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Letter of Comment No: 38
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Financial Accounting Standards Board
401 Merrit 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Re: File Reference No. 1201-100

FILED ELECTRONICALLY (director@fasb.org)

Dear Ms. Bielstein,

We appreciate the opportunity to respond to the Financial Accounting Standards Board's Exposure Draft, "Fair Value Measurement."

Detailed below are some general comments, and our responses to the specific questions highlighted in the Exposure Draft (ED) are included in an attachment.

We support the efforts by the Board to improve U.S. financial accounting and reporting standards. However, we have concerns with the Board's stated objective of reporting all financial instruments at fair value. As noted in Statement of Financial Accounting Concepts No. 2, *Qualitative Characteristics of Accounting Information*, the two primary qualities that make accounting information useful for decision making are relevance and reliability. We acknowledge the fair value of certain liquid assets and currently redeemable liabilities may be relevant information to the readers of financial statements. However, we are concerned with 1) the reliability of fair value measurements for assets and liabilities which do not have a ready reference market, 2) reporting assets and liabilities at fair value rather than as set forth in Statement of Financial Accounting Concepts No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*, and 3) the impact on the statement of operations when recording the offsetting debit or credit resulting from the remeasurement of the asset or liability to fair value.

This statement proposes fair value, for assets and liabilities not referenced to ready markets, be determined by reconciling the results of three valuation methodologies, the market approach, income approach and cost approach. We do not think the information derived from these methodologies is reliable enough to warrant remeasurement of assets and liabilities in the statement of financial condition. Each of these methods relies heavily on the assumptions of the party preparing the valuation. The reliability of the information generated from these methodologies is absolutely dependent upon the reasonableness of these assumptions and the ability of the model to accurately estimate value. To require these assets and liabilities be recorded at fair value will substantially increase the time and cost involved in preparing and auditing the financial statements and may result in less reliable information being reported.

Furthermore, we think there is substantial support for reporting assets and liabilities, other than marketable securities, at amounts other than fair value. Companies have long relied on the basic principles established by Statement of Financial Accounting Concepts No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*, for reporting assets and liabilities at either historical cost, net realizable value or the amount of cash required to settle a liability. In our opinion the principles established in Concept No. 5 provide a more than adequate framework for reporting assets and liabilities.

Remeasuring assets and liabilities at fair value, of necessity, will result in increased volatility in either earnings or equity depending on where the offsetting debit or credit is recorded. This volatility will distort operating results and we suspect financial statement users will adjust operating results to compensate for the effects of remeasurement. We think a more useful approach for non-financial companies would be to report financial instruments at cost with either parenthetical or footnote disclosure of fair value. This would provide financial statement users with information on the fair value of assets or liabilities without distorting operating results or the financial condition of non-financial companies.

With regard to implementation of fair value remeasurement we continue to think the Board, in an effort to move toward a more principles-based approach, should focus on the expected benefits of any proposed change and let individual companies determine the methodology to implement the accounting for each principle. The guidance provided for Level 3 estimates seems to mandate the use of three particular methodologies when remeasuring fair value for assets or liabilities which do not qualify for remeasurement under Levels 1 or 2. The methodologies specified by Level 3 are the market approach, income approach (discounted cash flow) and cost approach. Mandating the use of three methodologies in these circumstances will result in additional cost and time to prepare the financial statements and, as noted above, may not produce more reliable information. We recommend the statement not mandate the use of the three methodologies listed for measuring fair value. Furthermore, we recommend that Statement of Financial Accounting Concept No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*, not be elevated to A-level GAAP. We think A-level GAAP should be reserved for broad principles and should not focus on the application of a particular technique.

Attached are responses to the specific questions in the Exposure Draft.

We appreciate the opportunity to comment on the Board's proposal.

Very truly yours,

Donald G. DeBuck

Attachment

Attachment – Issues Related to ED, *Fair Value Measurement*, on which the FASB has requested comments.

Definition of Fair Value

Issue 1: This proposed Statement would define fair value as “the price at which an asset or liability could be exchanged in a current transaction between knowledgeable, unrelated willing parties” (paragraph 4). The objective of the measurement is to estimate the price for an asset or liability in the absence of an actual exchange transaction for that asset or liability. Will entities be able to consistently apply the fair value measurement objective using the guidance provided by this proposed Statement together with other applicable valuation standards and generally accepted valuation practices? If not, what additional guidance is needed?

