PCPS
PRIVATE COMPANIES PRACTICE SECTION

January 15, 2008

LETTER OF COMMENT NO. 7

Russell G. Golden, CPA
Director of Technical Application and Implementation Activities
FASB
401 Merritt 7
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Norwalk, CT 06856-5116

Re: December 14, 2007 Proposed FASB Staff Position (FSP) FAS 157-b, *Effective Date of FASB Statement No. 157*

Dear Mr. Golden:

One of the objectives that the Council of the American Institute of Certified Public Accountants (AICPA) established for the PCPS Executive Committee is to act as an advocate for all local and regional firms and represent those firms' interests on professional issues, primarily through the Technical Issues Committee (TIC). This communication is in accordance with that objective. These comments, however, do not necessarily reflect the positions of the AICPA.

TIC has reviewed the Proposed FSP and is providing the following comments for your consideration.

GENERAL COMMENTS

TIC appreciates the proposed extension of the effective date for nonfinancial assets and nonfinancial liabilities that are measured at fair value on a nonrecurring basis in periods subsequent to initial recognition.

TIC still strongly believes that the Proposed FSP does not provide sufficient relief for nonissuers from the standard's most difficult provisions. Therefore, TIC reiterates the request made during our October 5, 2007, TIC/FASB Liaison Meeting for the Board to defer the provisions of FASB Statement of Financial Accounting Standards No. 157 (SFAS 157) in their entirety for all nonissuers.

The comments that follow discuss the reasons why a complete deferral for nonissuers is

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preferred and offer some alternative disclosures and effective date options that have been used as precedent during other standard-setting efforts.

SPECIFIC COMMENTS

Request for Full Deferral of SFAS 157 for Nonissuers

The Proposed FSP addresses two of the most difficult applications in SFAS 157 for TIC's constituency—the initial measurement of intangibles in a business combination and impairment testing. TIC is pleased that the Board has recognized the need for more implementation time in these areas.

However, TIC continues to believe that a complete deferral of all required disclosures in SFAS 157 is necessary for all nonissuers. TIC believes practitioners need more time to understand the provisions of the standard and to research the available inputs for each asset or liability subject to fair value measurement.

TIC believes this is especially important since the FASB has stated that it will not provide guidance related to exit market concepts, which is one of the more complex concepts in the Standard. The lack of implementation guidance from an authoritative source will prolong the time needed to resolve implementation issues.

Unique Issues For Nonissuers

Nonissuers have unique difficulties in implementing the standard since they need to rely more frequently than issuers on Level 3 inputs. For example, even if issuers and nonissuers had exactly the same resources for understanding the standard, nonissuers would still need more implementation time because Level 3 inputs require more time to develop. In addition, nonissuers have a number of unique SFAS 157 issues, such as restricted stock, which would not even be relevant to issuers. This complexity, together with the myriad of fair value measurements of a "recurring" nature appearing in nonissuers' financial statements, creates special problems for nonissuers that issuers will not have.

In addition, TIC believes that the Board's arguments for deciding against a full deferral, as stated in paragraph 3 of the Proposed FSP, are not applicable to nonissuers. In its decision to grant a limited deferral, the Board stated that "many financial statement users" have already cited the improved quality of information that the SFAS 157 framework and disclosures provide for "financial assets and liabilities and other items that are recognized or disclosed at fair value on a recurring basis." Based on TIC's knowledge and experience, users of

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nonissuers' financial statements would not share this view.

The "user needs" justification for adopting the measurement methods and disclosures in SFAS 157 is not very prevalent within our constituency. With some exceptions, most fair value measurements and the disclosures required by SFAS 157 are not as relevant to issuers as they are for nonissuers. Users base their decisions on cash flow information and, generally, have already disregarded other noncash and intangible gains/losses.

