COMMENT LETTER

By e-mail: commentletters@iasb.org

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Re: Discussion Paper Fair Value Measurements

Dear Mr. Nelson,

National Accounting Standards Board of Russia appreciates the opportunity to submit comments to Discussion Paper Fair Value Measurements (hereinafter, DP). We are generally concerned that the DP attempts to oversimplify valuation process, obtaining an objective but not necessarily correct figures. In our view, current IFRSs as principles-based standards to a greater extent permit the use of entity-specific data in valuation process, which results in more faithful fair value estimates. Russian Society of Appraisers substantially contributed to our deliberations.

***Question 1**. In your view, would a single source of guidance for all fair value measurements in IFRSs both reduce complexity and improve in measuring fair value? Why or why not?*

We support a single source of guidance for all fair value (FV) measurements. We believe that specific FV measurement provisions should be removed from the standards and replaced by references to the paragraphs of the FV guidance. This will eliminate potential contradictions between the FV guidance and the standards. As the FV guidance will contain important provisions, the IASB should make a decision on the status of the document, i.e. whether the guidance will be an IFRS or Implementation Guidance.

***Question 2**. Is there fair value measurement guidance in IFRSs that you believe is preferable to the provisions of SFAS 157? If so, please explain.*

In Russia valuation activity is regulated by the state, and federal valuation standards are based on International Valuation Standards (IVSs). Any divergence of the IASB FV guidance from IVSs may create practical difficulties for Russian entities, as it is unclear whether the IASB FV guidance can be adopted in Russia in such a manner that it can override federal valuation standards. Thus, IFRSs could refer to investment value or market value instead of fair value where appropriate in order to use valuation profession's terminology.

***Question 3**. Do you agree that fair value should be defined as an exit price from the perspective of a market participant that holds the asset or owes the liability? Why or why not?*

We do not agree that fair value should be defined as an exit price from the perspective of a market participant that holds the asset or owes the liability. The definition referring to an arm's length price should be preserved.

Exit price appears to be far more subjective than a general reference to an arm's length price in current IFRSs. This approach may be justified in the current US GAAP where fair value concept mainly applies to financial instruments. Dealers in the US provide continuous pricing and liquidity for financial instruments, which makes exit prices and bid-ask spreads easily observable.

IFRS are often applied in emerging markets, where financial markets may be less developed. IFRS allow revaluation of property, plant and equipment which will expand the scope of IFRS FV guidance application. One of the problems identified by our constituents is measurement of recently acquired assets in emerging markets. Other potential buyers may not be willing to pay a similar price for the asset, whereas the reporting entity might not intend to resell the asset.

***Question 4**. Do you believe an entry price also reflects current market-based expectations of flows of economic benefit into or out of the entity? Why or why not? Additionally, do you agree with the view that, excluding transaction costs, entry and exit prices will differ only when they occur in different markets? Please provide a basis for your views.*

In certain cases entry prices reflect the flows of economic benefits into or out of the entity. Relationship of transaction costs, entry and exit prices is distorted in illiquid markets. In such markets, it is necessary to consider intention of an entity in order to faithfully represent the flows of economic benefits. For example, an asset may generate significantly different economic benefits depending on whether it is sold or used by an entity, and if so how it is used. This difference is recognized in valuation standards.

***Question 5.** Would it be advisable to eliminate the term 'fair value' and replace it with terms, such as 'current exit price' or 'current entry price', that more closely reflect the measurement objective for each situation? Please provide a basis for your views.*

We believe that elimination of the term "fair value" would not be advisable. Bid-ask spreads always disadvantage an entity, unless it is a market maker. However, in reality an entity would incur the cost of a bid-ask spread only if it sells the asset. Assumption that such a sale would occur contradicts going concern principle and often does not reflect economic reality. Therefore, we do not support replacing "fair value" with "current exit price".

***Question 6.** Does the exit price measurement objective in SFAS 157 differ from fair value measurements in IFRSs as applied in practice? If so, which fair value measurements in IFRSs differ from the measurement objective in SFAS 157? In those circumstances, is the measurement objective as applied in practice an entry price? If not, what is the measurement objective applied in practice? Please provide a basis for your views.*

We believe that the exit price measurement objective in SFAS 157 differs from fair value measurements in IFRS as applied in practice. Valuation professionals use several types of value that apply in different circumstances. For example, capital expenditures should be valued at entry price. Presumably, the buyer will go through the same valuation procedure as the seller. The IASB FV guidance can enumerate different types of value and stipulate which is fair value in which case. A good attempt to do so was made in the discussion paper Measurement on Initial Recognition.

