

MINUTES



Financial Accounting
Standards Board

To: Board Members

From: Fair Value Measurement Team
(Hoermann), Ext 317)

Subject: Minutes of the September 21, 2004 FVM Public Roundtable
Date: October 4, 2004

cc: Bielstein, Smith, Petrone, Leisenring, Project Team, Mahoney,
Thompson, Getz, Sutay, Gabriele, Swift, Polley, FASB Intranet

Topic: Proposed FASB Statement, *Fair Value Measurements*

Basis for Discussion: Agenda (attached)

Length of Discussion: 9:00 a.m. to 12:00 p.m.

Attendance:

Board members present: Seidman, Herz, Schipper, Batavick,
Crooch, and Schieneman

Board members absent: Trott

Staff in charge of topic: MacDonald

Other staff at Board table: Munro, Pinson, Smith, Bielstein and
Hoermann

Outside participants: Participant Listing (attached)

Summary of Decisions Reached:

The Board held a public roundtable discussion with constituents to discuss issues relating to the proposed Statement, *Fair Value Measurements*. Board members and participants expressed their views; no decisions were reached.

Objective of the Roundtable

The objective of this roundtable was to provide information to assist the Board in its redeliberations of the proposed Statement. That objective was met.

Matters Discussed:

The following text summarizes participant responses to questions posed by Board members and others and the topics discussed at the public roundtable; however, this summary does not include direct quotes from the meeting. The questions may not be in the specific order in which they were discussed at the meeting.

FAIR VALUE DEFINITION

The “Exchange” Notion for Assets and Liabilities

Ms. Seidman asked Mr. Dorchester to elaborate on his comments on the exchange notion for assets and liabilities. He said that he applauds the move toward current value in financial reporting, but that he would prefer using the term *market value* rather than the term *fair value* for the measurements required in GAAP. He said that the definition of fair value is very close to what others refer to as market value, but that market value more clearly indicates that one should look to the market for a price. The term *fair* in fair value is ambiguous, because it is not clear to whom it is “fair” (i.e., the owner, the buyer, or the marketplace). Mr. Blanchard commented that there is no “market” for insurance liabilities.

Valuation Premise

Mr. Mehm said that the two premises mentioned in the ED—“in-use” and “in-exchange” could lead to different fair value measurements for identical assets depending on the assumptions used by the measurer. He gave an example that if an entity had three identical plants and was planning to keep two and sell one, the valuer would value the plants differently if different premises were used. Mr. Charles noted the difficulty in selecting the appropriate valuation premise and suggested that the Board consider the valuation premise together with a highest and best use concept (for assets).

Valuation of Liabilities

Several participants questioned whether a change in an entity's credit standing should be reflected in subsequent remeasurements of liabilities. Many of those participants said that liabilities should be adjusted for changes (decreases) in credit standing *only* when the resulting gain/loss is realizable. They said that the resulting measurement is not necessarily relevant if the issuer is not able to actually settle that liability at the lower value. Mr. Schroeder said that at Goldman Sachs, they believe that derivatives should be valued based on credit spread

because they believe that it is realizable and it also creates symmetry between assets and liabilities. Mr. Uhl suggested that the FASB research that issue with users.

FAIR VALUE HIERARCHY

Objective

Several participants said that the objective of the hierarchy (to maximize market inputs in estimates of fair value) could be achieved by focusing on application of relevant valuation approaches and techniques without the constraints indicated by the proposed levels within the hierarchy. Several participants also expressed concerns about how Level 3 estimates would be perceived.

Level 1

Mr. Schroeder discussed comments on "most advantageous markets" and transaction costs. He said that it would seem incorrect to disregard transportation costs, that is, costs to transport an item (a commodity) to the most advantageous market when estimating fair value, referring to the related example in the Goldman Sachs comment letter. Mr. Joseph agreed, stating that AcSEC had similar comments. He added that in FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, location causes a basis difference (i.e., it is not a transaction cost).

Bid/Ask Spread Pricing

Several participants referred to the proposed guidance for offsetting (using mid-market pricing). They said that such offsetting should be allowed within and across all levels of the hierarchy since most firms look at risk on a portfolio basis, rather than on an individual item (transaction) basis. Ms. Mills explained that the unit of account is the cash flows, which is why portfolios should be measured based on net open risk even if, for example, some of the instruments fall in Level 1 and some fall in Level 3. Ms. Mills further said that, consistent with a more principles-based approach to standard setting, the Board should reconsider its decision to mandate bid and asked prices in other situations.

Level 3

Some participants referred to the reliability of Level 3 estimates, in particular, those estimates developed using entity-specific data versus market data. Mr. Herz asked whether an estimate is representative of fair value if it is developed using entity-specific data. Ms. Mills responded that it might be, when considered in the context of the alternative. Mr. Kruger suggested that there is a point where the value is so unreliable that it is no longer relevant and therefore no longer fair value.

Mr. Joseph said that like other respondents, AcSEC was concerned about the "requirement" to use multiple valuation techniques for Level 3 estimates. He asked participants who are valuation specialists whether there is an existing standard for how to decide which method or methods to use and, if multiple

methods are used, how to reconcile the results to arrive at a single fair value estimate. Mr. Dorchester said that as a valuation expert, they start with the methods market participants use and look at the fundamentals of economics.