As a general rule, the provisions of SFAS 157 are still relatively unknown to lenders and creditors within TIC's constituency. Most users of nonissuers' financial statements have neither the knowledge nor the understanding of SFAS 157 to assess whether it will improve the quality of the information provided for lending decisions. Lenders will need a significant amount of time to obtain an understanding of the standard through comprehensive training and then determine how to incorporate the disclosures into their loan models, if at all. SFAS 157 represents a significant departure from lenders' cash flow models; therefore lenders are not requesting its implementation for either recurring or nonrecurring fair value measures.

TIC is concerned that the FASB staff may erroneously perceive that fair value measures for nonissuers are few in number and involve relatively simple inputs and valuation techniques. Complexity is a matter of the level of understanding of the preparers, coupled with the inherent difficulty of the measurement. TIC has prepared the following list of some of the common fair value measures applicable to nonissuers (including those that are unique to nonissuers) to illustrate that most involve the more complex, Level 3 inputs within the fair value hierarchy:

Recurring Fair Value Measures

a) Investments in non-trading securities without readily determinable fair values Examples include:
   i) "Alternative investments" such as hedge funds, private equity funds, real estate funds, venture capital funds, commodity funds, offshore fund vehicles, and funds of funds, as well as bank common/collective trust funds
      (1) One TIC member commented that institutions and some banks are entering into a wider variety of these investments.
      (2) Employee benefit plans are also starting to invest in these funds.
   ii) Restricted stock
   iii) Municipal bonds (possibly a Level 2 measure)
b) Derivatives such as interest rate swaps (SFAS 133 and related standards)
c) Derivatives related to equity instruments (such as warrants, beneficial conversion

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features, etc.) (SFAS 133 and related standards)

Nonrecurring Fair Value Measures

a) Business combinations—purchase price allocations, including intangible assets (SFAS 141)
b) Asset impairments, including goodwill impairment (SFAS 142 and 144)
c) Long-lived assets held for sale (SFAS 144)

A number of unique issues face nonissuers (including NPOs) in implementing SFAS 157. These include:

a) Special training issues will extend the time needed to complete the CPE cycle for our constituency.
   i) Unlike large issuers, nonissuers generally do not have the expertise in-house or the ability to attract the technical experience to implement SFAS 157.
   ii) Nonissuers need longer transition times because they lack the valuation advantages of issuers. The fact that issuers have market-based inputs on the price of their own stock simplifies other related valuations, such as stock options, impairment testing (future cash flow and discount rate assumptions) and segregation of intangible value.
   iii) Nonissuers need the benefit of the experiences of issuers with SFAS 157 to accumulate best practices, wherever possible. As discussed above, some measures are not encountered in the public company environment, providing no issuer precedent for nonissuers to emulate.
   iv) Accounting guidance does not yet exist for certain basic principles underlying SFAS 157. Lack of guidance in these areas presents significant barriers to understanding and, therefore, high likelihood of misapplication:
      (1) Distinguishing among the three levels of inputs within the fair value hierarchy is often difficult. For example,
         (a) Nonissuers don't understand how 3rd party custodians value investments, especially those without readily determinable fair values. Nonissuers erroneously assume that fair values on a custodian's statement are always Level 1 measures, when in fact they may be Level 2 or Level 3.
         (b) Determining when Level 2 v. Level 3 inputs are appropriate takes considerable knowledge and research.
      (2) The exit market (including the characteristics of the market participant) and exit pricing are new paradigms that are not intuitive.
   v) Auditors of nonissuers also face training issues
      (1) During 2007 and 2008, auditors needed to prioritize implementation training

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for other new, complex standards, such as the new risk assessment standards and FIN 48.

(a) Most auditors of issuers adopted the principles of the risk assessment standards years ago and will not need the training this year.

(b) FIN 48 will present special challenges for accounting firms and preparers, especially for pass-through entities that are most prevalent in the nonissuer environment.

(c) Auditors of nonissuers may not have the time or resources to receive training in all three areas concurrently. Some may not realize the importance of the SFAS 157 training.

(2) Auditors will need more guidance and training specific to auditing fair value measurements. Issues have already surfaced with certain firms that audit issuers.