Question 7. *Do you agree with how the market participant view is articulated in SFAS 157? Why or why not?*

We would not agree with how the market participant view is articulated in SFAS 157. The newly introduced principal market requirement is different from both current IFRSs and the market value definition in valuation standards. In our view, markets should not be artificially segregated. We believe that market participants should be independent, knowledgeable, willing and able to transact, but we would not agree that market participants definition should be restricted to the principal market only.

Question 8. *Do you agree that the market participant view in SFA S 157 is consistent with the concepts of 'knowledgeable, willing parties' and 'arm's length transaction' as defined in IFRSs? If not, how do you believe they differ?*

SFAS 157 view is consistent with the concepts of 'knowledgeable, willing parties' and 'arm's length transaction' but not vice versa. IFRS concepts are broader and permit the use of various appraisal methods developed by valuation profession.

Question 9. *Do you agree that the fair value of a liability should be based on the price that would be paid to transfer the liability to a market participant? Why or why not?*

We agree, if market participants are not restricted to principle market only.

Question 11. *In your view is it appropriate to use a measurement that includes inputs that are not observable in a market as fair value at initial recognition, even if this measurement differs from the transaction price? Alternatively, in your view, in the absence of a fair value measurement based solely on observable market inputs, should the transaction price be presumed to be fair value at initial recognition, thereby potentially resulting in the deferral of day-one gains and losses? Please give reasons for your views.*

We believe it is not appropriate to use a measurement that includes inputs that are not observable in a market as fair value at initial recognition, even if this measurement differs from the transaction price. Transaction price is normally a better indicator of fair value than an estimate, even if it is based on market indicators. In our view, initial recognition should be based on transaction price that may subsequently be re-measured based on observable market inputs, even if this results in a deferral of one-day gains and losses. Resulting data will be less subjective and thus more reliable and relevant, especially in the emerging markets.

Question 13. *Do you agree that a fair value measurement should be based on the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability? Why or why not?*

We disagree with this statement. This question appears to be aimed at establishing a rule for fair value measurement. This is hardly possible if standards are to remain principles-based. A general definition of fair value as an arm's length price would be sufficient. Any details such as the hierarchy of markets may be provided as explanation only, as appraisers have valuation techniques that are widely applied by market participants for pricing arm's length transactions. The same techniques must be used for financial reporting purposes; otherwise decision usefulness of financial statements may be compromised. Besides, the principal market and the most advantageous market concepts seem vague. It is unclear whether only geographical characteristics and confines of markets are implied, or market boundaries with respect to diverse categories of bidders also enter into consideration, e.g. markets composed of synergistic purchasers might be most advantageous markets, but existing-use market participants would form a majority of bidders, as might be expected were the property to be assigned for sale. Are those two types of bidders actually operating in different markets? Is a merger and acquisition market, where shares are bought en bloc, a distinct market as opposed to ordinary transactions on stock exchanges? Some additional guidelines would be needed, as the issue is closely intertwined with the highest and best use principle, and might be addressed integrally in conjunction with it (i.e. future IASB Fair Value Measurement Standard would need to contain a specific section under the heading of the "highest and best use principle"). In view of the foregoing, we believe that standards do not need to refer to the principal market.

Question 14. *Do you agree that a fair value measurement should consider attributes specific to the asset or liability that market participants would consider in pricing the asset or liability? If not, why?*

We agree.

Question 15. *Do you agree that transaction costs that would be incurred in a transaction to sell an asset or transfer a liability are an attribute of the transaction and not of the asset or liability? If not, why?*

Transaction costs relating to tangible assets may be substantial, especially where de-installation and transportation is involved. In certain cases, it may be necessary to consider them in fair value measurements.

Question 16. *Do you agree that the risk of non-performance, including credit risk, should be considered in measuring the fair value of a liability? If not, why?*

We disagree, as this would contradict going concern assumption. Financial statements must assume that debts are to be repaid in full, unless the liability has already been reduced by contract or by law. It is not prudent to permit entities to reduce their liabilities based on their perceived inability or unwillingness to pay, as this may mislead both debt and equity investors. In many jurisdictions civil law protects creditors by requiring entities to maintain certain minimum net assets, and balance sheets are important to regulators in assessing potential difficulties of entities.

