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September 9, 2010
Technical Director
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

File Reference: No. 1830-100

Dear Mr. Golden:

The Financial Reporting Executive Committee (FinREC) of the American Institute of Certified Public Accountants is pleased to offer comments on proposed FASB Accounting Standards Update (ASU), “Fair Value Measurements and Disclosures (Topic 820) - *Amendments for Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs.*” FinREC supports the continuing efforts of the FASB and the International Accounting Standards Board (IASB) to develop common requirements for measuring fair value and for disclosing information about fair value measurements in accordance with U.S. generally accepted accounting principles (GAAP) and International Financial Reporting Standards (IFRSs).

We have three fundamental concerns with the proposed ASU. The proposed ASU:

1. Changes the highest and best use concepts in ways that will cause a significant change in practice, be inconsistent with market participant assumptions and cause confusion about the determination of unit of account,
2. Excludes the ability to use market participant assumptions as applied to an appropriate unit of valuation, and
3. Requires burdensome additional disclosures that are not practical to prepare or audit, with questionable additional value for users.

There is confusion and diversity in practice today in identifying the appropriate unit of account and applying concepts such as minority discounts, illiquidity discounts and control premiums. The changes in the proposed ASU will not resolve existing diversity in practice. We believe the proposed changes will increase confusion and would have the affect of moving away from the principle of determining fair value based on market participant assumptions.

The remainder of this letter provides greater detail surrounding these concerns, provides FinREC’s responses to certain questions for respondents raised in the proposed ASU, and provides some additional specific comments.

Question 1

We agree with the overall premise of developing common fair value measurement and disclosure guidance with the aim of having consistent comparable fair value measurements and disclosures under US GAAP and IFRS.



However, we are concerned that some provisions of the proposed ASU will not result in consistent fair value measurements or disclosures for a number of businesses. We further believe that certain proposed amendments would lead to unintended consequences. Our specific concerns are addressed in our responses to other questions.

Question 2

We are concerned about the Board's decision to specify that the concepts of highest and best use and valuation premise are only to be applied when measuring the fair value of nonfinancial assets. This will cause a significant change in practice. We believe there are situations in which financial assets and liabilities should be valued as a group to be consistent with market participant assumptions. We believe that imposing a restriction on application of highest and best use and in-use valuation premise can lead to fair value measurement results that may be contrary to the economics of certain transactions and to the principles of fair value measurement, including the market participant concept. If these concepts are eliminated, we believe that for certain financial assets and liabilities the resulting fair value measurements would be different from those determined under current guidance and those measurements would not necessarily be better or more meaningful for users of financial statements.

One example is when a reporting entity owns various tranches in the capital structure of a company, such as a controlling equity interest and debt. Historically, in this situation, debt and equity have been valued as if they would be transacted together. With the elimination of the concepts of highest and best use and valuation premise for financial assets and liabilities, we are concerned that reporting entities will no longer be able to consider controlling equity ownership when valuing debt and will be forced to value debt and equity individually without taking into account a market participants perspective that claims on the capital structure of a private company by the same owner should be grouped when determining its value. The new approach would result in a change in practice and in a fair value measurement different from the one derived under the current approach, and specifically affecting the measurement of the debt. We believe that in control situations it is more appropriate to determine the fair value of the claim on the capital of a company as if transacted in combination, rather than to value individual instruments as would be required by the proposed ASU. This is because when an investor controls an underlying company, the investor often can control or impact the overall capital structure and can decide to convert debt to equity or equity to debt. The proposed change would impact not only entities that directly own various tranches in the capital structure of an investee company, such as private equity or venture capital funds, but it would also directly impact investors in such funds which generally use net asset value (NAV) as a practical expedient to estimate the fair value of their investments. Entities in various industries often invest in private equity and venture capital funds, including investment companies, broker-dealers, banks, insurance companies, employee benefit plans, healthcare organizations, and not-for-profit organizations. All of these industries would be impacted by the proposed change in measurement.