(a) To audit assets and liabilities without readily determinable fair values that are material to the financial statements, auditors will be challenged to obtain a sufficient amount of high-quality audit evidence. Many auditors of nonissuers have no prior experience with auditing such estimates.

(b) The PCAOB report on 2004-2006 inspections of U.S. firms that audited 100 or fewer public companies cited problems with auditors' procedures relating to fair value measurements.

(i) Numerous deficiencies were found resulting from audit firms' failure to test the reasonableness of fair value estimates of equity-based transactions.

(ii) Firms are not always following all procedures concerning the use of valuation specialists.

b) There will not be enough suitably qualified 3rd party valuation specialists available to perform fair value measurements for nonissuers.

i) Qualified specialists will be serving larger companies and may not have the resources to serve smaller entities as well. In many cases, both management specialists and auditor specialists will be needed so that independence conflicts may be avoided.

ii) Most valuation specialists that serve our clients will have to re-learn how to perform valuations for financial reporting purposes under SFAS 157. The concept of exit pricing for Level 3 valuations will present the greatest challenges.

iii) More time is needed to allow the secondary valuation marketplace to develop to meet the needs of nonissuers.

c) Without an appropriate rollout period to put resources, wraparound guidance and

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training in place, many private entities will refuse to implement the framework and the disclosures in the standard and will elect (wherever possible) to take a GAAP exception. This occurred with FIN 46R, *Consolidation of Variable Interest Entities (revised December 2003)*, for many of the same reasons and is a trend that detracts from the quality and value of GAAP financial statements.

Proposed Alternatives to the SFAS 157 Deferral in the Proposed FSP

TIC believes a number of deferral options exist that should be reconsidered by the Board. At the October 17, 2007 FASB meeting, one of the alternatives considered was a deferral of SFAS 157 in its entirety with a requirement for the non-adopters to provide certain disclosures during the deferral period. TIC believes a full deferral of the SFAS 157 framework for all nonissuers, with a modified disclosure requirement during the deferral period, would be a viable option. TIC would like to offer its views about the nature and timing of such disclosures:

A nonissuer not adopting SFAS 157 should make one of the following disclosures for its first annual reporting period (i.e., exempt all disclosures for interim periods) in the year of deferral:

a) The available information currently required by paragraphs 32(a) and (b) and 33(a) and (b) of SFAS 157, as appropriate, or
b) The fact that such information is not currently available (without the need to explain the reason(s)).

TIC's proposal, which involves selective disclosures, a practicability exception when disclosure information is not available, an exemption from disclosures in interim periods, and the complete deferral of the disclosures required by paragraphs 32(c) and (d) and 33(c) and (d), would provide significant relief to those entities struggling with implementation of the standard.

Other alternatives to complete deferral for nonissuers should also be considered and include:

a) Adopt a deferral protocol similar to that used for an older fair value standard
   i) SFAS 107, *Disclosures about Fair Value of Financial Instruments*—Entities with less than $150 million in total assets were given a three-year deferral beyond the effective date for larger entities.
   ii) As discussed in paragraph 88 of SFAS 107, smaller entities often look to the experience obtained by larger entities in implementing a standard.
b) Another possibility is to set an initial deferral period for nonissuers, with an extended

or permanent deferral period for entities below a certain asset threshold.

c) Drop the requirement to apply SFAS 157 for interim periods within the first year of adoption.

The Board's objectives of consistency and comparability in the application of the fair value framework and its required disclosures, as well as improving the quality of information provided to users, will only be achieved if users understand the disclosures and preparers and practitioners know how to apply the framework and develop the disclosures. Users of financial statements of nonissuers are not ready for the new standard and will not be adversely affected by a broader deferral of its provisions.

TIC appreciates the opportunity to present these comments on behalf of PCPS member firms. We would be pleased to discuss our comments with you at your convenience.

Sincerely,

Stephen Bodine

Stephen Bodine, Chair
PCPS Technical Issues Committee

cc: PCPS Executive and Technical Issues Committee

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