Furthermore, it is unclear how credit risk can be considered in measuring the fair value of a liability if a liability's fair value is defined as the price that would be paid to transfer the liability to a third party. Presumably, this third party is a going concern, will be expected to repay the liability in full, and the price payable to transfer the liability will be effectively a loan to this third party and reflect the latter's credit risk, not the risk of the original borrower.

Question 17. *Is it clear that the 'in-use valuation premise' used to measure the fair value of an asset in SFAS 157 is different from 'value in use' in IAS 36? Why or why not?*

We believe it is clear that "in-use valuation premise" is different from "value in use". The in-use valuation premise refers to Fair Value that, by its nature, belongs to the value-in-exchange family. Value-in-use refers to an entity, being in valuation theory antithetically distinct from value-in-exchange. SFAS 157 drafters have developed a detailed interpretation of the premises in the Standard Implementation guidance section (SFAS #157 Appendix A, pp. A4-A5). The IVSC has recently incorporated the notions of in-use and in-exchange valuation premises in relation to Market Value in the IVS's Guidance Note 3 "Valuation of plant machinery and equipment". So, we observe a convergence of thinking in this respect between international accounting and valuation communities.

As far as we know, the IVSC is going to introduce significant changes to the International Valuation Standards in 2007 that will affect, in particular, value in use. In our view, both accounting and valuation professions would benefit if the IASB and the IVSC could coordinate their definitions.

Question 18. *Do you agree with the hierarchy in SFAS 157? If not, why?*

We generally agree with an important reservation. The hierarchy attempts to introduce a structure to subjective judgment. It would be more logical to discuss such issues after conceptual framework issues are resolved and a new framework adopted.

Question 19. *Are the differences between the levels of the hierarchy clear? If not, what additional information would be helpful in clarifying the differences between the levels?*

We believe that the hierarchy is generally clear, however entity specific measurement is to be specified within the third level of hierarchy to distinguish it from market participant view.
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Question 20. *Do you agree with the provision of SFAS 157 that a blockage adjustment should be prohibited for financial instruments when there is a price for the financial instrument in an active market (Level 1)? In addition, do you agree that this provision should apply as a principle to all levels of the hierarchy? Please provide a basis for your views.*

We understand that the question only refers to blockage adjustments and does not cover control premiums or discounts. We would like to stress, that in our view control premiums should be considered for listed instruments. A stock market bubble may turn control premium into a control discount. There must be room for professional judgment even when exchange quotations exist.

Limited free-float of a security may disadvantage its holder. This makes it imprudent for the IASB to prohibit blockage adjustment for the financial instruments in an active market. The IASB may permit not to account for blockage adjustment on the face of financial statements; however it may be useful to encourage disclosure of liquidity limitation in the notes without necessarily quantifying blockage adjustment.

The issue of blockage adjustments across Level 2-3 Fair value hierarchy is more controversial Business Valuers often value blocks of shares of unquoted entities proceeding from the 100% equity capital value of the business (based on the application of income or cost approach) and in this case lack -of -control discounts or adjustments for differences in the level of control are incorporated into calculations of the block value: this is a wide-spread Business Valuation industry practice, even though it is sometimes difficult to defend from the point of view of valuation theory. Account should be taken of these circumstances and business valuation conventions in elaborating blockage adjustment guidance, or the prohibition to use blockage adjustments should be explained on theoretical grounds.

Question 21. *Do you agree that fair value measurements should be determined using the price within the bid-ask spread that is most representative of fair value in the circumstances, as prescribed by paragraph 31 of SFAS 157? Alternatively, do you believe that the guidance contained in IFRSs, which generally requires assets to be valued at the bid price and liabilities at the ask price, is more appropriate? Please explain the basis for your view.*

We agree that fair value measurements should be determined using the price within the bid-ask spread that is most representative of fair value in the circumstances, as prescribed by paragraph 31 of SFAS 157. If a particular standards prescribes measurement at fair value less transaction costs, bid price for assets and ask price for liabilities will be more appropriate.