Fair value measurements under Level 1 and Level 2 of the hierarchy, as described in the Exposure Draft, are straight forward and based on observable markets, and companies should be able to consistently apply these methods with limited management judgment or estimates required in most cases. However, the fair value measurement methods proposed for Level 3 require significant management judgment and estimates and may be subject to a significant degree of measurement bias and error. In particular, developing future cash flow projections requires significant judgments and estimates on the part of management. To require, in addition to estimating future cash flow, an estimation of the probability of occurrence of a particular cash flow would compound the measurement bias and error. Therefore, we recommend the Exposure Draft simply list a number of different acceptable methodologies and let companies determine how best to determine fair value.

Valuation Techniques

Issue 2: This proposed Statement would clarify and incorporate the guidance in FASB Concepts Statement No. 7, Using Cash Flow Information and Present Value in Accounting Measurements, for using present value techniques to estimate fair value. Is that guidance sufficient? If not, what additional guidance is needed?

Generally, the guidance provided is sufficient for the use of the present value technique. However, we do question the proposed requirement for adjusting the discount rate when measuring the present value of liabilities to take into account the entity’s credit rating. We think the guidance for estimating fair value for liabilities should follow the guidance for estimating fair value for assets, i.e. either the discount rate or the cash flows may be adjusted to reflect uncertainties in future cash flows.

We also request the Board clarify the guidance provided in paragraph A28 which states “For a liability measured at fair value, the guidance in FASB Statement No. 5, *Accounting for Contingencies*, and FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss*, does not apply.” Please clarify whether this statement is

referring only to the measurement guidance in FASB Statement No. 5 or applies to the recognition criteria as well. We note FASB Statement No. 5 and FASB Interpretation No. 14 also provide guidance regarding the recognition of impairment to an asset. FASB Interpretation No. 14, paragraph 7 provides the following example “As a further example, assume that at December 31, 1976 an enterprise has an investment of \$1,000,000 in the securities of another enterprise that has declared bankruptcy, and there is no quoted market price for the securities. Condition (a) in paragraph 8 has been met because information available indicates that the value of the investment has been impaired, and a reasonable estimate of loss is a range between \$300,000 and \$600,000. No amount of loss in that range appears at the time to be a better estimate of loss than any other amount. *FASB Statement No. 5* requires accrual of the \$300,000 loss at December 31, 1976, disclosure of the nature of the contingency and the exposure to an additional amount of loss of up to \$300,000, and possibly disclosure of the amount of the accrual.” The ED states that for liabilities measured at fair value FASB Statement No. 5 and FASB Interpretation No. 14 do not apply. No reference is made to assets measured at fair value. We request the Board clarify whether this guidance is still applicable as we note no reference in Appendix D of the Exposure Draft, “Amendments to Existing Pronouncements” with regard to amendments to FASB Interpretation No. 14.

Active Markets

Issue 3: This proposed Statement would clarify that valuation techniques used to estimate fair value should emphasize market inputs, including those derived from active markets. In this proposed Statement, active markets are those in which quoted prices are readily and regularly available; readily available means that pricing information is currently accessible and regularly available means that transactions occur with sufficient frequency to provide pricing information on an ongoing basis. Is that guidance sufficient? If not, what additional guidance is needed?

We think the guidance is sufficient.

Valuation Premise

Issue 4: This proposed Statement would provide general guidance for selecting the valuation premise that should be used for estimates of fair value. Appendix B illustrates the application of that guidance (Example 3). Is that guidance sufficient? If not, what additional guidance is needed?

We think the guidance is sufficient.

Fair Value Hierarchy -

Issue 5: This proposed Statement would establish a hierarchy for selecting the inputs that should be used in valuation techniques used to estimate fair value. Those inputs differ depending on whether assets and liabilities are identical, similar, or otherwise comparable. Appendix B provides general guidance for making those assessments (Example 4). Is that guidance sufficient? If not, what additional guidance is needed?

The requirement to measure and report at fair value instruments with little or no available market price information (e.g. investments in non-publicly traded companies or partnerships) may require significant time and expense to generate an estimate of fair value which may or may not be reasonably accurate. This information may have limited benefit for financial statement users and will reduce comparability of financial statements due to the various assumptions required to develop the estimate. We think there should be an exclusion from fair value measurement for assets or liabilities for which there is limited market information available or, at a minimum, a materiality threshold.

