



March 28, 2009

LETTER OF COMMENT NO. 163

Mr. Russell G. Golden  
Technical Director  
Financial Accounting Standards Board  
401 Merritt 7  
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Norwalk, CT 06856-5116

**File Reference: Proposed FSP FAS 157-e**

Dear Mr. Golden:

We appreciate the opportunity to comment on the Exposure Draft of Proposed FASB Staff Position FAS 157-e *Determining Whether a Market Is Not Active and a Transaction Is Not Distressed* (the "Exposure Draft"). Huron Consulting Group helps clients address complex challenges that arise in litigation, disputes and investigations. Huron provides services to a wide variety of organizations, including Fortune 500 companies, medium-sized businesses, leading academic institutions, healthcare organizations, and the law firms that represent these various organizations.

While we agree that preparers need guidance on how to identify whether a transaction is distressed, we believe the Board should not issue the Exposure Draft, as currently drafted, as a final FSP. We believe the application of the guidance in the Exposure Draft will result in measuring financial assets at amounts that are not consistent with the definition of fair value in FASB Statement No. 157 *Fair Value Measurements*. We set forth our specific concerns with the proposed guidance below. We also set forth recommendations to clarify the final FSP or make the guidance operational in the event the Board decides to issue a final FSP with guidance that is substantially the same as that proposed in the Exposure Draft.

**Presumption of Distressed Transactions**

We disagree with the presumption in the Exposure Draft that transactions in an inactive market are distressed transactions. We understand the Board is attempting to resolve issues arising from preparers feeling compelled to use, or reconcile to, transaction prices for the same or a similar financial asset, even though the transaction prices may require significant adjustments, but believe presuming transactions are distressed if they occur in an inactive market is an overcorrection. We believe the presumption that transactions in inactive markets are distressed is inconsistent with the guidance the Board provided in FSP FAS 157-3 *Determining the Fair Value of a Financial Asset When the Market for That*

*Asset Is Not Active.* Paragraph 9(a) of FSP FAS 157-3 reiterated that the measurement objective in paragraph 5 of Statement 157 – estimating the price a company would receive to sell the financial asset at the measurement date – does not change in situations where there is little market activity. Paragraph 9(a) of FSP FAS 157-3 states, in part:

Even in times of market dislocation, it is not appropriate to conclude that all market activity represents forced liquidations or distressed sales.

It appears that, contrary to the proscription in FSP FAS 157-3, the FASB has concluded that market activity in inactive markets presumptively represents forced liquidations or distressed sales. If the Board decides to retain the presumption, we believe it should reconcile its views in FSP FAS 157-3 to its current views.

We also disagree that a company may only overcome the presumption that transactions are distressed by obtaining information about whether a company had sufficient time before the sale of the asset to allow for marketing activities that are usual and customary for the asset and whether it obtained multiple bidders for the asset. We believe those factors will make it difficult for companies to rebut the presumption. Our concern about the difficulty in overcoming the presumption that a transaction in an inactive market is a distressed transaction is not limited to the current economic circumstances. Even in good times, there are classes of financial assets that do not trade in active markets. As we read the guidance in the Exposure Draft, one would have to conclude that transactions in inactive, but “normal,” markets are distressed transactions. Given the lack of transparency characterized by principal-to-principal transactions, we believe it will be difficult for most companies to overcome the presumption, even in “normal” market conditions. If the Board retains the presumption that transactions in inactive markets are distressed, we suggest it modify the conditions in paragraph 13 to rebut that presumption. We believe the Board should permit a company to exercise judgment in deciding whether a particular price is the result of a distressed transaction.

#### *Results of Applying FSP May Not be Fair Value*

We are concerned the application of the FSP will lead to results that do not approximate the exit price of financial assets at the measurement date. We are not sure what the result in Example 11 represents. The company has estimated a value for a financial asset by averaging the rate of return in a hypothetical active market and the rate of return in a hypothetical inactive market where sales are not distressed sales. Whether the result is the exit price for the asset at the measurement date seems debatable. The result appears to be a measurement that is neither fair value in an active market nor fair value in an inactive market. We are not sure this information will be useful to investors.

#### *Due Process*

We understand the Board’s desire to move quickly to provide guidance to preparers and auditors on estimating fair value given the current market turmoil. However, as we are sure the Board understands, we do not believe it is optimal to provide constituents with

such a short period to read, understand, and comment on significant proposed changes. Compressing the amount of time that constituents have to comment creates a risk that they will not have sufficient time to identify any unintended consequences created by the proposed guidance. We hope the extent of the debate among constituents in various forums over the issues addressed in this Exposure Draft prior to the Board's decision to issue it is sufficient to reduce that risk.