DISCLOSURES

Many participants indicated support for the proposed summary disclosures about the techniques used to measure various assets and liabilities, but not the proposed income statement disclosures (unrealized gains or losses). They said that it would give an impression that unrealized gains are of a lower quality than realized gains. Moreover, those disclosures would require significant additional costs because it is not current practice to separately track those amounts and would not be meaningful (to users or management).

Mr. Woikey suggested additional disclosure of the effect of changes in models on fair value estimates, referring to the detailed proposal in the CFA Institute comment letter. He suggested that those proposed disclosures supplement the current proposed disclosures, not replace them.

Mr. Joseph commented that the proposed disclosures are incremental to other existing disclosure requirements and suggested that the Board take a comprehensive look at all fair value disclosures, developing a disclosure framework, instead of considering such disclosures piece-meal.

Mr. Dorchester suggested additional disclosures about the valuation, in particular, the effective date of the valuation and a statement that the valuation was performed in accordance with applicable valuation standards.

OTHER ISSUES

EITF Issue 02-3

Many participants referred to the interaction between EITF Issue No. 02-3, "Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities," and the proposed guidance in the ED. Like others, Mr. Uhl said that the ED should address related issues, focusing on changes in fair value estimates that give rise to revenues. Mr. Schroeder agreed, and suggested that the Board consider establishing a "single standard of reliability," discussed in the Goldman Sachs comment letter.

Blockage Factors

Ms. Seidman asked Mr. Woikey to elaborate on the comment to prohibit blockage factors. He said that instruments should be measured using "P" (in active markets) with blockage adjustments being separately recorded similarly to transaction costs (in the period in which the premium or discount is realized). The other participants disagreed, stating that fair value should not be PxQ in all cases, especially if the total quantity held can only be sold at a discount to "P." As a basis for identifying such situations (in which to use a blockage factor), Ms. Smith suggested that institutions use judgment in determining whether a position is a "block." Both Ms. Mills and Ms. Smith said that the measurement should consider the size of the position held and whether and how that position could be sold in the

marketplace—not how the securities were acquired, whether one by one or as a block.

Interaction with Other FASB Projects

Mr. Joseph suggested that the Board amend FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*, to conform to the revisions to that guidance contained in Appendix A. He and other participants encouraged the Board to work on its conceptual framework, focusing on issues of relevance and reliability of fair value measurements, before expanding the use of fair value in other GAAP. Mr. Charles suggested that the Board deal with those issues expeditiously, but that the Board should not delay issuance of a final Fair Value Measurements Statement pending resolution of those (and other) conceptual issues.

Implementation Guidance

Ms. Mills said that for financial instruments, she found the implementation guidance to be sufficiently principles-based. Other participants indicated that for nonfinancial assets and liabilities, they found the guidance to be lacking. Mr. Charles suggested that for nonfinancial assets and liabilities, it would be helpful to provide examples where two or more applicable valuation approaches are used and provide different indications of value, illustrating how the determination of the single estimate of fair value is resolved. Other participants suggested additional guidance for intangible assets.

EFFECTIVE DATE

Most participants agreed that the effective date and transition provisions were sufficient. Mr. Woikey disagreed, stating that comparability would be enhanced by retroactive restatement. Mr. Schroeder disagreed, noting that a retroactive approach requires the use of hindsight in prior periods.

Follow-up Items:

None.

General Announcements:

None.

FVM Roundtable Participants
September 21, 2004
9:00 a.m.-12:00 p.m.

<u>Name</u>	<u>Organization</u>	<u>CL #</u>
Ralph Blanchard	American Academy of Actuaries	021
Matthew Schroeder	Goldman Sachs	024
Don Dorchester	Appraisal Institute	028
Esther Mills	Merrill Lynch	032
Michael McCarter	The Group of North American Insurance Enterprises	043
*Sal Conti	Credit Suisse Group	055
Randy Kruger	Calpine	057
Kristine Smith	Lehman Brothers	061
Gerry Mehm	AITF	070
Bob Uhl	D&T	071
Don Charles	E&Y	079
Michael Joseph	AcSEC	080
Douglas R. Woikey	CFA Institute	081
Jenifer Minke-Gerard	SEC	
*Gregory Fletcher	PCAOB	
Galina Ryltsova (by phone)	IASB	

* Scheduled but unable to participate

AGENDA
FAIR VALUE ROUNDTABLE
September 21, 2004

INTRODUCTION (5 minutes)

FAIR VALUE DEFINITION (30 minutes)

- The “exchange” notion (for assets and liabilities)
- Valuation of liabilities under current GAAP (using an entity’s own credit standing)
- Valuation premise (in-use versus in-exchange, interaction with highest and best use concept for assets)

FAIR VALUE HIERARCHY (60 minutes)

- Objective (measurement versus disclosure)
- Revisions to levels (considering valuation approaches and/or inputs)
- Level 1 reference markets (most advantageous markets versus principal trading markets, liquidity, “transaction” costs, application within other levels)
- Level 1 bid/asked spread pricing (offsetting positions, application within other levels)
- ***Level 3 valuation approaches (clarifications, single versus multiple)***

DISCLOSURES (15 minutes)

- Unrealized gains/losses
- Other

OTHER ISSUES (60 minutes)

- EITF Issue 02-03
- Changes in valuation techniques (including under EITF Issue 02-03)
- Use of blockage factors (broker/dealers, investment companies, other entities)
- Interaction with other FASB projects (improvements to conceptual framework, fair value option)
- Implementation guidance (financial versus nonfinancial, valuations of intangible assets)

EFFECTIVE DATE (10 minutes)

- Timing and Transition