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Director, Accounting Standards
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CANADA

Discussion Paper

Measurement Bases on Financial Accounting – Measurement on Initial Recognition

We are responding to your invitation to comment on the above discussion paper on behalf of Norsk RegnskapsStiftelse (the Norwegian Accounting Standards Board).

We have a number of general comments on the setting of this discussion paper. The discussion paper is to represent the first step of IASBs due process for the measurement aspects within the broader conceptual framework project. We believe a measurement discussion preferably should be based on an updated existing framework dealing with the objective and qualitative characteristics of accounting, or alternatively be discusses as a broad solution that includes measurement after initial recognition and framework development. Without yet having received any due process paper from the conceptual framework project we find it hard to comment on this measurement paper as a free standing paper.

Especially we find it difficult to conclude upon measurement on initial recognition when it is not clear to us what the purpose of initial recognition measurement is in relation to the economic performance that the financial statements should portray. Hence, without having a clear understanding of this we are not able to conclude, agree or disagree upon the view that fair value should be the preferred measurement basis on initial recognition. Further to this we would like to emphasize that we also believe that the distinction between entry and exit values should be clarified and discussed in relation to initial recognition and subsequent measurement.

However, we believe that this paper represents a valuable starting point on the current work of IASB on future measurement basis to be applied in accounting standards and a reference for the work on the measurement chapter in a revised framework. We believe that the paper adequately highlights the need for more analysis, research and testing to be carried out before conclusions can be drawn.

It is our understanding that this paper represents an early phase in a long term project to come up with an improved framework and basis for development of future accounting standards and not a first step to the development on a general standard for initial measurement. However, as emphasised above, we do strongly believe there is a need to develop and clarify the proposals set forth in this paper in relation to the main elements of the framework.

The way we read the discussion paper the argument is largely driven by comparative analysis of different measurement basis's for individual assets or liabilities. We believe that there, at this stage, also is a strong need for analysis of the information content of aggregations (e.g. line items, total assets or total liabilities) of the different measurement basis's and the aggregations of different measurement basis's.

From financial instruments we have seen a large number of practical challenges in relation to day 1 profit. Based on these experiences we do believe that a discussion of day 1 gains or losses should be included in the discussion of measurement on initial recognition.

A discussion of market based fair values requires a precise understanding of what constitutes a, or the, market and when a market is present. We believe that more work is warranted in connection with these issues. We are also concerned that the discussion paper seems to assume that efficient

markets exists for most assets and liabilities, while we are of the opinion that such markets normally are more of an exception than a norm. Especially we see a large number of departures from the assumption of efficient markets in connections with business combinations, intangible assets and long term contracts.

An issue possibly closely related to the market issue is the issue of what is the proper "unit of account". We see a principle based and operational resolution of this issue as a key measurement issue and crucial to achieve comparability and enforceability of any standards on measurement.

In recognition of the existing incompleteness of market based fair value measures the discussion paper recommends a hierarchy of measurement basis to be applied. When ever a hierarchy of measurements is to be applied we see a need for clear principles to ensure comparability between entities in the application. Therefore we would like to see an expanded discussion of connections to the qualitative characteristics given in the framework, linkage to general economic measurement theory and practicable enforceability.

Given these general comments we strongly support and recommend further work and research along the issues for further research outlined in the discussion paper and in our general comment above and special answers below.

Our answers to your specific questions are attached below and should be read in conjunction with our general comment above. A number of answers are limited to the phrase "We provide no answer to this question". When this is the case we are refraining from presenting a view and therefore neither supporting nor opposing any views inclined in the question. Generally this is the case when we have a wide divergence of opinions internally and thus no united view externally.

Yours sincerely
Norsk RegnskapsStiftelse

PP 

Erik Mamelund
Chairman

Appendix - responses to specific questions

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.

We agree that the list of identified possible measurement bases contains the bases that should be considered.

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?

We have not done a thorough analysis of this, but on an overall level we agree with the definitions of each of the identified measurement bases as working term definitions at the current stage of the measurement project. We expect a need to reconsider wordings at a later stage in the project.

We would also like to emphasize that we believe there is a need to clarify the concept of fair value, especially in relation to market values vs entity specific values, entry and exit values and transaction costs.

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.

We do currently not have sufficient knowledge on market measurement to conclude that the sources described in a) and b) above are the only set of fundamental sources of differences between asset and liability measurement bases. We believe that there is a need for a better understanding, within the accounting literature and profession, of what constitutes a market and thus when a market measure exists. We currently see a fundamental difference between a market measure and a measure derived by any sub group or observer of the market including the entity preparing the financial statement. Before we have a more thorough understanding of market and market measure we are not able to conclude that the only fundamental different measure is the market measure and the entity-specific measure as opposed to the measure of any individual or group of market participants or observers.