Level 1 Reference Market

Issue 6: In this proposed Statement, the Level 1 reference market is the active market to which an entity has immediate access or, if the entity has immediate access to multiple active markets, the most advantageous market. Appendix B provides general guidance for selecting the appropriate reference market (Example 5). Is that guidance sufficient? If not, what additional guidance is needed?

We think the guidance is sufficient.

Pricing in Active Dealer Markets

Issue 7: This proposed Statement would require that the fair value of financial instruments traded in active dealer markets where bid and asked prices are more readily and regularly available than closing prices be estimated using bid prices for long positions (assets) and asked prices for short positions (liabilities), except as otherwise specified for offsetting positions. Do you agree? If not, what alternative approaches should the Board consider?

We agree bid prices for assets and asked prices for liabilities is the appropriate attribute to measure fair value.

Measurement of Blocks

Issue 8: For unrestricted securities with quoted prices in active markets, many FASB pronouncements (including FASB Statement No. 107, Disclosures about Fair Value of Financial Instruments) require that fair value be estimated as the product of a quoted price for an individual trading unit times the quantity held. In all cases, the unit of account is the individual trading unit. For large positions of such securities (blocks) held by broker-dealers and certain investment companies, the AICPA Audit and Accounting Guides for those industries (the Guides) permit fair value to be estimated using blockage factors (adjustments to quoted prices) in limited circumstances. In those cases, the unit of account is a block.

The Board initially decided to address that inconsistency in this proposed Statement as it relates to broker-dealers and investment companies. The Board agreed that the threshold

issue is one of determining the appropriate unit of account. However, the Board disagreed on whether the appropriate unit of account is the individual trading unit (requiring the use of quoted prices) or a block (permitting the use of blockage factors). The majority of the Board believes that the appropriate unit of account is a block. However, the Board was unable to define that unit or otherwise establish a threshold criterion for determining when a block exists as a basis for using a blockage factor. The Board subsequently decided that for measurement of blocks held by broker-dealers and certain investment companies, current practice as permitted under the Guides should remain unchanged until such time as the Board fully considers those issues.

For those measurements, do you agree with the Board's decision? If applicable, what approaches should the Board consider for defining a block? What, if any, additional guidance is needed for measuring a block?

No comment.

Level 3 Estimates

Issue 9: This proposed Statement would require that in the absence of quoted prices for identical or similar assets or liabilities in active markets, fair value be estimated using multiple valuation techniques consistent with the market approach, income approach, and cost approach whenever the information necessary to apply those techniques is available without undue cost and effort (Level 3 estimates). Appendix B provides general guidance for applying multiple valuation techniques (Examples 6–8). Is that guidance sufficient? If not, what additional guidance is needed?

In the absence of quoted prices for identical or similar assets or liabilities we think the Board should provide guidance to assist companies in applying the principle of fair value measurement but should avoid specifying a particular methodology for determining fair value. We question the validity of the market approach for Level 3 estimates. If quoted prices for identical or similar assets are not readily available, will the market approach provided meaningful information? Probably not. With regard to the replacement cost approach, this basis of valuation was not acceptable in the past due to the difficulty in determining the relationship between the replacement cost and the fair value of a particular item. To require each of these methods be used in determining a Level 3 estimate, particularly when the information provided by the market and cost approaches may not be relevant, seems an unnecessary and costly burden for companies to bear.

Restricted Securities

Issue 10: This proposed Statement would require that the fair value of restricted securities be estimated using the quoted price of an otherwise identical unrestricted security, adjusted for the effect of the restriction. Appendix B provides general guidance for developing those estimates, which incorporates the relevant guidance in SEC ASR No. 113, Statement Regarding "Restricted Securities." Is that guidance sufficient? If

not, what additional guidance is needed?

No comment.

Fair Value Disclosures

Issue 11: This proposed Statement would require expanded disclosures about the use of fair value to remeasure assets and liabilities recognized in the statement of financial position. Appendix B illustrates those disclosures. This proposed Statement also would encourage disclosures about other similar remeasurements that, like fair value, represent current amounts. The Board concluded that those disclosures would improve the quality of information provided to users of financial statements. Do you agree? If not, why not?