Assuming the Board decides to retain the presumption that all transactions in inactive markets are distressed transactions, we recommend it address the following issues:

- scope of the FSP
- conditions indicating a market is inactive
- how a company should obtain the inputs needed to estimate fair value when it has been unable to rebut the presumption that all transactions involving the same or similar financial assets are distressed transactions
- effective date of the FSP

#### Scope

We believe the Board should expand the scope to apply to all assets and liabilities measured at fair value, whether on a recurring or nonrecurring basis. We believe many of the same issues affecting financial assets also affect nonfinancial assets and financial liabilities. As an example, if a company has elected to measure its own debt at fair value under FASB Statement No. 159 *The Fair Value Option for Financial Assets and Financial Liabilities* but that debt trades in an inactive market, we see no reason why the issuer should be required to consider the price of the most recent transaction when the holder is required not to do so.

Similarly, estimating the fair value of long-lived assets in an inactive market may result in a valuation specialist estimating a higher discount rate than in a more normal market. If increased liquidity premiums are the basis for the higher discount rate, we believe the discussion in paragraph A32E of FSP FAS 115-1 and FAS 124-1, as amended, about using "reasonable assumptions" for liquidity risk is as applicable to a long-lived asset as it is to a financial asset.

#### Factors Indicating a Market is Inactive

We are not sure why additional guidance on determining when a market is inactive was necessary, but we believe the Board should provide application guidance to make the conditions in proposed paragraph 29A(e) and (f) of Statement 157, as amended, operational. Paragraph 29A(e) refers to "Abnormal ... liquidity risk premiums" and paragraph 29A(f) refers to "Abnormally wide bid-ask spread". How should a company determine whether a liquidity risk premium is "abnormal" or a bid-ask spread is "abnormally wide"? What should the company compare the liquidity risk premium or bid-ask spread against in making that determination?

Further, we believe the Board should clarify whether a company could conclude that a market is active if certain factors are not present, even if others are. For example, if a company concludes that liquidity risk premiums are not abnormal, bid-ask spreads are not abnormally wide, and price quotations consider current information, could it then conclude that the market is active even if transactions in that market do not occur with sufficient frequency and volume on a consistent basis?

### Determining Model Inputs

Because we expect the number of Level 3 fair value measurements will increase under the FSP, we believe the Board should provide additional guidance on how a company should determine the inputs when the company has not been able to overcome the presumption that all of the transactions involving the same or similar assets are distressed transactions. Given the difficulty we expect companies to have obtaining the information required by paragraph 13 of the Exposure Draft to rebut the presumption that transactions involving the same or similar assets in an inactive market are distressed transactions, we expect this issue to arise frequently. If a company cannot use the transactions that would normally provide evidence of certain model inputs (such as the rate of return derived from the transaction price for a financial asset), how should it determine the inputs? Paragraph A32F of Statement 157, as amended by the FSP, provides possible rates of return based either on a hypothetical active market or on bid-level yields adjusted for a "reasonable" risk premium, but provides no insight into how a company would determine those rates of return. If the Board does not provide guidance, we would expect diversity in practice to result as companies apply judgment to determining their inputs.

If the Board intends that a company look to indicative yields during periods where markets were "normal," we believe it should provide some guidance so a company does not look to periods characterized by "irrational exuberance", as may have been the case for mortgages during the period from 2004 to 2007. If the Board believes it is not appropriate for a company to consider transaction prices that incorporate abnormally high liquidity and nonperformance risk premiums, it presumably has the same view of transaction prices that incorporate abnormally low liquidity and nonperformance risk premiums.

### Effective Date

We recommend the Board make application of the FSP optional for the first quarter of calendar year companies. We are concerned that requiring companies to apply the guidance in the first quarter may result in delayed filings with the SEC, which may have negative consequences for companies so affected. We believe the application of the final FSP will significantly increase the number of financial assets for which companies use models to estimate fair value. To identify the inputs necessary to estimate fair value and to test controls over how the company determined those inputs will require time that a company may not have if they are an accelerated or large accelerated filer. In addition

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to the increase in the number of financial assets that require modeling, the increase in Level 3 assets will require a company to provide the roll-forward information in paragraph 32(c) of Statement 157. Compiling the required information and testing the controls over that information will also require time and could result in delaying a company's SEC filing.

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We would be pleased to discuss any of our comments with the Board or the FASB staff. Please direct any questions or comments to Jeff Ellis at 312-880-3019.

Sincerely,

*/s/ Jeffrey H. Ellis*

Jeffrey H. Ellis  
Managing Director