Accounts receivable is another example in which the elimination of the concepts of highest and best use and valuation premise for financial assets and liabilities may result in a different fair value measurement. In a



business combination, the book value of accounts receivable, accounts payable and other working capital items¹ is often equivalent when aggregated to their fair value because a market participant generally pays par value for working capital in a transaction or specifies a dollar for dollar adjustment for changes in working capital. While the Board's proposed financial instrument standard would not require short-term accounts receivable or accounts payable to be reported at fair value if certain criteria are met, upon initial measurement in a business combination the proposed elimination of the concepts of highest and best use and valuation premise would result in a change in which market participants could be considered when valuing accounts receivable and other working capital items. Under the current guidance, fair value of accounts receivable and other components of working capital are generally estimated by applying an in-use valuation premise assuming that their highest and best use would be within a reporting entity's ongoing business operations in combination with other working capital items. Under the proposed ASU, the fair value of accounts receivable would need to be determined separately from other working capital items and would generally be based on their transfer to a market participant engaged in the business of acquiring accounts receivable. In this instance, the fair value of accounts receivable would typically be lower than the fair value determined under the in-use valuation premise and the carrying amount as a result of incorporating a profit element to the market participant.

Because accounts receivable are generally used in combination with other working capital items, their fair value measured on an individual basis would not provide users of financial statements with more relevant information. Furthermore, fair value measurement of accounts receivable that does not consider how an entity manages its business would be inconsistent with the Board's view on financial instruments expressed in paragraph BC26 of the proposed ASU (see our response to Question 4 for further information).

Question 3

We do not disagree with the proposed guidance for measuring the fair value of an instrument classified in shareholders' equity. However, in situations in which an entity records gains or losses resulting from changes in the fair value of its own equity instruments we are not clear what the other side of the journal entry would be and whether such gains or losses would be treated consistently. We believe that additional guidance may be needed in this area to specify in which situations a component of equity should be reported on a fair value basis and whether changes in fair value should be reported within net income or other comprehensive income.

Question 4

We do not agree with the Board's decision to label the fair value of a group of financial assets and financial liabilities that are managed on the basis of the reporting entity's net exposure to a particular market risk (or risks) (that is, interest rate risk, currency risk, or other price risk) or to the credit risk of a particular counterparty as an exception to fair value measurements. To the extent that a market participant perspective would be to transaction such assets and liabilities on a combined, or group, basis, we believe that the resultant fair value estimate is consistent with the principles of topic 820 and should therefore not be deemed an exception. Furthermore, we believe that there are other situations in which a market participant would look at a group of

¹ According to the FASB ASC master glossary, working capital is represented by the excess of current assets over current liabilities and identifies the relatively liquid portion of total entity capital that constitutes a margin or buffer for meeting obligations within the ordinary operating cycle of the entity.



assets and liabilities, for example, securitized loans and as noted in our response to Question 2 above. As noted above, it would be appropriate to use the highest and best use or in-use premise when measuring the fair value of certain financial assets and financial liabilities. It appears inconsistent to with the market participant perspective to label net assets and liabilities managed as a group as an exception to fair value measurement. It further appears inconstant with the principles of topic 820 to prohibit valuing assets as a group whose highest and best use is in a group.

The explanation of Board's rationale in the Basis of Conclusions section for providing an exception for financial assets and liabilities that are managed on the basis of a reporting entity's net risk exposure further supports the need to retain the concepts of highest and best use and valuation premise for financial assets and liabilities. Specifically, paragraph BC26 states the following:

The Board believes that the accounting for financial instruments should provide information about the risks inherent in financial instruments on the basis of how a reporting entity manages its business so that users of financial statements can assess the amounts, timing, and uncertainty of future cash flows.

If the concepts of highest and best use and valuation premise for financial assets and liabilities are eliminated, the resulting accounting will not reflect the risks inherent in financial instruments on the basis of how a reporting entity manages its business, how a market participant views the financial instruments and will not provide users of financial statements with relevant information.