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?**

a) We provide no answer to this question.

b) While not disagreeing with the market definition in the paper we fear that the proposed definition includes too much subjectivity to serve well as a definition for measurement purposes. While knowledgeable, willing and sufficiently are discussed to some extent we fear that it remains too much uncertainty around these terms including what constitutes a (sufficient) body to result in an operating definition of market.

When this is said we believe that the definition can serve as a valuable tool in forthcoming phases of this project. We strongly support further work in this area.

c) We provide no answer to this question.

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 the discussion and conclusions of the paper on entity-specific measurement objectives and their relationship to management intentions.

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.

The comparison of market and entity-specific measurement objectives is based on an implicit assumption that there is a clear understanding of what constitutes market measurements. We find this not always to be the case in practice. In situations where there is a clear understanding of what constitutes a market measurement we agree with the comparison of market and entity-specific measurement objectives.

- 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.

- a) We agree with the conclusion that there can be only one market value for an asset or liability on a measurement point in time. However as indicated in our answers to question 3 and 4 b) seemingly different "market" values might also be due to lacking understanding on when a market value exist and when a fair value is implied from incomplete market data.
b) We agree with the need for further investigations into the reasons for differences between apparent market values for seemingly identical assets or liabilities at the same points in time.

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 a promise to pay has the same fair value whether it is an asset or a liability.

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.

We strongly support the indications in the paper that further analyses and testing has to be carried out on the appropriate unit of account for measurement purposes. We are challenged to identify the principle that is underlying the proposal in (a). We see the proposals in (a) and (b) as starting working hypotheses, but do not see how these hypotheses constitutes a part of a coherent and working measurement theory. Before conclusions can be drawn from the recommended further analysis and testing, we can not give a clean statement of agreements on the propositions regarding the relationship of a portfolio, as opposed to the individual items making it up, or what constitutes the appropriate unit of account or level of aggregation.

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 would like to refer to our initial comments.

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 not provide an answer to this question. Our preliminary view, however, is that we do not disagree with the conclusion that transaction costs, as defined, are not part of the fair value of an asset or liability.

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 feel compelled by the proposal that, when more than one measurement basis achieves an acceptable level of reliability, the most relevant of these should be selected, however do to the lacking discussions of the information content and relevance of aggregations of different measurement basis's we are not able to draw a final conclusion on this issue.

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 agree with the discussion in the paper on this issue.

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.

We provide no answer to this question. The reason is that we find it difficult to conclude upon measurement on initial recognition when it is not clear to us what the purpose of this exercise is in relation to the economic performance that the financial statements should portray. Hence, without having a clear understanding of this we are not able to conclude or agree upon the view that fair value should be the preferred measurement basis on initial recognition.

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.

- d) We agree, but even though it is easy to agree with this wording it would probably be many times in practice that these situations might occur. As we have mentioned earlier, the understanding of what constitutes a market is important to clarify, and in this relation it is key underlying factor in determining whether the exchange price for the asset in question should be accepted to be equal to fair value. In reality, even if there is not persuasive evidence that a single exchange price would be equal to fair value, the transaction price paid or received could be assumed to be a reasonably approximation or a reasonable representation of fair value at initial recognition.**
- e) We agree, but the difference between "market expectations" and "entity specific expectations" are not always easy to differentiate. Even though this distinction clearly can be described theoretically, in practice many of the expectations of the market participants are influenced by entity specific expectations.**

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.**

The description and discussion in the paper clearly is focusing on the strengths of fair value and the weakness of historical cost. Even though this could be theoretically correct we do believe that the

discussion paper should try to elaborate more on the weaknesses of fair value and the strengths of historical cost. One important aspect that could have been discussed in more "in-depth" detail is the fact that it will in many instances not be an efficient market for the asset or liability in question. Based on this we have some problems to see why historical cost can not be used as a reasonably approximation to fair value. Historical cost is not subject to the same degree of entity specific measurement influence as other entity specific measures.

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 believe it is difficult, without clarifying and further strengthening the understanding of what constitutes a market, to understand the full meaning of "consistent as possible with the fair value measurement objective". We do therefore believe that this should be elaborated and described in more clarity in the discussion paper. We believe more clarity is needed to ensure that entities, in circumstances where efficient markets don't exist, are able to have a clear understanding of which other measurement basis is most consistent with fair value.

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.

Based on our initial comments we are not in a position to answer this question. We need to see the other pieces of the measurement puzzle before we can have a firm view on this.

Q19. Do you have comments on any other issues or proposals, including the proposals for further research? If so, please provide them.

Please see our initial remarks on information content of aggregated numbers based on mixed measurement basis's.