
277 Wellington Street West
Toronto, Ontario
M5V 3H2 Canada

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

Dear Sir or Madam,

National Accounting Standards Board of Russia (NASB) appreciates the opportunity to comment on the Discussion Paper referenced above ("the Paper").

NASB supports the work to improve financial reporting while promoting the international convergence of accounting standards. We appreciate the efforts made by the Canadian Accounting Standards Board in summarizing information on various measurement bases to stimulate worldwide debate. Generally, fair value appears to be superior to historical cost incurred decades ago to acquire assets. As impairment is allowed to re-measure assets downward, maybe it is time consider moves towards fair value that would permit upward re-measurement. However, we have broad conceptual and practical concerns with the Paper, which are discussed below. All references in our letter are made to the condensed version on the Paper.

1. Paragraph 5 states that the paper addresses initial measurement in financial statements without dealing with when assets or liabilities should be recognized initially or when re-measurement should take place. If this is the case, the Paper de-facto should apply to re-measurement in financial statements as opposed to initial recognition in the accounting records. However, the rest of the Paper actually discusses initial recognition in the accounting records, which is confusing. As correctly noted in paragraph 7, there is no clean division between initial measurement and re-measurement. We believe that initial measurement and re-measurement in financial statements should be discussed together, whereas initial recognition in accounting records should not be addressed in this paper.

2. Applying fair value model to non-financial instruments that cannot be supported by substantive evidence raises serious reliability issues. We believe that historical cost is the

best basis for initial recognition of most assets. Historical cost is clearly preferable at initial recognition when cash is paid for an asset, except related party transactions. It may be possible to argue that fair values should be used when assets or liabilities are exchanged.

3. Although the authors of the Paper clearly favor market-based over entity-specific measurement, the Paper envisages application of both approaches to different assets and liabilities. Application of both market value and value in use in the same balance sheet will reduce comparability of financial information presented therein.

4. We believe that the Paper should be agreed with the FASB, as it directly affects the convergence project.

5. The Paper does not distinguish between different types of assets and liabilities. Some assets or liabilities can be reliably measured at fair value (financial instruments), others may not (various intangibles, unique equipment). Current measurement rules differently treat various assets and liabilities in different circumstances (e.g. normal operations as opposed to business combinations). This is briefly mentioned in the Paper without sufficient detail.

6. In the modern world, substantial value is created in new hi-tech industries. Fair value measurement in new industries may be complicated and sometimes misleading, as during the Internet bubble. The Paper does not address this issue.

7. Fair values of most financial assets and liabilities in the emerging markets are extremely volatile. Many of these financial markets lack sufficient depth and liquidity, and it is not uncommon for a local market index to move up or down substantially due to investor sentiments. These short-term market swings have little or no impact on operating performance of most local companies. It appears unreasonable to re-measure their operating assets in financial statements due to activities of speculators on the local market. Many emerging financial markets do not meet the definition of an ‘active market’. So this is more a problem of measuring fair value rather than of whether it is, or it is not, reasonable to re-measure assets to the values obtained from such markets.

8. Initial recognition of a new production plant at fair value will result in immediate recognition of the present value of the project’s profit over its entire life, which is not prudent. (The same will apply to goods for resale – profit will be recognized before it is earned). Such an approach in accounting may further hurt the private sector should the tax authorities choose to tax companies based on their unearned income measured at initial recognition. Operating performance will be measured in the income statement as income accrued at the cost of capital. We do not think this is the type of information investors expect to see in the financial statements. As far as we understand, analysts seek adequate disclosure of reliable information, which they can use in their own models.

9. Paragraph 62 of the Paper contains an assumption that there can be only one market (fair) value for an item on any measurement date. This assumption is incorrect. The issue of drafting enforceable rules prescribing measurement at fair market value was encountered and resolved in international taxation. The tax authorities of all developed nations have agreed that there always is a range of market prices for any item on any measurement date. Various countries have different rules to determine this range. Detailed discussion on the issue is provided in OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. Transfer pricing rules are expensive to administer both for the

taxpayers and the tax authorities worldwide, even considering that they normally apply only to cross-border transactions with related parties. Compliance burden is further increased by contemporaneous documentation rules, such as the ones applied in the US. Financial accounting has far less transfer pricing risk, as the risk of setting a price outside the arm's length range normally occurs in transaction with or among subsidiaries that are eliminated in consolidation. Experience of tax transfer pricing rules indicates that fair value measurement at initial recognition of all items obtained from unrelated parties is impracticable, as their cost is normally within an arm's length range of market prices.

10. Ranges of market prices are commonly determined for valuation purposes. If full fair value approach is adopted for financial reporting purposes, at least two sets of financial statements will be required - an optimistic and a pessimistic scenario.

Thank you for the opportunity to present our views. Please do not hesitate to contact me should you wish to discuss this letter in more detail.

Yours sincerely,

Mikhail Kiselev
Chairman
National Accounting Standards Board