Question 5

We understand that the Board's use of the term "blockage" is in the context of selling sufficient volume of an actively traded stock at one point in time such that the market price is depressed, or cannot be achieved. We further understand that the Board has deemed it appropriate to ban discounts for such a situation, not only for Level 1 measurements, but now for all measurements. We agree that the Board's clarification of the meaning of blockage factor and the prohibition of using a blockage factor in any level of the fair value hierarchy is inherently more consistent. However, we do not believe that prohibiting the use of blockage factors will result in better fair value estimates.

Many preparers and users of financial statements interpret the concept of blockage more widely than as defined by the Board. In addition, some assets or liabilities are only traded as a block. For example, an investment by an alternative asset manager in an underlying private company is normally traded in its entirety, not share by share. Therefore, the prohibition of using the concept of blockage causes all assets to be implicitly valued on an individual share basis, rather than at the level that the asset would be transacted (the entire private company, or an entire block of publicly traded stock). While the Board may not wish to re-open debate on the use of blockage factors for Level 1 inputs, we do not believe the Board should prohibit the use of the blockage concept from valuing assets using Level 2 and 3 inputs.

Question 6

We agree with the Board's decision to acknowledge that all features of an asset or liability should be taken into account in fair value measurement, including features such as control. However, we believe that other provisions of the proposed ASU (specifically, the elimination of the concepts of highest and best use and



valuation premise for financial assets and liabilities and the requirement to focus on the unit of account used for the related asset or liability as defined in other accounting standards) would not allow reporting entities to apply control premiums and noncontrolling interest discounts. Further, while concepts such as a control premium or minority discount are commonly used in theoretical valuation discussions, some accountants and valuation professionals question whether a control premium or a minority discount is measurable, and to what extent it is observable in a business transaction.

We believe that the proposal will result in inconsistent estimates of fair value. For example, investment companies are required by FASB ASC 946 to report underlying investments at fair value. FASB ASC 946 does not clearly define the unit of account for investments in private companies; current practice is to determine the amount that would be received if the entire holding (or block) of the private company were sold. Features, such as control, are included in the fair value estimate, which, under current practice, is based on the amount that a market participant would pay for the entire portion of the underlying investee company owned by the investment company. Because FASB ASC 946 is silent on the unit of account, the provisions of FASB ASC 820-10-35-36B combined with the Board's prohibition of the use of blockage for assets such as these would likely be interpreted to require that individual shares of the underlying investee company be valued rather than the entire holding. Therefore, while the Board appears to be supportive of including concepts such as control in estimating the fair value of a private company, the impact of the current wording would be the opposite—all investments would be valued on a single share, or minority interest, basis.

Question 7

We do not support the Board's decision to require a reporting entity to disclose a measurement uncertainty analysis for recurring fair value measurements categorized within Level 3 of the fair value hierarchy. We are concerned that these disclosure amendments are not operational and they would not necessarily provide users of financial statements with meaningful information, especially for complex instruments with multiple variables (inputs).

Entities often use a pricing vendor (or broker) to determine Level 3 fair value measurements. These vendors often have proprietary pricing models. Therefore, it may be difficult, if not impossible in certain circumstances, for an entity to effectively determine other inputs "that could have reasonably been used in the circumstances." In addition, inputs to models often are interrelated. Changing one input in many cases will require that other inputs also be modified. The number of permutations in even simple models will lead to the disclosure of significant amounts of information with questionable value. As a result, the quality of such disclosures may be lacking even when entities are trying to comply with the spirit of the requirements.

Furthermore, the example provided on p. 127 of the proposed ASU seems to imply that an entity which invests in venture capital, private equity or hedge funds and, most likely, uses NAV as a practical expedient for estimating fair value of those investments, would need to provide the measurement uncertainty disclosures. We are concerned that information needed for such disclosures in many cases will not be available to investors (preparers). This is because the fund itself, which generally would be an investor's primary source of information, would not need to provide measurement uncertainty disclosures for its investments in private companies due to the exception in the proposed Financial Instruments standard.



Also, in connection with the exception for measurement uncertainty disclosures provided in the proposed Financial Instruments standard, we are concerned that if this proposed ASU is implemented before the Financial Instruments standard, there could be a period during which disclosures about measurement uncertainty would be required for investments in equity securities of private companies only to be later eliminated by the Financial Instruments standard which would not be effective for many investment companies until 2017.