Entities might abuse the notion of representativeness on some emerging illiquid markets, where spreads are wide and are on the order of multiples between the low and high of the range, this question assumes a far greater significance. In such situations, IFRS insistence on bid prices for assets allows a reality check on representativeness speculations of the preparers of financial statements. In our view, professional judgment is required to determine what price within the bid-ask spread represents fair value in a particular case.

Question 22. *Should a pricing convention (such as mid-market pricing or bid price for assets and ask price for liabilities) be allowed even when another price within the bid-ask spread might be more representative of fair value? Why or why not?*

We believe that a pricing convention can be allowed to reduce compliance costs. However, in (especially, Level 2) situations when spreads are wide and their impact upon general sensitivity of measurements is substantial, entities should also be permitted to investigate the structure of spreads, rather than fall back on any specific convention. In the absence of an efficient dealer market, many reporting entities may wish to determine a proper arm’s length price, as a pricing convention will frequently give an arbitrary figure.

Question 23. *Should bid-ask pricing guidance apply to all levels of the hierarchy, including when the fair value measurement includes unobservable inputs? Why or why not?*

When the fair value measurement includes unobservable inputs, such measurement should be made using the same methods that would be used by knowledgeable and willing parties in an arm’s length transaction. Even if a pricing convention mentioned in Question 22 is permitted in such situations, unobservable bid-ask spreads are unlikely to be measured reliably. This proves again that an arm’s length fair value principle should not be replaced by bid-ask pricing rules.

Question 24. *Do the disclosure requirements of SFAS 157 provide sufficient information? If not, what additional disclosures do you believe would be helpful to users and why? Alternatively, are there enclosures required by SFAS 157 that you believe are excessive or not beneficial when* *considered in conjunction with other disclosures required by IFRSs? Please provide a basis for your view.*

We generally believe that the disclosures envisaged by SFAS 157 are sufficient. In our view, an entity should disclose the valuation technique used and whether an independent appraiser performed valuation. If a reference to valuation report is made from the financial statements, such valuation report should not be confidential. If an independent appraiser was not involved, financial statement users will benefit from the disclosure of valuation procedure. However, such disclosure would entail additional costs, as the auditor would not only verify the final figure, but also the valuation procedure used by the entity. Therefore, the Board could encourage such disclosure without requiring it.

Question 25. *Does the guidance in Appendices A and B of SFAS 157 sufficiently illustrate the standard's principles and provisions as they would apply under IFRSs? If not, please specify what additional guidance you believe is needed and why.*

Guidance in Appendix B SFAS 157 is certainly important and should be retained in the future IFRS. As to the content of Appendix A, it is well-fitting for the structure of SFAS 157. However, certain revisions and additions might be suggested for its inclusion into the IFRS Standard: in our view, it is necessary to:

(1) add interpretation of the theory behind fair value so as to link it up with other measurement bases (for example, with the 'IFRS Measurement Bases for Financial Reporting' project); and/or

(2) refer users of the future IFRS Standard to the basics of valuation theory contained in the International Valuation Standards;

(3) indicate the status of IVSs in connection with accounting fair value measurements; and

(4) explore the issue of bid –ask spreads in connection with entry/exit prices.

We believe that any additional guidance should be concise.

Question 26. *Does the guidance in Appendices A and B of SFAS 157 sufficiently illustrate the standard's principles and provisions as they would apply in emerging or developing markets? If not, please specify what additional guidance you believe is needed and the most effective way to provide this guidance (for example, through additional implementation guidance or through focused education efforts).*

The Standard and its Appendices should not concern themselves with country-specific guidance or general features of valuation on emerging markets. Provision of such implementation guidance should be left within the scope of national accounting and valuation bodies. There is little difference in the measurement objectives between developed and emerging markets, so educational efforts are likely to be forthcoming from those quarters to accommodate the international best practice in the area of accounting and valuation.

Question 27. *Please provide comments on any other matters raised by the discussion paper.*

General comments: in our view, the current general fair value definition used by IASB should be fully retained for purposes of the IFRS fair value measurement project. However, the interpretation of this definition should be minutely elaborated: a paragraph should be drawn up explaining the differences and similarities between market value concept (since it is already being used in the current body of IFRSs, egg IAS 16) and Fair Value.

Thank you for the opportunity to present our views.

Yours sincerely,

Mikhail Kiselev
Chairman
National Accounting Standards Board