We disagree with the requirements to disclose the fair value amounts at the end of the period in total and as a percentage of total assets and liabilities. This is an analysis exercise and should be included in MD&A to the extent it's material or meaningful. The total assets and liabilities carried at fair value as well as the percentage of total assets and liabilities carried at fair value is information the reader should be able to derive on their own given the fair value disclosures in the footnotes and financial statements.

Furthermore, paragraph B20 of the proposed Statement seems to indicate disclosures about the use of fair value to remeasure assets and liabilities would be required to be provided in one place. While this seems reasonable for those assets and liabilities remeasured during the period which are not discussed elsewhere in the footnotes, it would lead to duplication for those assets and liabilities discussed in other footnotes. For example, to disclose goodwill and intangibles in the footnotes to the financial statements without a discussion of the remeasurement of those assets, if deemed impaired, in the same footnote would be confusing to the reader of the financial statements but to include the discussion in both a footnote on fair value and a footnote on goodwill and intangibles is unnecessary and confusing. We propose the Statement allow disclosure about the use of fair value to remeasure assets and liabilities be included in the relevant footnotes and an additional footnote be required only if the fair value measurement for a particular asset/liability or group of assets/liabilities is not disclosed elsewhere in the footnotes.

Effective Date

Issue 12: This proposed Statement would be effective for financial statements issued for fiscal years beginning after June 15, 2005, and interim periods within those fiscal years. The Board believes that the effective date provides sufficient time for entities to make the changes necessary to implement this proposed Statement. Do you agree? If not, please explain the types of changes that would be required and indicate the additional time that would be needed to make those changes.

Given the significant amount of regulatory changes companies have addressed recently, together with compliance with Section 404 of Sarbanes-Oxley, we recommend that the

Board, if it chooses to proceed, make the Statement effective for fiscal years beginning after June 15, 2006.

Other Issues

Issue 13: This proposed Statement represents the completion of the initial phase of this project. In subsequent phases, the Board expects to address other issues, including issues relating to the relevance and reliability of fair value measurements and the unit of account that should be used for those measurements. What, if any, other issues should the Board address? How should the Board prioritize those issues?

Our concerns may be categorized into two categories, 1) the assets or liabilities for which fair value measurement would provide relevant and reliable information, and 2) the impact of remeasurement on financial statements and the relevance of the results of operations when assets/liabilities are remeasured.

The Board has indicated that its long-term objective is to measure all financial instruments at fair value. We question the utility to financial statement users of reflecting assets which do not have a ready market, or liabilities which must be extinguished at par, at fair value. For example, reflecting bank debt or similar liabilities at fair value when these liabilities must be paid at par (or if subject to early retirement penalties, more than par) would not be relevant to the users of financial statements and may be misleading. We think assets for which there is no ready market or liabilities which will be extinguished at par should continue to be reflected in the financial statements at historical cost.

With regard to the impact of remeasurement on the financial statements we continue to be concerned with where the offsetting debit or credit will be recorded and whether the resulting amounts reported in the statement of operations will be relevant to financial statement users. The movement away from a historical cost basis to a fair value basis of reporting assets and liabilities will introduce additional volatility to the results of operations. Is this additional volatility relevant information to financial statement users or will this information mask the operating performance of the company? If we take, as an example, bank debt (as discussed above) which will be retired at par on the termination date and remeasure the fair value of the bank debt on a periodic basis, recording the changes to fair value in the statement of operations, the net change in fair value from inception through extinguishment will be zero. However, during the time the bank debt is outstanding the statement of operations will reflect increased volatility due to the remeasurement of the fair value of the bank debt each period. In other words, the results of operations will reflect changes in fair value which, in the long run have no impact on cash flow or equity.

Current users of the statement of operations typically adjust the results of operations for non-cash items, one-time charges, etc. We suspect that if changes in the fair value of assets and liabilities are recorded in the statement of operations that financial statement

users will adjust the results of operations to compensate for these effects as well. How relevant is a financial statement which users modify significantly to obtain the data which they think is useful to analyzing a company's results?

Public Roundtable Meeting

Issue 14: The Board plans to hold a public roundtable meeting with respondents to the Exposure Draft on September 21, 2004, at the FASB offices in Norwalk. Please indicate whether you are interested in participating in the meeting. If so, comments should be submitted before that meeting.

The letter and our responses contained in this attachment address our concerns and at this time, we are unable to be present at the meeting. We do request the meeting be web cast.