If the Board decides to proceed with these disclosure amendments, we urge the Board to review experience with such disclosures in financial statements prepared under IFRS standards and consider whether analysts perceive this information as useful.

Question 8

With respect to alternative disclosures to the proposed measurement uncertainty analysis, we believe that identification of the key unobservable inputs as part of the disclosure of the inputs utilized in developing the fair value measurement would serve to alert readers as to what factors might have an impact and are most subjective. The calculation of the impact is not relevant in a complex valuation as it implies a degree of certainty about the variables that does not exist. Further, as discussed in our response to Question 7, if a number of individual assets or liabilities are being valued, each with independent and unrelated inputs, upon aggregation, the resultant end points of the range of values would more than likely be deemed remote. Any aggregation of non-homogeneous assets valued using non-homogeneous inputs would result in near meaningless disclosure. We believe that disclosing the nature of those unobservable inputs that are key inputs, from a qualitative rather than a quantitative perspective is more critical to a reader's understanding of what is driving the valuation and would allow users to arrive at their own conclusions regarding the appropriateness of those factors.

Question 9

We agree with the Board's decision to require limited retrospective transition.

Question 10

As discussed in our responses to other questions, we believe that if the proposed ASU is finalized in its current state it would result in changes in practice which would need transition guidance. However, we believe that the effective date and transition guidance should be the same for the entire proposed ASU.

Question 11

Conceptually we agree that the proposed ASU should apply to all entities reporting fair value of financial and non-financial instruments. However, we believe that the proposed ASU does not enhance or support high quality financial reporting for a number of industries for the reasons outlined above. For example, we believe the proposed ASU will not lead to improved accounting and disclosures for employee benefit plans, healthcare organizations, and not-for-profit organizations, just to name a few. Significant costs required to implement the proposed ASU will cause those entities to reduce mission oriented resources (in the case of not-for-profit organizations) or benefits distributed to employees (in the case of employee benefit plans.) Furthermore, we do



not believe that primary users of those entities' financial statements will benefit from additional disclosures. We also believe that some of the provisions in this proposed ASU are inconsistent with the Board's decision reached in ASU 2009-12 (which permitted, as a practical expedient, a reporting entity to measure the fair value of certain investments on the basis of NAV) and, more recently, the Board's tentative decision in EITF Issue No. 10-C (which would change the classification of participant loans of an employee benefit plan from "investments" to "notes receivable" and, therefore, would allow participant loans not to be measured at fair value.) When making those decisions, the Board focused on primary users of financial statements and information that would be relevant to those users. Consistent with this approach, we believe that the Board should re-examine provisions in the proposed ASU focusing on their impact on primary users of financial statements.

Question 12

Given that a number of entities depend on service providers for information that will be needed to implement this proposed ASU, we believe that when determining the effective date it is important to consider how much time service providers will require to modify their systems to provide their users with needed information. We believe that a year and a half should provide service providers, and therefore their users, a sufficient lead time needed for implementation of this proposed ASU. Furthermore, we recommend that the Board considers effective dates for all of its convergence projects when establishing the effective date of this proposed ASU. However, we believe that, at a minimum, the effective dates of this proposed ASU and the proposed Financial Instruments standard should be consistent (for the reasons outlined in our response to Question 7.)

Other Matters

Elimination of "undue cost and effort" concept. The proposed ASU would renumber and amend the original paragraph 820-10-35-55 as follows:

820-10-35-54A ~~Unobservable inputs shall be developed based on~~ A reporting entity shall develop unobservable inputs using the best information available in the circumstances, which might include the reporting entity's own data. In developing unobservable inputs, ~~the~~ reporting entity may begin with its own data, which shall be adjusted if reasonably available information indicates that other market participants would use different data or there is something particular to the reporting entity that is not available to other market participants (for example, an entity-specific synergy). A reporting entity need not undertake ~~all possible~~ exhaustive efforts to obtain information about market participant assumptions. However, ~~the~~ reporting entity shall not ignore information about market participant assumptions that is reasonably available. ~~available without undue cost and effort. Therefore, the reporting entity's own data used to develop unobservable inputs shall be adjusted if information is reasonably available without undue cost and effort that indicates that market participants would use different assumptions. Paragraph 820-10-55-22 discusses Level 3 inputs for particular assets and liabilities. Unobservable inputs developed in the manner described above are considered market participant assumptions and meet the objective of a fair value measurement.~~



