



BOARD OF GOVERNORS
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FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

May 1, 2007

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LETTER OF COMMENT NO.

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Re: File Reference No. 1520-100
Invitation to Comment on Valuation Guidance for Financial Reporting

Dear Mr. Smith:

We appreciate the opportunity to respond to the FASB's Invitation to Comment on Valuation Guidance for Financial Reporting. Sound financial reporting and related accounting policies, practices, and controls are very important aspects underlying a safe and sound banking system and financial stability. Accordingly, we strongly support your efforts to consider the need for additional valuation guidance.

The Federal Reserve continues to have concerns about the reliability of reported financial results based on fair values for illiquid instruments, as expressed in our previous comment letters. We have also strongly encouraged the FASB to conduct further research and testing related to the use of fair value. The increased use of fair value estimates in financial reporting, such as through the use of a fair value option, highlights the need to develop additional guidance on valuation at this time. In comment letters, the Basel Committee on Banking Supervision has also stressed the need for reliable financial reports and reasonably specific guidance related to fair value estimates.

Accordingly, we strongly support the development of valuation guidance to improve reliability of financial reports and to increase understanding of valuation methods and models. However, due to the dynamic nature of financial markets and valuation and modeling techniques, accounting standard setters should be careful about developing "rules" or standards that are overly prescriptive and that may stifle innovation and improvements in fair value estimation techniques.

Therefore, we recommend the development of more specific "sound" practice guidance that financial statement preparers, auditors, and supervisors should consider in preparing

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and reviewing financial statements, but that are not prescriptive requirements. We are pleased to provide the following responses to the issues raised in the Invitation to Comment.

Need for Valuation Guidance

In the Federal Reserve's comment letter on Fair Value Measurements (FAS 157), we supported the FASB's efforts to develop a standard that provides, in one place, broad conceptual objectives and guidance for estimating fair values for financial reporting purposes. However, we noted that issuing such a standard was only a first step in ensuring reliable financial reports based on fair values and that additional implementation guidance would be necessary.

Consistent with our previous comment letters, we strongly support the issuance of additional valuation guidance that would be applicable for financial reporting purposes. As part of that effort, we encourage a review of existing valuation guidance (e.g., nonauthoritative guidance that is not issued by accounting standards setters, such as guidance from appraisal organizations, industry, etc.) to determine if that guidance is consistent with the objectives of financial reporting. Such a review could assess whether any new guidance could be based on pre-existing literature.

Application guidance on valuations should provide appropriate detail to help improve professional judgments, reduce excessive diversity in practice, and improve understanding of the reported valuations. This guidance may include examples that illustrate the application of accounting standards to a particular type of financial instrument or transaction. Valuation guidance related to illiquid instruments where no active markets exist would be expected to be more detailed than the valuation guidance for more actively traded positions where observable market prices exist.

We agree with the view that valuation techniques may differ depending on the nature of a specific asset or liability and related transactions and that a high degree of professional judgment will be necessary. Nonetheless, the guiding principal should be obtaining fair values that would reflect actual transaction prices between market participants for the specific instruments. Valuation guidance also should reflect that the applied assumptions, methods, and professional judgments should result, in concept, in a fair value estimate by one preparer that is reasonably consistent with the estimates of others with the same (or a closely similar) asset or liability.

In any event, guidance on valuation methods should provide individual users sufficient flexibility to determine the best approaches for their own assets or liabilities. Consequently, the reliability of fair value estimates will depend greatly on the broader principals employed and the methodologies selected and applied in practice. Among other things, valuation guidance might include broader principals or procedures that need to be in place in determining valuation methods and their use - - such as criteria for

selecting among methods, requirements for testing where modeling is involved, and valuation controls more generally.

Industries where fair value reporting is extensive often have well-defined valuation practices. Industry practice also continues to evolve for the valuations of non-traded financial instruments, and best practices are emerging. In this regard, industry practices can also be an important source of valuation guidance.

Level of Participation by Existing Appraisal Organizations

We believe that existing appraisal organizations should have a role in the establishment of valuation guidance, perhaps as an advisor or working group member, but not as the principal standard setter. While appraisal organizations may have valuable experience with valuing certain assets and liabilities, such valuations may not be consistent with the objective of financial reporting.

Process for Issuing Valuation Guidance

We recommend that any group or organization convened to issue guidance for valuation purposes should include a cross-section of knowledgeable professionals, including appraisers and other valuation experts, industry experts (preparers) that use fair value, auditors, regulators, and other users of financial statements. This approach would ensure that the group's output considers a breadth of views and expertise.

Valuation guidance will need to keep pace with changes in accounting standards and financial products and markets, especially as the potential use of fair value accounting increases. Due process (including open meetings) and appropriate ratification of such valuation practices by the FASB (or other appropriate standard setter) are appropriate to ensure that valuation practices remain consistent with the applicable accounting standards and overall objective of financial reporting. Accordingly, valuation guidance activities will need to continue on an on-going basis to appropriately respond to these changes.

As discussed in more detail below, we believe it would be appropriate for the group or organization to consider providing implementation guidance for broader issues including internal audits, external audits, or internal controls. If the group takes on a broader mandate, consideration should be given to housing it outside of the FASB.

International Convergence

Consistent with the goal of the FASB and the International Accounting Standards Board to achieve standard-setting convergence, the development of internationally converged valuation guidance would facilitate a converged application of those standards. However, this may be challenging to achieve in practice, especially if the accounting standards are not yet sufficiently converged. We suggest that the valuation development

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process consider the potential impact of guidance that may create a significant divergence in practice between U. S. and international standards.

Additional Guidance to Address Internal Control, Internal Audit, and External Audit Issues Related to Fair Values

The Federal Reserve's comment letter on Fair Value Measurements (FAS 157) indicated that achieving the goal of reliable financial reports based on fair values is a multidisciplinary effort that involves more specific guidance on valuation, internal and external audits, and internal controls over financial reporting. Accordingly, we encouraged the FASB to work with other important parties, including the SEC, PCAOB, AICPA, and IIA before taking significant steps towards a fair value accounting framework.

We believe any new group convened to develop additional guidance for fair values for financial reporting purposes also consider developing more application guidance on related issues such as internal controls over financial reporting and internal and external audits. Before being issued, any guidance the group develops should be ratified by an appropriate standard setter. For example, any guidance for financial reporting should be ratified by the FASB, and any external audit guidance should be ratified by the PCAOB for public companies and the AICPA for nonpublic companies.

Please contact me or Laurie Priest if you have any questions or would like to discuss our views further.

Sincerely,



Charles H. Holm
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