We are unclear as to why the reference to “undue cost and effort” is being deleted. Practitioners may start question this change and whether there is some intent behind it. Therefore, we believe it would be helpful if the Board could address this change and the reasoning behind it in the Basis for Conclusions section.

Comparative disclosures. The proposed ASU would amend FASB ASC 820-10-50-2 as follows:

~~To satisfy the objectives-principles in of the preceding paragraph, the reporting entity shall disclose, at a minimum, all of the following information (except as specified in paragraph 820-10-50-2B) in (a) through (e) below for each interim and annual period separately for each class of assets and liabilities-liabilities (see paragraph 820-10-50-2C for information on determining appropriate classes of assets and liabilities) measured at fair value in the statement of financial position after initial recognition. The reporting entity shall determine appropriate classes of assets and liabilities on the basis of guidance in the following paragraph. It shall provide sufficient information to permit reconciliation of the fair value measurement disclosures for the various classes of assets and liabilities to the line items in the statement of financial position.~~

These amendments include deleting reference to “each interim and annual period.” We are concerned that this change could lead constituents to interpret that fair value disclosures are not required to be comparative when comparative financial statements are presented. We understand that the Board’s intent was to require that disclosures be comparative and, therefore, we recommend clearly communicating this requirement in the proposed ASU. Given that even under the current guidance there has been some debate as to whether disclosures are required to be comparative, we recommend strengthening the language to indicate that required disclosures should be provided for “each reporting period presented.”

Disclosure when a reporting entity uses an asset in a way that differs from the asset’s highest and best use. We believe that an entity should not be required to provide a disclosure when an asset is not being used in a manner consistent with its highest and best use. We believe that such disclosures will not provide users of financial statements with helpful information. .

Calibration. Paragraph 820-10-35-35C of the proposed ASU reinforces the need to calibrate the initial transaction price (if it represents fair value) with the valuation techniques used in future fair value measurements. We believe that the revised wording is confusing and may result in inconsistent application of the concept of calibration and the need to use judgment at each measurement date. We suggest that the paragraph be modified as follows:

820-10-35-35C If the transaction price represents fair value at initial recognition and a valuation technique that uses unobservable inputs will be used to measure fair value in subsequent periods, the valuation technique and inputs shall be calibrated so that at initial recognition ~~it equals they result in fair value~~ (the transaction price). Calibration ensures that the valuation technique and inputs reflects current market conditions and helps a reporting entity to determine whether ~~an~~ adjustments to the valuation technique and inputs are ~~is~~ necessary at future measurement dates ~~(for example, there might be a characteristic of the asset or liability that is not captured by the valuation technique)~~. After initial recognition, when measuring fair value using a valuation technique that uses unobservable inputs, a



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reporting entity should exercise judgment in continuing to calibrate the valuation technique(s) and unobservable inputs used with ~~to~~ observable market data (for example, the price for a similar asset or liability), if available.

We suggest deleting the phrase “(for example, there might be a characteristic of the asset or liability that is not captured by the valuation technique)”. The phrase is confusing as any fair value measurement should use techniques and inputs which capture all of the characteristics of the asset or liability that would impact the amount that a market participant would be willing to pay on the measurement date.

We appreciate the opportunity to comment on the proposed ASU. We are available to discuss our comments with Board members or staff at their convenience.

Sincerely,

A handwritten signature in black ink that reads "Jay D. Hanson". The signature is written in a cursive, flowing style.

Jay D. Hanson
Chairman
Financial Reporting Executive Committee

A handwritten signature in black ink that reads "David L. Larsen". The signature is written in a cursive, flowing style.

David L. Larsen
Chairman
Fair Value Comment Letter Task Force